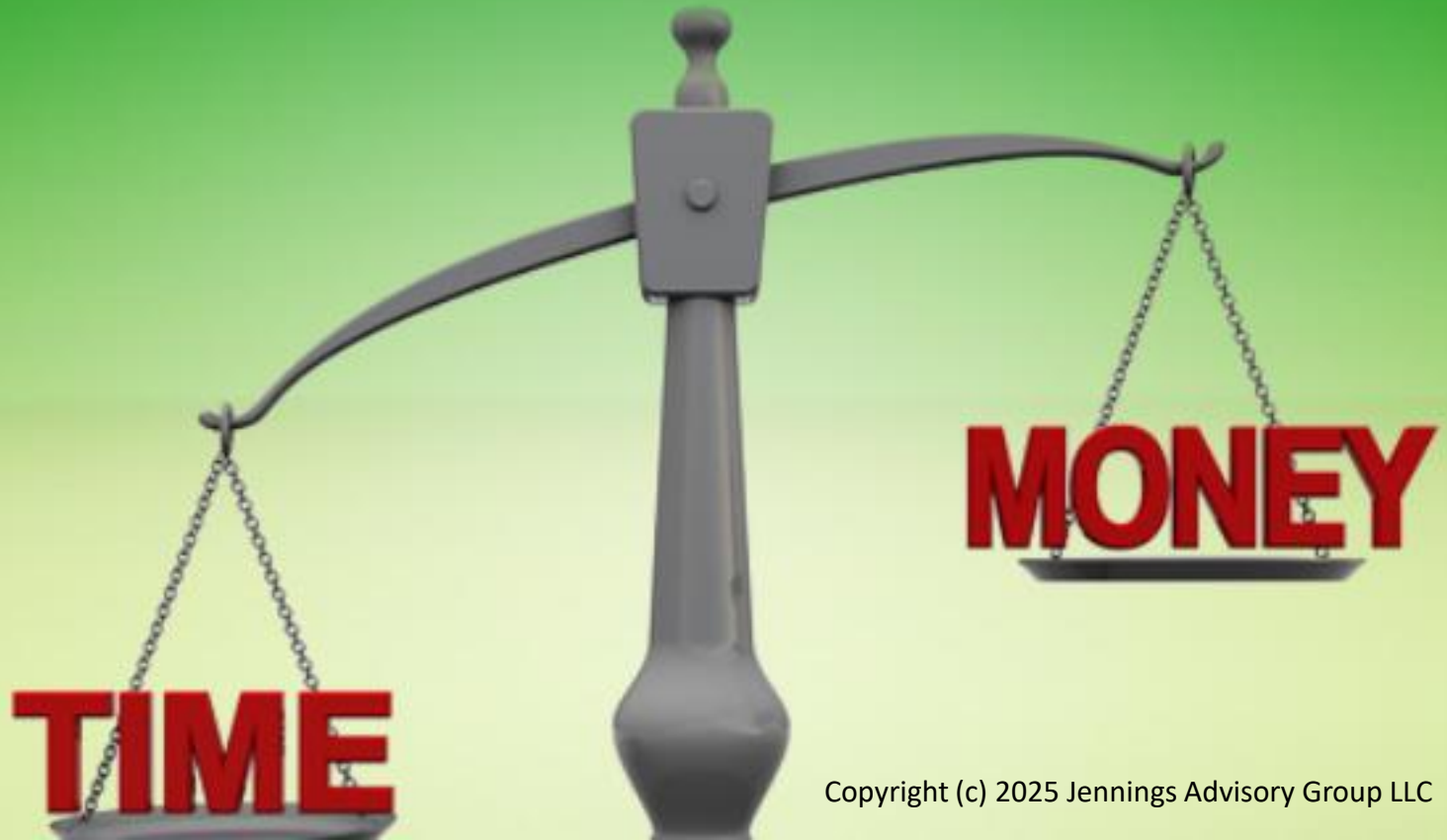
Federal Tax Update - Business





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Administrative Reminders



- Manual is ***our opinion***
  - A starting reference point, ***not the ending point***
    - ALWAYS do your own research because opinions differ
    - Lots of hyperlinks to underlying citations for you to perform your own research and form your own conclusions
  - PLEASE ASK QUESTIONS
  - Page Reference in upper right corner of slides
  - Download code –

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Who wrote in 1789 that "in this world nothing can be said to be certain, except death and taxes"?

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2026 General Business Topics





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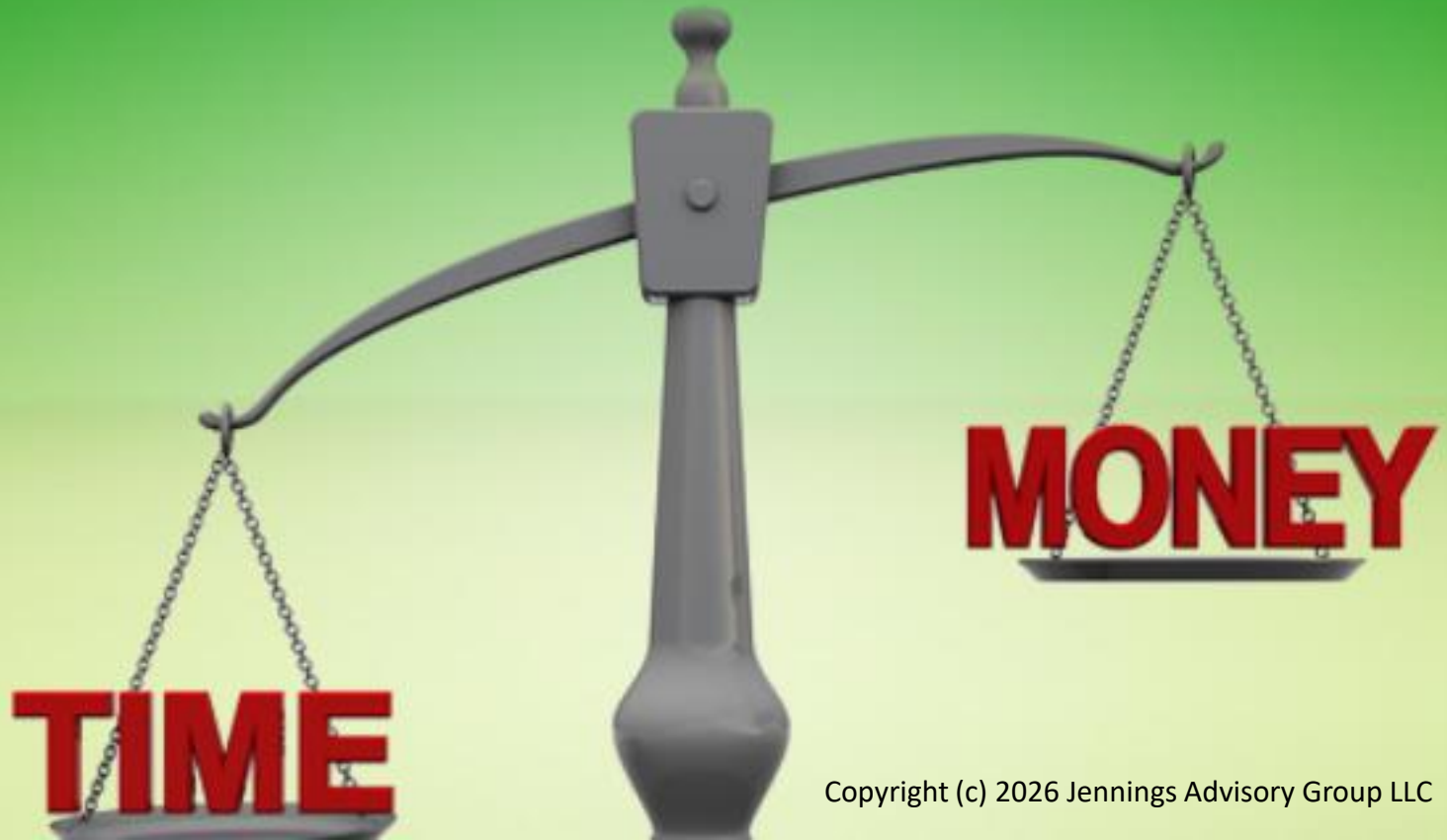
Business v. Hobby





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Business or Hobby – Groetzinger S Ct, 1987



Supreme Court says most important factors are whether the activity carried on

1. **On a full-time basis**
2. **With regularity**
3. **Continuously, and**
4. **To make a profit**

– **All 4 not required, but more the better**

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Business or Hobby – Reg Factors



1. Manner in which taxpayer carries out activity
2. Expertise of the taxpayer or those hired
3. Time and effort invested
4. Expected appreciation of business assets
5. Success of taxpayer in other business activities
6. History or income and loss on this activity
7. Amount of any occasional profits
8. Financial status of taxpayer
9. Elements of personal pleasure

NOTE – no one factor is controlling nor is a majority. It's about facts and circumstances

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Rancher Loses Money, but May Deduct



- Ken Kolar took over 836 acre Texas ranch from his parents in 2016
- The ranch was in disrepair as Ken's parents were elderly when he took over
- Revenue sources for the ranch included
  1. Land appreciation
  2. Oil and gas royalties (approx. $390,000 annually)
  3. Cattle ranching

- Court ruled each revenue stream stood alone – couldn't rely on one to justify another activity

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Rancher Loses Money, but May Deduct



- For the ranch, court analyzed the 9 factors
  1. Manner of conducting activity – Ken maintained separate bank accounts, multi-step bookkeeping and credibly testified he had a business plan – favored profit motive
  2. Taxpayer expertise – Ken held bachelor's degrees in animal science and biology and a master's in water supply and waste water. He grew up on the ranch and worked all phases during his life – favored profit motive
  3. Time and effort – Kolar spent long hours working the cattle ranch. He was not a weekend rancher, he worked full time and had been most of his life – favored profit motive

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Rancher Loses Money, but May Deduct



- For the ranch, court analyzed the 9 factors
  4. Expectation of asset appreciation – While the court specifically excluded land appreciation, it found this factor neutral
  5. Success in similar activities – The court found no credible evidence finding Ken was successful in similar activities. His real estate, rental and water sales activities were deemed dissimilar – factor was neutral
  6. History of income and loss – 2017 – 2022 the cattle income was $26,000 and expenses were $2 million. Ken argued rebuilding costs and circumstances – hurricanes, COVID, winter storms, etc. Slightly favored the or IRS

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Rancher Loses Money, but May Deduct



- For the ranch, court analyzed the 9 factors
  7. Occasional profits – There were no occasional profits, but the Slightly favored the IRS
  8. Financial status of taxpayer – The ranch losses were offsetting the significant oil and gas royalty income. While the Court ruled this factor strongly favored the IRS, it also noted that one factor is not dispositive.
  9. Personal pleasure – Ken was very credible that working the 826 ranch was not fun – clearing invasive plants, building fence, working with cattle was not fun. He did not rodeo, ride cutting horses, attend conventions, etc. Factor favored profit motive

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Rancher Loses Money, but May Deduct



Factor	Kolar	IRS	Neutral
1. Manner business carried	X		
2. Expertise	X		
3. Time and effort	X		
4. Asset appreciation			X
5. Similar activity success			X
6. Profit/loss history		X	
7. Occasional profit		X	
8. Financial status		X	
9. Personal pleasure	X		

Hobby Note



- Substantial outside income with large lossess continues to be the most scrutinized factor and the number one audit trigger
- TPs who maintain documentation and have a credible path to profitability are generally successful
- Documentation especially important for casualty and macroeconomic setbacks – drought, disease, weather events, etc.

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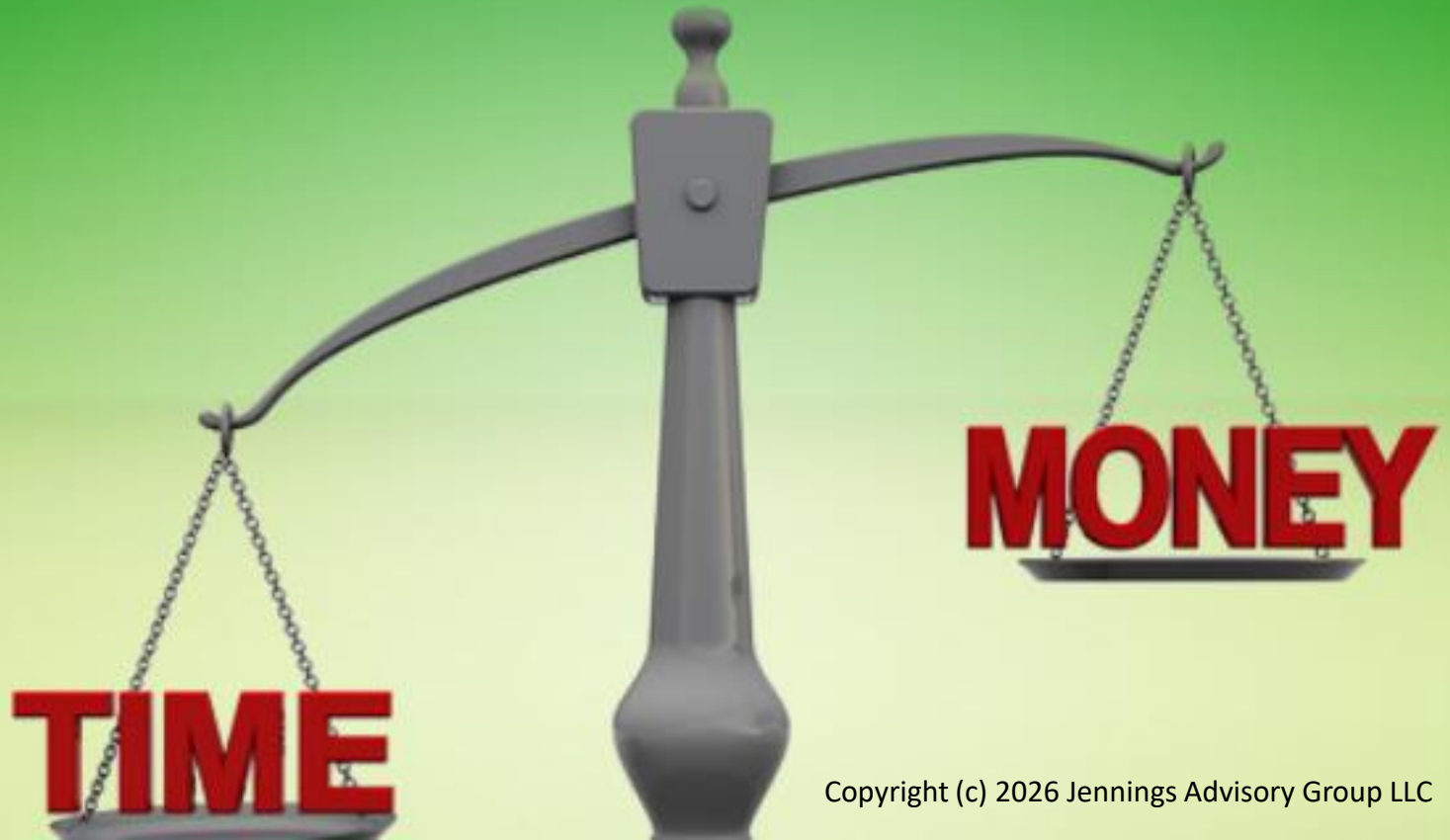
Mileage and Meals





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2026 Standard Mileage Rates



	1/1/26 – 6/30/26	7/1/26 – 12/31-26
Business	72.5¢	76¢
Medical and moving	20.5¢	23.5¢
Charity	14¢	14¢

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Depreciation Included in Standard Mileage



- Depreciation per mile included in standard mileage rate
  - 2019 26¢
  - 2020 27¢
  - 2021 26¢
  - 2022 26¢
  - 2023 28¢
  - 2024 30¢
  - 2025 33¢
  - 2026 35¢

- See example on page 8

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Meals for Employer Convenience

- Meals provided to employees are excludable from employee income if the meals are (§119(a)):
  1. Provided on the employer premises, and
  2. Provided for the convenience of the employer
     - Facts and circumstances test
     - No payment from employee indicates employer convenience
     - Generally meals provided outside normal work hours don't count, including meals provided on non-working days
     - Employees with required living accommodations may exclude all meals provided at that location
- But deduction no longer allowed for employer (§274(o))

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De Minimis Meals

- De minimis meals also excluded from employee income if (1.132-6 (a):
  1. Value is so small to make accounting unreasonable
  2. As long as frequency is taken into account
     - Includes coffee, doughnuts, soft drinks, and similar low-value items are specifically listed as examples of de minimis fringes and can be excluded from employee income
- But employer deduction is no longer allowed (§274(o))

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Deductible Meal Expenses

- Employee meals are still deductible for
  - Occasional recreation or social gatherings for employees (group meals, cocktail parties, company picnics, etc.)
  - Food and snacks made available to general public
  - Crew members on commercial vessels and offshore drilling rigs
  - Fishing and processing facilities crews. Any processing facility must be located in the US and north of the 50 degrees north latitude

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Meal and Lodging Per Diems



- Per diem rules
  - All substantiation rules waived – just prove away from home overnight
  - Partial day per diems are calculated
    - 75% of the full day per diem
    - Any other reasonable prorated method that is used consistently applied

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Per Diems – Meals and Lodging

Most Common Current Per Diem Rates (GSA Update)		
Type	Oct. 2025 – Sept. 2026	Oct. 2026 – Sept. 2027
Meals CONUS – general	$ 68	$68
Meals partial day (75%)	$ 51	$51
Meals OCONUS – general	Varies by Location	Varies by Location
Meals – US transportation	$ 80	$80
Meals – non-US transportation	$ 86	$86
Incidental – Both	$ 5	$5
Lodging – general rate	$110	$113
Lodging – other locations	Varies by Location	Varies by Location

Accountable Plan Reimbursements



- Accountable plan reimbursement programs (see sample plan page 15)
- 30-60-120 rules
  - 30 – No reimbursements more than 30 days prior to anticipated expense
  - 60 – Accounting provided to employer within 60 days of expense being incurred
  - 120 – any excess payments are returned within 120 days
- Receipts required for all lodging, transportation and other expenses of $75 or more
- Far preferable to employee business expense deduction

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Accountable Plan Reimbursements



- Work related education, supplies, and equipment.
- Employer required physical exams and passports for business trips.
- Internet usage to work from home.
- Computers, tablets, and related equipment.
- Local occupational taxes on work income.
- Travel to and from a temporary out-of-town business location.
- Mileage, plus a portion of vehicle licensing and interest costs.
- Secure, regular, and exclusive home office expenses including utilities, insurance, repairs, rent and all normal home office expenses such as those normally deducted by a self-employed person on Form 8829.
- Legal fees related to the job.
- Tax compliance and preparation fees related to the job, such as those arising because of incentive stock options, retirement plans, business travel Schedule K-1s, and planning for use of cafeteria and other fringe benefit plans.
- Cell phones when required by work.
- Malpractice premiums and possibly umbrella insurance premiums.
- Security clearances and TSA pre-check fees for traveling employees.

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Small Business Exceptions

- Tax Act of 1986 added the first small business revenue threshold at $5 million with Internal Revenue Code Section 448(c)
  - Primarily applied to 263A for inventory capitalization
- Rev. Proc. 2000-22 introduced a $1 million threshold for cash method
- TCJA increased it to $25 million and added inflation indexing
  - Added uniform revenue threshold across 5 tax application methods
- 2026 current threshold is $32 million (Rev. Proc. 2025-32)

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The 5 Small Business Exceptions

1. §448 – The Cash Method of Accounting
2. §263A – Uniform Capitalization of Inventory
3. §471 – Simplified Inventory
4. §460 – Long Term Contracts
5. §163 – Business Interest Deduction

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Tax Shelters/Syndicate

- A “tax shelter” does not qualify for any of the small business exceptions
- Partnership or other entity where more than 35% of losses are allocated to limited partners/entrepreneurs
  - Any interest owned by a non-individual is treated as a limited partner

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Revenue Test Calculations

- **The calculation:**
  - **Use 3 prior year average revenues – current year gorss receipts are irrelevant**
  - **Reduce revenues by returns and allowances, but include sales proceeds, investment & rent income**
  - **Annualize short years**
  - **Add together controlled groups revenues**

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Exemption 3 – Inventory

- IRC Sec. 471(c)(1)(B) allows inventory as either:

1. Non-incidental materials & supplies (expense when consumed/sold), or

2. As shown on applicable financial statements (AFS-audited), or

3. If no AFS, books and records of taxpayer

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Exemption 4 – Long Term Contracts

- **Large contractors must use the percentage complete method for contracts over 2 or more years**
  - **Income recognized ratably over life of contract**
- **Exempt small business contractors use**
  1. **Completed contract or**
  2. **Cash method method of accouints**

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Exemption 5 – Business Interest Expense

- **Limited deduction for interest expense**
  - **Business interest income, plus**
  - **30% of adjusted taxable income, plus**
  - **Flooring costs**
- **Small businesses may deduct 100% of business interest**

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TaxSpeaker® Small Business Planning

- Summary chart page 22
- Watch tax shelter trap
- Monitor average revenues annually with carry forward schedule
- Larson case page 25 regarding controlled groups
- Olson case page 25 regarding limited members and tax shelter
- See checklist on page 26

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§199A Qualified Business Income Deduction



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§199A Deduction

- **Deduction allowed for 20% of "qualified business income" from pass through entities at *individual owner level***

- **Includes income from**
  - **Partnerships**
  - **S Corporations**
  - **Sole proprietorships (Sch. C, Sch. F and Sch. E)**
  - **Trusts and estates – if trade or business**
  - **REIT dividends**
  - **PTPs**

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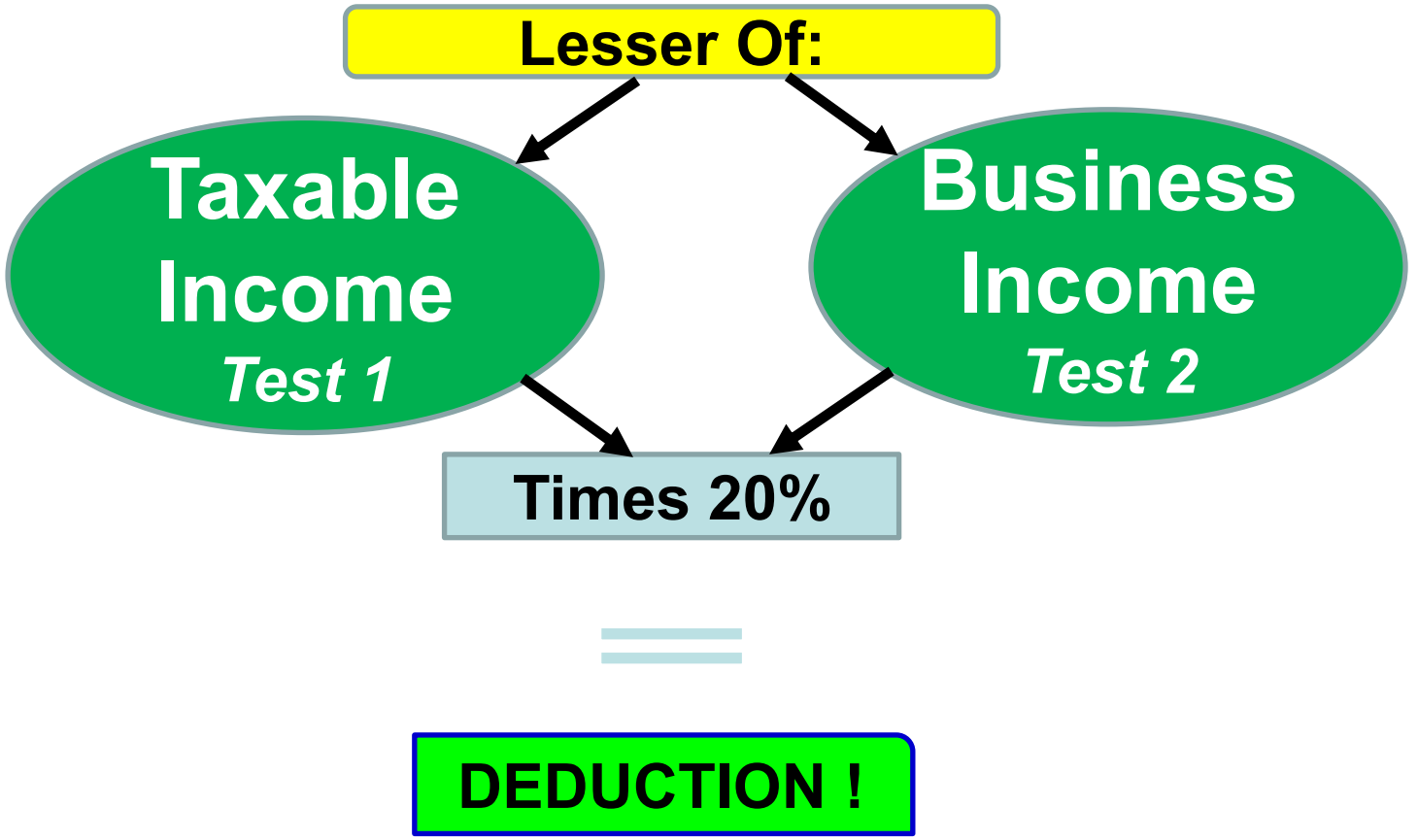
QBI Deduction – Review



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"High" Income Taxpayers Have Additional Tests

- **Two additional tests**

  1. **Wage or capital investment limitation**

  2. **Specified service trade or business limitation (SSTB)**

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OBBBA Changes to QBI

- **OBBBA made QBI permanent**
- **Phase out ranges increased for**
  - **High income taxpayers**
  - **Specified service trades or businesses**

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QBI High Income Taxpayers

199A Phase Out	2026	2027
Single begins	$201,775	
Single ends	$276,775	
Joint begins	$403,500	
Joint ends	$553,500	

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High Income Phaseout

Example. Harry (a single man) operates his construction business as a sole proprietor and generated QBI of $280,000 in 2026. Harry's business paid payroll of $80,000 and he had equipment with UBIA of $350,000 as of Dec. 31, 2026. Harry's pre-QBI taxable income is $300,332, which exceeds the $201,750 threshold and the entire phase-out range. Harry is subject to the W-2 and/or the UBIA limitations. His QBI deduction is calculated:

a. 20% of Harry's QBI ($265,332* x 20%)		$53,067
b. 50% of W-2 wages ($80,000 x 50%)	$40,000	
or		
c. Sum of 25% of W-2 wages ($20,000) plus 2.5% of qualified basis ($350,000 x 2.5% = $8,750)	$28,750	
d. Greater of b. or c.		$40,000
e. QBI deduction - lesser of a. or e.		$40,000

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High Income Phaseout

- Remember – all wages count including wages paid to owners
- See Josie example on page 30

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Specified Service Trades (SSTBs)

- **SSTB limitation applies to those in services businesses**
  - **Health**
  - **Law**
  - **Accounting**
  - **Actuarial**
  - **Performing arts**
  - **Consulting**
  - **Athletics**
  - **Financial services and brokerage**
  - **Investing or investment management**
  - **Trading or dealing in securities, commodities, or partnerships**
  - **Any other trade or business where owner or employee(s) reputation or skill is the principal asset**

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QBI and Sch. E

- **But what about Sch E rental activities?**
  - **If activity rises to the level of a trade or business – YES, otherwise NO**
  - **Trade or business not defined in Code**
  - **IRS says**
    - **Look to §162 and court cases**
    - **Do not look to §469 or §1411 – passive rules are irrelevant**
- **IRS FAQs say one rental may be trade or business but not in every case – what?**

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QBI and Sch. E

- **IRS has provided specific guidance in two areas**

  1. **Self rentals are QBI if tenant is trade or business**
     - **50% or greater common control test – not the same as the §469 test**
  2. **Rentals as a business safe harbor**

- **But FAQ 62 specifically says material participation is NOT required**

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Rental Real Estate – No Safe Harbor

- **Reminder - What is a safe harbor?**
  - **No hassle zone**
- **First thing to remember is "What is the question?"**

Example. Terry owns and rents a duplex. During the year, Terry collected 24 rent payments, made monthly mortgage payments that included property taxes and insurance. Terry also made major repairs to the rental property during the year which she estimates took 95 hours of her time. Terry doesn't have enough time to qualify for the safe harbor.

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Rental Real Estate and QBI

- **What about Triple Net Leases?**
  - **Cannot qualify for safe harbor**
- **But, IRS FAQ #65 concedes that triple net lease may qualify for QBI**

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Rental Real Estate and QBI

- **Court cases**
  - **James Murtaugh – used property manager to rent two timeshare interest – Trade or business**
  - **ER Curphy – Court ruled renting a single piece of property to generate income is a trade or business**
  - **Gilford – Court ruled fractional real estate interests were trade or business**
  - **Hazzard – lived in home 9 years, rented for three years after moving away – no involvement – trade or business**

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QBI and Sch. E – Final Note

- See summary of cases on page 38
- For individuals or relevant passthrough entities (RPEs)
  - All rentals are separate unless taxpayer treats all similar rentals as one activity
    - Cannot separate winners and losers
    - Commercial and residential rental are NOT similar
- If you're going to argue business you better do 1099s

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Guaranteed Payments

- **Are guaranteed payments required?**
  - **No requirement to pay guaranteed payments – it is not reasonable comp as in an S corporation**
- **Guaranteed payments are**
  - **Paid for services provided to the partnership or for use of capital**
  - **To the extent paid without regard to partnership income**

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LLC Member/Partner

Chloe and Laina Example	w/ guaranteed payment	Without
Tax Practice LLC profit (50%)	$ 40,000	$100,000
LLC guaranteed payment	$ 60,000	$ - 0 -
Retirement income	$ 60,000	$ 60,000
IRA	($ 7,000)	($ 7,000)
SE Tax	($ 7,065)	($ 7,065)
AGI	$145,935	$145,935
Standard deduction	($ 32,200)	($ 32,200)
Taxable income	$113,735	$113,735
QBI Deduction	($ 7,435)	($ 18,587)
Final taxable income	$106,300	$ 95,148
Lesser of QBI or TI	$ 37,174	$ 92,935

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Cannabis Update



- Executive Order 14370 (April 22nd, 2026) requires marijuana be moved from Sch I to Sch III controlled substance
- Medical marijuana only
  - Unlicensed crops, bulk marijuana, and other non-medical marijuana are not included
- DOJ ordered medical marijuana be moved to Sch III in April
  - DOJ initiated hearings evaluate if all marijuana should be moved to Sch III, not just medical marijuana
- Treasury announced on April 30th that tax guidance is coming and it won't be retroactive

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April 15th hasn't always been Tax Day. Before 1955, when were individual Federal returns due?

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ARTIFICIAL INTELLIGENCE AND THE TAX OFFICE

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AI – Replacing the Workforce or Glorified Search Engine?

- Generative AI – advanced autocomplete
- It can
  - Create content – text, images, audio, code
  - Newsletters
  - Client letters
  - Advertising content
  - Power Point presentations
  - ?

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AI – Replacing the Workforce or Glorified Search Engine?

- AI hallucinations
  - Looks and sounds correct but is factually wrong
    - "Where are non-itemizer charitable deduction reported in 2026?"
  - AI gets its answers from the web, including old and out of date sites
  - Caution is extremely important

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AI – The Options

- There are four well known generic AI providers
  1. ChatGPT
  2. Claude (Anthropic)
  3. Google Gemini
  4. Microsoft Copilot
- Tax specific AI solutions (proprietary libraries)
  - TaxSpeaker Research Assistant
  - CCH Answer Connect – AI Assistant
  - Thomson Reuters – CoCounsel

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AI – Replacing the Workforce or Glorified Search Engine?

- **What are the problem areas?**
  - **Very current tax law, regs and other IRS developments**
  - **Math and calculations – yes, really!**
  - **Legal citations and references – may use copyrighted materials**
  - **Specific client advice - confidentiality**

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AI – Replacing the Workforce or Glorified Search Engine?

- **Security reminders**
  - **Bad actors are using AI to write their content – and it is very convincing. Phishing emails and other – be more vigilant than ever**
  - **Most AI programs are set to use your conversations to improve the program – go to settings to turn off sharing**

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AI and Circ 230

- **Bottom line – be very cautious about using any of the generic AI products with client identifying info**
  - **Potential issues include**
    - **Entering client names, SS#s, EINs or other such info**
    - **Using or pasting client's tax return**
    - **Describing facts sufficient to figure out who the client is**
  - **Sharing confidential client info is a Circular 230 violation**

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AI – It's All in How You Ask

- For best results, it takes practice to learn AI language
- Five keys to asking the right question
  1. ID your role – "Please explain" versus "I'm a CPA explaining to my client"
  2. Share the context to AI – who is getting the info and what do they need it for?
  3. Explain the task – have AI write a letter, write a news article, write an article for a professional journal, etc.
  4. Request a specific format – newsletter, checklist, bullets, number of words, etc.
  5. Tell AI what to leave out – leave out citations, disclaimers, etc.

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AI – It's All in How You Ask

- **Examples**
  - **"Write a CPA newsletter for business clients" OR**
  - **"Write a year end tax planning newsletter my CPA firm can send to its Schedule C and Schedule F filers whose average gross receipts are less than $5 million. Limit the newsletter to 1000 words or less."**
  - **For best results, it takes practice to learn AI language**

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Other AI Considerations

- **Good uses for AI in an accounting office**
  - First drafts of client communications
  - Review of written correspondence before finalizing and sending to clients
  - Marketing and content writing (e.g. newsletters, media content, website copy, social media posts, etc.)
  - Job postings and staff onboarding materials
  - Office procedures
  - Meeting agendas and meeting summaries
  - Plain language explanations of tax law for client materials
  - FAQs for common client questions – website content
  - Handouts explaining processes – e.g. what to bring to first appointment

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Other AI Considerations

- **What to say when the client asks if you use AI**
  - **Some curious, some concerned**
  - **Be brief and honest – "Yes, we use AI tools to help with internal work. Your personal data never goes into those systems and everything we produce is reviewed before it reaches you."**
  - **Don't ever promise you won't use AI – you will**

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AI – That's It!

- No go forth and conquer!

- And consider Ryan Jennings' AI in a Tax Office webinar!

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Business Pension Plans

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2025 Retirement Savings by Age

2025 Retirement Savings Account Balances by Age
Source – Vanguard's How America Saves 2026 Report

Age	Average	Median
<25	$7,259	$2,234
25–34	$50,261	$18,732
35–44	$120,742	$46,919
45–54	$214,991	$78,730
55–64	$305,006	$107,269
65+	$330,186	$103,202



Business Pensions

- **See retirement plan summary for small to medium size businesses on page 49**

2026 Deposit Limits – Notice 2025-67

IRA

$7,500 Maximum - $1,100 if 50+

SEP/IRA

Lesser of 25% or $72,000
50 and over $0

Simple IRA

Deferral: $17,000 or $18,100
50 and over: $4,000 or $3,850
Employer Match (Maximum) 3%

401(k)

Deferral: $24,500
50 and over: $8,000
Employer Match 25% (Maximum)
Limited to overall maximum of
$72,000 (plus 50 and over amount)

A Tale of Two SIMPLEs

Description	Enhanced SIMPLE IRA Rules	Traditional SIMPLE IRA Rules
Employer qualifications for the Enhanced or Traditional SIMPLE IRAs	Employers who, in the prior calendar year, had 25 or fewer employees whose W-2 Medicare wages were $5,000 or more are required to follow the Enhanced SIMPLE IRA rules. Employers who had 26 or more qualifying employees may elect to have the enhanced rules apply.	Employers with 26 or more employees who made $5,000 or more in the preceding calendar year are subject to the Traditional SIMPLE IRA rules unless they elect to utilize the enhanced SIMPLE IRA rules.
2026 maximum regular employee elective deferral	$18,100	$17,000
2026 over age 49, but not age 60 – 63, catch-up contribution	$3,850	$4,000
2026 catch-up contribution for those age 60 to 63	$5,250	$5,250
Employer matching contribution	3%, but may elect lower percent in 2 of 5 years. 4% for electing employers.	3% but may elect lower percent in 2 of 5 years.
Employer nonelective contribution	2% for all qualifying employees. 3% for electing employers.	2%

Which SIMPLE Do I Use?

- Step 1 – look to prior year W-2s and count how many employees had $5,000 or more of Medicare wages
- Step 2 – if the there were 25 or fewer W-2s, you are automatically required to use the enhanced SIMPLE rules
- Step 3 – if there were 26 or more W-2s, you may elect to offer the enhanced SIMPLE. If elected, employer must
  - Notify the employees before the start of the year, and
  - Agree to increase employer SIMPLE contributions to either
    - 4% matching contribution (normally 3%) or
    - 3% non-elective contributions (normally 2%)

Enhanced v. Traditional – Example 1

- CDB offers a SIMPLE IRA to its employees
- In 2025, CDB had 20 employees whose W-2 wages were $5,000 or more
- CDB is required to offer the enhanced SIMPLE
- Dave, age 55, has the following activity in 2026
  - Enhanced SIMPLE regular contribution $18,100
  - Age 50 and above catch-up $ 3,850
  - Total deferrals by Dave $21,950

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Enhanced v. Traditional – Example 2

- Assume same facts except CDB had 30 employees in 2025 whose W-2 wages were $5,000 or more
- CDB does not elect to offer the enhanced SIMPLE
- Dave, age 55, has the following activity in 2026
  - Enhanced SIMPLE regular contribution $17,000
  - Age 50 and above catch-up $ 4,000
  - Total deferrals by Dave $21,000

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Enhanced v. Traditional – Example 3

- Assume the same facts as in Example 1 except Dave turned age 60 in 2026
- CDB is required to offer the enhanced SIMPLE
- Dave, age 60, has the following activity in 2026
  - Enhanced SIMPLE regular contribution $18,100
  - Age 50 and above catch-up $ 5,250
  - Total deferrals by Dave $23,350

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SIMPLE – Calculating the 25 Employee Threshold

- Test #1 – look to prior year W-2 and count how many had $5,000 or more Medicare wages
- Test #2 – once test is met, there is a two-year grace period
  - Employers who pass Test #1, remain eligible for two additional years – the grace period
  - Does not apply in the case of an acquisition, disposition or similar transaction

SIMPLE – Calculating the 25 Employee Threshold

- See example page 53
  - Twain Harte Market (THM) had 20 employees in 2024 and 2025 but grew to 28 employees in 2026
  - THM is required to offer the enhance SIMPLE plan in 2026 as it is a “small” employer – 20 employees in 2025
  - THM is still a small employer in 2027 and 2028 due to the grace period rules. Starting in 2029, THM may choose whether to offer the increased limits

Other Enhanced SIMPLE Rules

- Employers who use the enhanced SIMPLEs, both by requirement or by election, must notify employees before the year begins
- Nothing needs to be filed with the IRS
- If employer is electing, employees must also be notified of the employer increased contributions – election remains in force until revoked by employer
- Employers should also notify the financial institutions the enhanced contribution limits will be used

Additional SIMPLE Employer Contributions

- Employers allowed additional discretionary contributions to SIMPLE IRAs
- Employers must have fewer than 26 qualifying employees in the prior year
- Contributions of up to 10% of employee wages must
  - Be nondiscriminatory (as a percentage, not a dollar amount)
  - Not exceed $5,300 (2026)
- Owners qualify if their wages are less than $100,000

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SIMPLE Employer Contributions

- Example 1 – DBC Construction has 12 employees who receive 2% nonelective SIMPLE contributions

Employer	Wages	SIMPLE
Bonus amount	$60,000	$60,000
Payroll taxes/WC Comp (20%)	$12,000	$ - 0 -
DBC Cost	$72,000	$60,000

SIMPLE Employer Contributions

- Example 2 – DBC Construction has 12 employees who receive 2% nonelective SIMPLE contributions

Employee	Wages	SIMPLE
Employee bonus	$60,000	$60,000
Payroll and income tax (22%)	($13,200)	$ - 0 -
Tax and penalties if withdrawn (25%)	N/A	($15,000)
Employee net	$46,800	$45,000

SIMPLE - Employee Roth Deferrals

- Employees may designate deferrals to Roth SIMPLE IRAs
  - Employee must elect to contribute – auto-enroll not allowed for Roth accounts
  - Employee elective deferrals are included in employee wages
  - Employers are not required to offer - elective
- Employee deferral Roth contributions are
  - Included in Form W-2, box 1, 3 and 5
  - Reported on Form W-2 in box 12 with code S

SIMPLE - Employee Roth Deferrals

- Employer contributions may be made to Roth SIMPLE IRAs
  - Employers are not required to offer – elective
  - Employer contributions to Roth accounts are included in employee income in year contributed, regardless of when employer is allowed deduction
    - Contributions not subject to FICA or FUTA
- Employer contributions are reported on Form 1099-R as if the contribution was a rollover contribution to a Roth IRA

25% TRAP for SIMPLEs

- Early withdrawal penalty increased to 25% for SIMPLE IRAs if
  - Early withdrawal penalty applies (§72(t)), and
  - Withdrawal is made within 2 years of ***first contribution by employer***
- Otherwise penalty is 10%
- Applies to rollovers to non-SIMPLE accounts, even IRAs or SEPs
- Goes away once account has been open for 2 years, regardless of when contributions are made



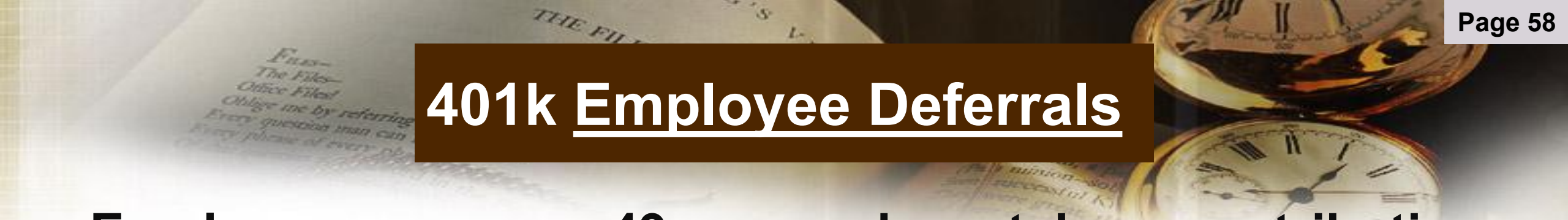
Qualified Retirement Plans

- Profit sharing plans
- Money purchase plans
- 401(k) plans
- Safe harbor 401k
- 403(b) and 457 plans – not really qualified
- ESOP
- Defined benefit plans
- Cash balance plans

401k Employee Deferral Extras

- Employees may defer up to $24,500 plus $8,000 if age 50+
- Employers may contribute up to 25% of wages, max $72,000 less the employee contributions plus $8,000 if applicable
- Example – Cindy is 52 in 2026 – her 2026 401k deferral is:

• Normal deferral	$24,500
• Catch up	$ 8,000
• Employer contribution	$47,500
• Cindy's total 2026 employee contribution	$80,000



401k Employee Deferrals

- Employees over age 49 may make catch-up contributions of $8,000 to deferral plans
- Increased deferral for employees ages 60, 61, 62 or 63
  - For these employees, the regular over age 49 catch-up contributions increases to greater of
    - $10,000 or
    - Current catch-up contribution multiplied times 150%
  - For 2026, the catch-up contribution is the greater of $10,000 or $11,250 ($7,500 x 150%) – doesn't use the new $8,000 amount?

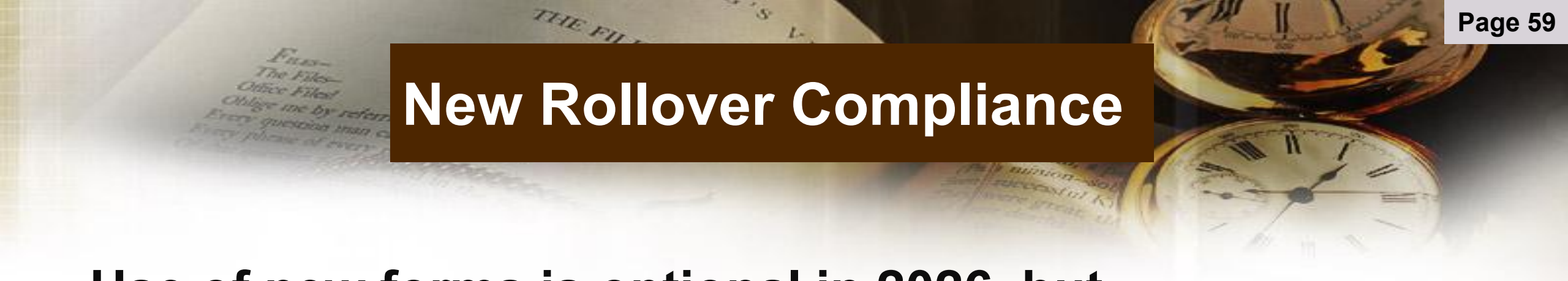
401k Employee Deferral Extras

- Assume same facts as prior example except Cindy is 60 as of 12/31/26
- Cindy's max 401k contribution in 2026 is:

• Normal deferral	$24,500
• Age 60 catch up	$11,250
• Total	$35,750
• Employer contribution	$47,500
• Final 2025 total	$83,250

New Rollover Compliance

- New rollover compliance rules are coming for qualified plans, 403(b) and 457 plans (Notice 2026-49)
- Congress and IRS think games are being played
- Notice includes new standardized forms
  - Form 1 – Participant rollover request
  - Form 2 – Receiving plan's request to distributing plan
  - Form 3 – Distributing plan's rollover certification
  - Form 4 – Receiving plan's rollover acceptance
  - Transfer execution – executed by distributing plan



New Rollover Compliance

- Use of new forms is optional in 2026, but…
- My guess they are worried about SD plans and related compliance – e.g., assets getting moved out without 1099Rs being filed
- They specifically mentioned cutting checks to new plan but giving it to participant was a weakness in the current system

Designated Roth Contributions

- Employers may, but are not required to, offer designated Roth accounts for employee deferrals
- Electing employers must
  - Establish separate Roth accounts for each participant
  - Maintain separate records for each account
  - Report Roth deferrals separately on W-2
- No AGI limits
- No longer subject to RMDs

Catch Up Contribution to Roth Only

- High income employees may only make catch up contributions to Roth accounts – deemed to have elected
- High income defined as employees of plan sponsor whose prior year wages were $150,000 (for 2026) or more from same employer
- Provision does not apply
  - To SIMPLE IRAs
  - Self employed persons ($150,000 test is W2 wages only)

Catch Up Contribution to Roth Only

- Final Regs issued (TD 10033) answer questions
  - Employee is deemed to have made an election to contribute to Roth account
    - Employee must be notified and must be allowed to change elective deferral amount
  - Employers still not required to offer designated Roth accounts
    - No catch up allowed for those required to contribute to Roth accounts if employer doesn't elect to offer
    - New rule says no discrimination
  - Does not apply to IRA based pensions

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Catch Up Contribution to Roth Only

- **Final Regs issued (TD 10033) provide**
  - **Only applies to employees who earned more than $150,000 (2026 test) for the specific employer**
  - **Employee is deemed to have made an election to contribute to Roth account**
  - **Catch up contributions must be made to designated Roth account – includes extra 60-63 catch-up contributions**
  - **Partial wages are not prorated to determine requirements**
  - **If no Designated Roth offered, no catch-up contributions allowed**
  - **SE income is not wages – doesn't apply to SE income**

Catch Up Contribution to Roth Only

- Provision enforced in 2026
  - Regulations applicable starting in 2027, but no additional relief provided
  - 2026 compliance must be reasonable

Employers May Contribute to Roth Accounts

- **Employer contributions to SEPs, SIMPLEs, 401(k)s, 403(b)s and 457 may now be made to Roth accounts**
  - **Elective, not required**
  - **No AGI limit on these Roth contributions**
  - ***Employee*** **Roth deferrals included in wages on W-2s and subject to payroll taxes in the year of deferral**
  - ***Employer*** **contributions are reported on Form 1099-R with Code "G", "2" or "7" and payroll taxes do not apply**
  - **Report in year contribution is actually paid**
  - **See reporting chart on page 64 and comprehensive example on page 65**

Student Loan Deferral Match

- Student loan payments may count as elective deferrals for matching purposes
  - Includes all deferral plans (e.g. SIMPLE, 401k, etc.)
  - Employers may choose whether or not to allow
- Employee must certify to employer
  - Amount of payments and that payments actually made
  - Date paid
  - Qualified loan for qualified individual
  - Loan incurred by employee
- Employers may rely on employee statement

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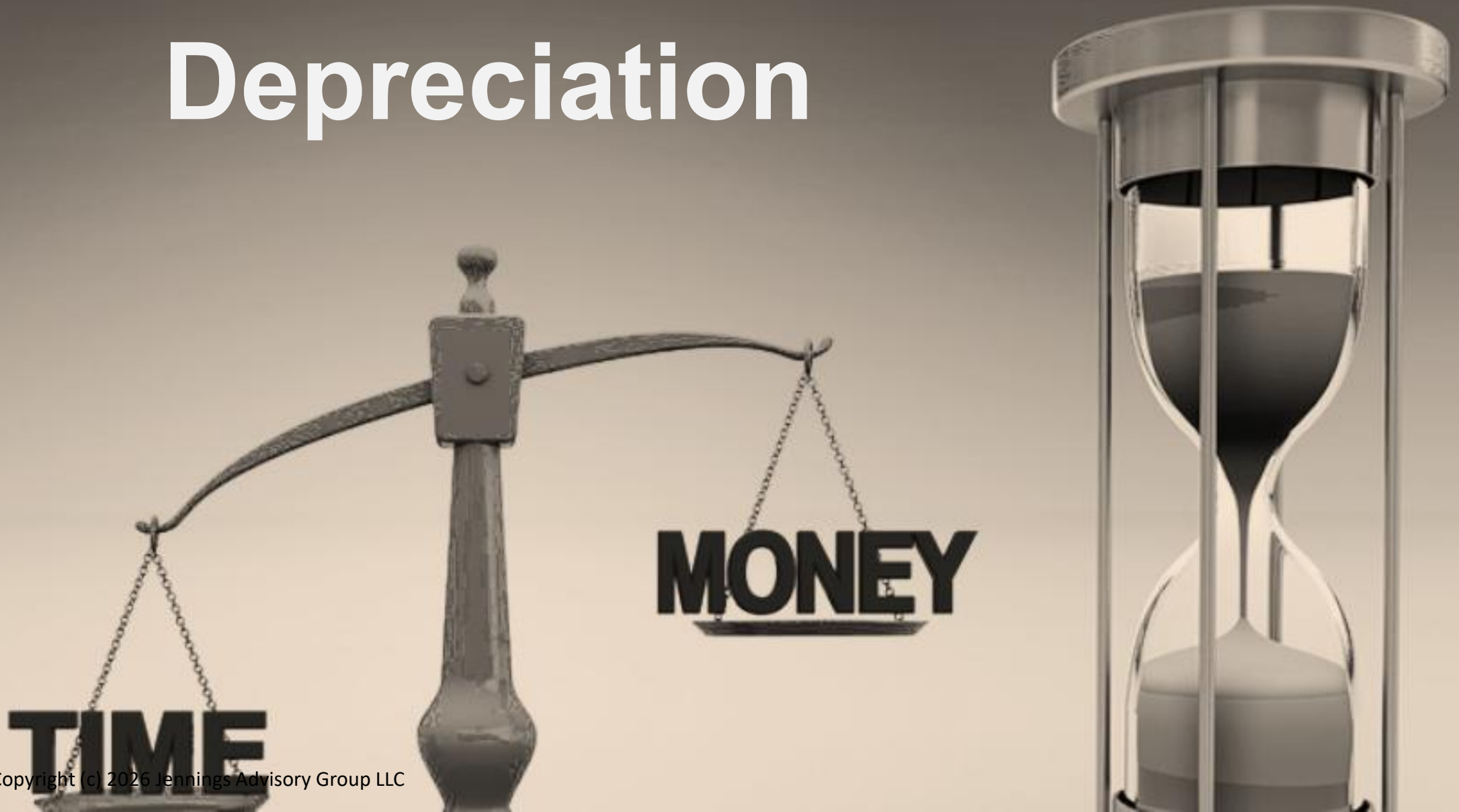
Depreciation



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Depreciation Review

- **Big 3**
  1. **Applicable life – 3, 5, 7, 10, 15, 20, 27.5, 39 years**
     - **Defined under MACRS rules and based on ADR class lives**
  2. **Applicable method – MACRS 200DB, 150DB, straight line**
     - **Determined based on asset (residential rental – straight line**
     - **Straight line generally allowed by election**
  3. **Applicable convention – mid-year, mid-quarter or mid-month**
     - **Personal property mid-year unless more than 40% of assets purchased in last quarter of year**

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Depreciation Review



- See notable lives in chart on page 75
  - Gas pump canopies – 5 year
  - Home used for adult day care – 27.5 year
  - Farm machinery and equip – 5 years
  - Qualified improvement property – 15 year
  - Residential rental furniture and appliances – 5 year
  - Solar and wind energy property – 5 years
  - Wells – 15 year
- See additional guidance cited at bottom of page 75

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2026 Form 4562 Changes

- Amortization no longer included
- Part II – includes new lines for new property qualified for bonus depreciation
  - Plants and nuts
  - Recycle and reuse property
  - QPP

Part II	Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)		
14a	Special depreciation allowance for certain qualified property (other than listed property) under section 168(k)	14a	
14b	Special depreciation allowance for certain specified plants bearing fruits and nuts under section 168(k)(5)	14b	
14c	Special depreciation allowance for qualified reuse and recycle property under section 168(m) . . .	14c	
14d	Special depreciation allowance for certain qualified production property under section 168(n) (attach statement)	14d	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

2026 Form 4562 Changes

- **Part III – two new lines**
  1. **Separate reporting of depreciation for QPP**
  2. **Separate reporting of depreciation for railroad grading, tunnel bore or water utility property**

19k	Qualified production property			39 yrs.	MM	S/L
	Section C—Assets Placed in Service During 2026 Tax Year Using the Alternative Depreciation Sys					
20a	Class life					S/L
20b	12-year			12 yrs.		S/L
20c	30-year			30 yrs.	MM	S/L
20d	40-year			40 yrs.	MM	S/L
20e	Railroad grading, tunnel bore, or water utility property			50 yrs.	MM	S/L

2026 Form 4562 Changes

- Part IV – rearranged lines – cosmetic only
- Part V – Listed property has new line to focus on aircraft

Section A – Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.)			
24a	Do you have evidence to support the business/investment use claimed?	☐ Yes	☐ No
24b	If "Yes," is the evidence written?	☐ Yes	☐ No
24c	Does at least 25% of the use of any aircraft listed in Section A consist of qualified business use not described in section 280F(d)(6)(C)(i)? See instructions	☐ Yes	☐ No

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2026 Form 4562-B Changes

- Amortization is gone from Form 4562
- New Form 4562-B used to report amortization

Form **4562-B**
(December 2026)
Department of the Treasury
Internal Revenue Service

Amortization

Attach to your return.
Go to *www.irs.gov/Form4562B* for instructions and the latest information.

OMB No. 1545-0172

Attachment Sequence No. **179A**

Name(s) shown on return	Business or activity to which this form relates	**Identification number**

1 Amortization of costs that began during your current tax year (see instructions):

(a) Description of costs (see instructions for allowed entries)	**(b)** Date amortization begins	**(c)** Amortizable amount	**(d)** Code section	**(e)** Amortization period or percentage	**(f)** Amortization for this year

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Section 179 Changes



- 2026 Update
  - 179 maximum is $2,560,000 (2026)
  - 179 phaseout begins at $4,090,000 of 179 property (2026)
  - No change to SUV limits other than inflation adjustments ($32,000 for 2026)
- 179 may be increased, decreased, or elected via amended return for open years

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Section 179 Non-Qualifying



- Outside US
- Acquired by gift or inheritance
- Acquired from related party
- Property in the 15, 20, 27.5 and 39-year life except
  - QIP
  - Non-residential roofs
  - HVAC equipment
  - Fire protection and alarm systems
  - Security systems

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Other 179 Notables



- Recapture if business use drops to 50% or below during class life
  - Not true for bonus depreciation
  - Recapture reported on Form 4797 and goes to the same form where it was deducted
- Cannot create a loss – but bonus can
- New and used property qualify

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Section 179 – Carryover/Recapture

- **Pass Through Dispositions require additional K-1 reporting**
  - Description
  - Date acquired
  - Date sold
  - Owner share
    - Sale price
    - Cost and selling expenses
    - 179 and depreciation
  - If casualty, details for Form 4684
  - Installment sale info if applicable

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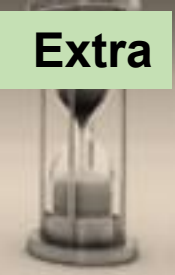
Bonus Depreciation Changes



- Bonus depreciation through the years
  - 2001 - 30% of qualified property
  - 2003 – Increased to 50%, but expired after 2005
  - 2008 – Temporarily reinstated at 50% and continually extended
  - 2015 – Extended 50% through 2017 and then phased out
  - 2017 – Increased to 100% and extended though 2022
  - 2023 – Dropped to 80%
  - 2024 – Dropped to 60%
  - 2025 – Assets purchased in 1/1 – 1/19/25 dropped to 40%
  - 2025 – Assets purchased 1/20/25 and permanent at 100%

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Bonus Depreciation

- All NEW & USED** assets in 3, 5, 7, 10, 15 and 20 classes
  - New and used property
  - Rental property furniture & furnishings & appliances
  - Parking lots & landscaping
  - All farm assets including buildings (20 year class life)
- Bonus mandatory unless elect out
  - Remember allowed or allowable on above items
  - Election out must occur by extended due date
- No maximums, phase-outs or income tests

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Bonus – Election Out

- Election can be made by class life, otherwise applies to all class lives
  - Cannot pick & choose within life group
- Change your mind no later than extended due date on amended return
- No bonus on equipment bought and sold in same year
- Safety election on all classes

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Bonus – Qualified Production Property (QPP)



- **100% bonus allowed for QPP, defined**
  1. **MACRS property**
  2. **Used by TP as integral part of QPP**
  3. **Located in US or possession**
  4. **Original use commences with TP – exception applies – later**
  5. **Construction begins Jan. 20, 2025 through December 31, 2028**
  6. **QPP is placed in service July 4, 2025 through Dec. 31, 2030**
  7. **TP designates as QPP – don't have too**
  8. **Not subject to ADS, and**
  9. **Is not ineligible property**

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Bonus – Qualified Production Property (QPP)

- Integral part requirement
  - De minimis rule – 95% test
  - Property used by lessee – generally doesn't count
    - Exception #1 – property rented to another member of consolidated group for QPP
    - Exception #2 – Lease to pass-through entity if entity is involved in QPP
      - Brandon builds a building and leases it to Rocon for a QPP activity.
      - Brandon owns 100% of Rocon
      - Building is 100% QPP on Brandon's Sch E on his 1040

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Bonus – Qualified Production Property (QPP)



- **Original use commences with taxpayer – built it**
- **Exception if:**

1. **Nobody used property for QPP purpose January 1, 2021 through May 12, 2025**
2. **Property was never used by TP for anything before buying it**
3. **Acquisition was a bonafide purchase (i.e., not a transfer between related parties or carryover from a corp reorg)**
4. **Cost is purchase price, not carryover from 1031, 1033, etc.**

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Bonus – Qualified Production Property (QPP)

- **Example**
  - **Brandon buys warehouse in May 2027 from an unrelated party**
  - **Brandon confirms the warehouse was built in 2015 and was always used as a warehouse**
  - **Brandon begins manufacturing fly reel operations in the building in 2027**
  - **Building is QPP**

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Bonus – Qualified Production Property (QPP)



- **Ineligible property includes any building *or part of a building* that is used for**
  - **Offices**
  - **Admin**
  - **Sales and marketing**
  - **Research and development**
  - **Engineering**
  - **Any other none QPP activities**

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Bonus – Qualified Production Property (QPP)



- Mixed use property – may use any reasonable method to allocate between QPP and non-QPP eligible property
- Examples are:
  - Square footage
  - Cost seg data
  - Architectural and engineering plans
  - Construction invoices, etc.
  - More than one method may be used, but must be consistent

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Bonus – Qualified Production Property (QPP)

- Note – QPP is a separate class of 168(k) property – it is not 39-year property

- QPP is the only 168(k) property where you elect in, not out of 168(k) treatment

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Bonus – Qualified Production Property (QPP)



- IRS issued Notice 2026-16 – this is the guidance until Regs are issued
- "Qualified Production Activity (QPA)" includes
  1. Production – the term "production" includes agriculture and chemical production only
  2. Manufacturing – but manufacturing can be any tangible personal property other than a food or beverage prepared in the same building where it is sold
  3. Refining which results in a substantial transformation of a qualified product

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Bonus – Qualified Production Property (QPP)



- **Production** – the term "production" focuses on two areas
  1. Agriculture, which includes
     - Preparing the soil
     - Planting seeds
     - Raising, cultivating, irrigating, and harvesting crops
     - Breeding, rearing, feeding and managing livestock (i.e., cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons and other poultry)

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Bonus – Qualified Production Property (QPP)



- **Production** – the term "production" focuses on two areas
  2. Chemical production is a chemical process where product is formulated from organic and nonorganic materials
     - Petrochemical, industrial gas, synthetic dye manufacturing
     - Ethyl alcohol, cyclic crude, gum and wood chemical manufacturing
     - Synthetic resins, plastics, etc.
     - Pharmaceutical products
     - Adhesives, glues, and caulking compounds
     - Soaps, detergents, polishes, textile and leather agents, etc.

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Bonus – Qualified Production Property (QPP)

2. **Manufacturing** – materially change the form or function of any tangible personal property to create another tangible personal property
   - But not food or beverage prepared in the same building where it is sold (e.g. restaurants)

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Bonus – Qualified Production Property (QPP)



3. **Refining** means to purify a substance to make it useful and higher value. Examples include
   - Removing fatty acids from animal fats
   - Processing petroleum products from crude oil
   - Processing vegetable oil from plan materials
   - Wet corn milling
   - Processing cane or beet sugar
   - Processing tar paving, roofing and saturated materials
   - Recovering copper from scrap, etc.

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Bonus – Qualified Production Property (QPP)



- QPA includes an essential activity if:
  - The activity occurs at the same property where the transformation takes place
  - The activity doesn't occur within ineligible property
  - The activity is required to substantially transform the property or product

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Bonus – Qualified Production Property (QPP)



- Examples of QPA essential activities include:
  - Storage – receiving and storage of raw materials to be used in QPA are essential so qualify as QPP
  - Oversight and supervision – for manufacturing, production, or refining activities
  - Purchasing – material or vendor selection, or control of raw materials
  - Product development – development of product design, trade secrets, technology and other intellectual property use in manufacturing

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Comprehensive example. Del Mar owns a factory building that it uses to process tomatoes and other vegetables into jarred tomato sauce that is sold in grocery stores. The jarred sauce is a qualified product, and the sauce ingredients are the property comprising the qualified product. The physical space of Del Mar's factory is divided up into the following areas:

- **Ingredient receiving.** A loading bay used to receive the sauce ingredients;
- **Ingredient storage.** A section used to store the sauce ingredients received at the loading bay;
- **Ingredient preparation.** A section used to, as applicable to each ingredient, inspect, sort, clean, blanch, peel, chop, mince, and/or otherwise prepare the sauce ingredients for further processing;
- **Sauce processing and jarring.** A manufacturing space in which the prepared ingredients are combined, blended, cooked, cooled, preserved, and sealed in labeled jars.; and
- **Sauce storage.** A section used to store the jarred sauce prior to shipping it to customers.

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Bonus – Qualified Production Property (QPP)

- Example
  - Ingredient receiving and storage
    - Ingredients are raw materials to be used in QPA
    - Stored in same building as QPA
    - Space is QPP
  - Ingredient prep
    - Ingredients are materially changed into new tangible personal property
    - While not a final product, the final product couldn't happen without ingredient prep – it is essential
    - Space is QPP

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Bonus – Qualified Production Property (QPP)

- Example
  - Sauce processing
    - Ingredients are materially changed into final, complete and distinct property – jarred sauce
    - Includes the supervision and quality control functions as essential activities
    - Space is QPP
  - Sauce storage – finished goods
    - No further modification or manufacturing process – storage only
    - Storage of finished product is not an essential activity – space is not QPP

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Bonus – Qualified Production Property (QPP)

- **Any bonus depreciation claimed on QPP is subject to §1245 recapture**
- **This means**
  - **Ordinary tax rates up to 37% apply (normally capped at 25%)**
  - **Installment sale method of accounting cannot be used**
  - **Anything else that isn't good about §1245**

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Bonus – Qualified Production Property (QPP)



- §1245 recapture of QPP happens in two instances
  1. Change to non-QPP within first 10 calendar years after being placed in service
     - Property immediatley treated as being disposed of
     - Entire QPP recapture related gain is subject to §1245 recapture in that year
  2. After the 10-year period expires, any sale or other disposition transaction generates §1245 recapture to the extent of QPP bonus depreciation

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Bonus – Qualified Production Property (QPP)

- §1245 recapture results in new asset being added to depreciation schedule and
  - Deprecation begins on the first day of the year of recapture
  - Normally this means 39-year straight line
- Look at Aldo example on page 96
  - Aldo must recognize $10 million 1245 gain in 2032
  - Aldo adds a new $10 million assets to depreciation schedule as of January 1, 2032 and claims $245,726 depreciation expense in 2032
    - Correct example – 2023 should be 2032

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Bonus – Qualified Production Property (QPP)

- QPP and § 1031 Exchanges – note that info is evolving in this area
- §1031 regs specifically state that like kind is determined on state law classification, not depreciation methods
- QPP notice says QPP is §1245 property – not §1250
- Safest methods
  1. Trade QPP for QPP – but what about after 2030 – no new QPP after 12/31/2030
  2. Exchange into §1245 property – use cost seg to establish enough 1245 property to avoid recapture – still real property

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Bonus – Qualified Production Property (QPP)

- Other relevant QPP rules
  - Contract manufacturing counts – doesn't matter even if contract manufacturer doesn't own the product
  - Making the election
    - Must be made by extended due date of return
    - Must attach statement to return which references Notice 2026-16 that includes
      - Name and ID # for taxpayer
      - Street address and description of property
      - Basis of QPP property
      - If de minimis rule is used, a statement saying so

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Cost Seg ATG Update

- IRS recently updated its Cost Seg ATG, which includes
  - Details on acceptable cost seg study techniques and related requirements
  - Details of supporting documentation requirements
  - Specific industry requirements

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EXTRA

Bonus v. §179

Description	§179	Bonus
Limit	$2.5 Million	None
Create loss	No	Yes
Residential rentals	No	Yes
Asset by asset	Yes	No – class by class
Recapture	If use ≤50%	Listed property and QPP only
Election	Elect in	Elect out
Change on amended	Yes	No

Luxury vs. Listed Property?

1. There are luxury autos (§280F) – depreciation is limited

2. Listed property – substantiation is required (§274(d))

Example – Dennis the Realtor

- Dennis bought BMW for $98,000 in 2026 that he uses 100% for business.
- Annual depreciation will be (without bonus)

Luxury Auto Depreciation	
Year	Amount
2026	$12,300*
2027	$19,800
2028	$11,900
2029 - 2035	$ 7,160
2036	$ 3,880

*This is also the max 179 expense so don't use 179 to avoid

What is Listed Property

- SUVs and trucks with a GVRW greater than 6000lbs are not luxury autos – deprecation limits do not apply
- However, there is a $32,000 (2026) §179 limit for SUVs over 6000lbs.
- While there is no §179 limit for trucks, a truck with less than a 6’ bed is considered an SUV for this purpose

What is Listed Property?

- Listed property is property that lends itself to personal use, including
  - All passenger automobiles
    - Does not include any ambulance, hearse, taxi, truck or van modified so as not to lend itself to personal use – see list on page 32
  - Any other means of transportation unless so modified as to no longer lend itself to personal use (boats, airplanes, etc.)
  - Any property used for entertainment, recreation or amusement (photographic, communication, video, etc.)

Part V **Listed Property** (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

Section A—Depreciation and Other Information (**Caution:** See the instructions for limits for passenger automobiles.)

24a	Do you have evidence to support the business/investment use claimed?	☐ **Yes**	☐ **No**
24b	If "Yes," is the evidence written?	☐ **Yes**	☐ **No**
24c	Does at least 25% of the use of any aircraft listed in Section A consist of qualified business use not described in section 280F(d)(6)(C)(i)? See instructions	☐ **Yes**	☐ **No**

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions						**25**		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L -		
		%				S/L -		
		%				S/L -		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21						**28**		
29 Add amounts in column (i), line 26. Enter here and on line 7						**29**		



Payroll and Related Tax Issues

TaxSpeaker®

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Final Change 1099K Reporting Rules!

- **OBBBA changed the 1099-K reporting thresholds back to $20,000 and 200 transactions retroactive back to 2022**

OBBBA Changes 1099K Reporting Rules

- IRS says if erroneous 1099-K received
  - First ask issuer for corrected 1099-K
  - If that doesn't work, then
    - Report 1099-K amount as Other Income on Sch. 1, line 8z
    - And then report "Form 1099-K received in error" as an other adjustment on Sch. 1, line 24z

OBBBA Changes 1099 Filing Threshold

- **Forms 1099-NEC and Form 1099-MISC filing threshold was $600 for decades – never inflation adjusted**

- **2026 filing threshold for both these forms is $2,000 (forms filed in January 2027)**
  - **This amount will be inflation adjusted in 2027 and beyond**
  - **Congress anticipates a one-third reduction in the number of 1099s filed**

2026 Form W-2

- 2026 W2 adds box 14B for tip occupation code
  - Box 12, Code TA for employer contributions to Trump account
  - Box 12, Code TP for amount of qualified tips non-SSTB
  - Box 12, Code TT for qualified overtime

22222

a Employee's social security number

[redacted]

b E… …ithheld

c Employer's name, address, and ZIP code

3 Social security wages

4 Social security tax withheld

5 Medicare wages and tips

6 Medicare tax withheld

7 Social security tips

8 Allocated tips

d Control number

9

10 Dependent care benefits

11 Nonqualified plans

e Employee's first name and initial | Last name | Suff.

13 Statutory employee | Retirement plan | Third-party sick pay

14a Other

14b Treasury Tipped Occupation Code(s)

12a Code TA Trump Account

12b Code TP Qualified Tips

12c Code TT Qualified Overtime

12d Code

f Employee's address and ZIP code

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage and Tax Statement** **2026** Department of the Treasury—Internal Revenue Service

☐ VOID ☐ CORRECTED

PAYER'S name		1 Rents $	OMB No. 1545-0115 Form **1099-MISC** (Rev. December 2026)	**Miscellaneous Information**
Street address	Room or suite no.	2 Royalties $	For calendar year	
City or town	Telephone number	3 Other income $	4 Federal income tax withheld $	**Copy 1** **For State Tax Department**
State or province / Country / ZIP or foreign postal code				
PAYER'S TIN	RECIPIENT'S TIN	5 Fishing boat proceeds $	6 Medical and health care payments $	
RECIPIENT'S name		7 Payer made direct sales totaling $5,000 or more of consumer products to recipient for resale ☐	8 Substitute payments in lieu of dividends or interest $	
Street address / Apt. no.		9 Crop insurance proceeds $	10 Gross proceeds paid to an attorney $	
City or town		11 Fish purchased for resale $	12 Section 409A deferrals $	
State or province / Country / ZIP or foreign postal code		13a Cash tips $	13b TTOC	
	FATCA filing requirement ☐	14 Overtime compensation $	15 Nonqualified deferred compensation $	
Account number (see instructions)		16 State tax withheld $ $	17 State/Payer's state no.	18 State income $ $

PAYER'S name

Street address

City or town

Telephone number

State or province

Country

ZIP or foreign postal code

PAYER'S TIN

RECIPIENT'S TIN

RECIPIENT'S name

Street address

Apt. no.

City or town

State or province

Country

ZIP or foreign postal code

Account number (see instructions)

OMB No. 1545-0116

For calendar year

Nonemployee Compensation

1a Nonemployee compensation

$

1b Cash tips

$

1c TTOC

1d Overtime compensation

$

2 Payer made direct sales totaling $5,000 or more of consumer products to recipient for resale

3 Excess golden parachute payments

$

4 Federal income tax withheld

$

5 State tax withheld

$

$

6 State/Payer's state no.

7 State income

$

$

Copy 1

For State Tax Department

2026 Rules Much Tougher

- **Tips and overtime must be reported on Form W-2, Form 1099-MISC, or Form 1099-NEC or no deduction**
  - **Exceptions for tips**
  1. **Self employed (§1.224-1(d))**
  2. **Tips reported by employee on Form 4137**

2026 Reporting on Tips/Overtime

Extra



- Sch C/E/F – No Tip deduction unless reported on 1099-NEC, 1099-MISC, 1099-K
  - No Overtime Deduction > 20% ownership

- 1120 C Corp – No tip deduction at entity level
  - Owner could get tip deduction if tips on W-2
  - Only for tips voluntarily given to owner/manager by customer – does not include tip pool
  - Overtime not allowed if > 20% ownership interest

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2026 Reporting on Tips/Overtime

Extra



- 1120S S Corp – No tip deduction at entity level
  - Owner could get tip deduction if tips on W-2
  - Only for tips voluntarily given to owner/manager by customer – does not include tip pool
  - Overtime not allowed if > 20% ownership interest

- 1065 Partnership - No tip deduction at entity level
  - Tips not allowed to be passed to owner on K-1
  - Overtime not allowed since Partner does not receive either a W-2 or a 1099

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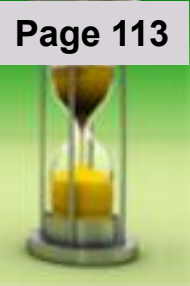
Tax Free Fringe Benefits



- List includes
  - §74 – Achievement awards
  - §79 – Group term life insurance
  - §104, §105, §106 – health insurance and medical reimb
  - §117(d) – Tuition reduction
  - §119 – Meals or lodging for employer convenience
  - §125 – Cafeteria plans
  - §127 – Education assistance
  - §128 – Trump Accounts
  - §129 – Dependent care assistance program

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Tax Free Fringe Benefits



- List includes
  - §132(b) – No additional cost services
  - §132(c) – Qualified employee discounts
  - §132(d) – Working condition fringe
  - §132(e) – De minimis fringe
  - §132(f) – Qualified transportation fringe
  - §132(m) – Qualified planning services
  - §137 – Adoption assistance programs
  - §139 – Disaster relief payments
- See summary on page 114 – includes PR tax info

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Cafeteria Plans §125

- Benefits allowed to offered via a 125 plan
  1. Health insurance
  2. HSAs
  3. Adoption assistance
  4. Health flex spending accounts (FSA) for medical – 2026 max $3,400
  5. Dependent care assistance – 2026 max $7,500
  6. SIMPLE cafeteria plan
  7. Group term life insurance
  8. Starting in 2026, Trump Account contributions

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Cafeteria Plans §125



- Two most common offerings are:

1. Flex Spending Accounts (FSA) medical
   - 2026 annual max is $3,400
   - May be funded by employer or by pretax employee contributions
   - General rule is anything left over at end of year is lost – employee doesn't get it back
   - Two exceptions – employer may elect (not employee choice)
     1. Carry over balance to next year and spend 100% within 2½ months
     2. Carry over up to $680 (2026) to following year

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Cafeteria Plans §125



2. Dependent care benefit

- Annual max for 2026 is $7,500
- May be funded by employer or by pretax employee contributions
- General rule is anything left over at end of year is lost – employee doesn't get it back
- Same exceptions apply

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Simple Cafeteria Plans §125



- Simple Cafeteria Plan may be offered by qualified employers if the employer
  1. Meets the eligibility requirements
  2. Passes the Simple Cafeteria Plan's employee participation requirements, and
  3. Makes the required contributions
- As with regular cafeteria plans, sole proprietors, partners, S corp SHs may not participate

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Cafeteria Plans §125



- **Simple Cafeteria Plan**
  1. **Eligibility rule – no more than 100 employees in either of the two preceding years**
     - **Once qualified, employer may continue to offer a Simple Cafeteria plan until it has 200 or more employees**

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Cafeteria Plans §125



- **Simple Cafeteria Plan**
  2. **Participation requirement – employees with 1,000 or more hours in the prior year qualify to participate, except those**
     - **Under age 21**
     - **Less than one year employment with employer**
     - **Covered by collective bargaining agreement**
     - **Nonresident alien working outside US**

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Cafeteria Plans §125



- **Simple Cafeteria Plan**
  3. **Required contribution – employer must make a contribution for each employee equal to either**
     1. **A uniform percentage (not less than 2%) of employee compensation, or**
     2. **The lesser of**
        - **a) 6% of the employee's compensation or**
        - **b) Twice the amount of the employee salary reduction**
- **No further discrimination testing required**
- **All other §125 plans rules apply**

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Cafeteria Plans §125



- Other Cafeteria Plan notables
  - FSA annual $3,400 limit is per employer, not per tax return. For MFJ, both spouses get $3,400, for a total of $6,800
    - If a taxpayer has 2 unrelated employers, and both offer an employer funded FSA, the employee can max both – see Example 3 on page 128
    - Employees may only self fund $3,400
  - But the dependent care 125 plan limit is $7,500 per tax return, regardless of filing status
    - Any amount over the limit is added back to wages
  - There is no limit for FSAs used to pay health insurance premiums

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Employer Education Assistance



- Employers may annually pay up to $5,250 towards employee graduate or undergrad education
  - Amount is deductible for the employer and tax free to employee
- Qualified expenses include
  - Tuition
  - Books and supplies (unless allowed to keep at conclusion of class)
  - Equipment and tools
  - Student loans payments are now permanently allowed
  - See sample plan on page 31

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Employer Education Assistance



- Other rules
  - No more than 5% of the total benefits may benefit key employees (e.g., owners)
  - Employees must be provided notice of plan's existence
  - Employees cannot receive cash instead of the benefit
  - But direct reimbursements of substantiated expenses are allowed
- Annual limit adjusted for inflation starting in 2027

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Employer Education Assistance



- See education related benefit comparison on page 131
  - Qualified education assistance (§127)
  - Working condition fringe (§132(d))
  - Qualified tuition reduction (§117)

- See sample plan on page 132

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Trump Account – Employer Payments



- Employers may contribute to Trump accounts for employees (under age 18) and dependents
  - Up to $2,500 per employee per year is tax deferred until beneficiary withdraws the money from the Trump account
  - Contributions in excess of $2,500 are taxable wages
- Contributions may also be offered via §125 plan salary reductions – but only for dependents, not for employees
- Employer contributions count against the $5,000 annual contribution maximum

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Trump Account – Employer Payments



- Dependents are those who meet the §152 definition in the year the contribution is made
  - Employers may make contributions for noncustodial parents who have a Form 8332
  - Employers may rely on employee certification that dependent qualifies
- Regs make clear that self-employed persons do not qualify (includes partners and S corp 2% shareholders)

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Trump Account – Employer Payments



- **Example 1.**
  - **Acme offers §128 plan contributions**
  - **Jerry is employed by Acme and he has two dependents**
  - **Jerry is allowed contributions of up to $2,500 – he may split it between his two children any way he chooses**

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Trump Account – Employer Payments



- Example 2.
  - Niko and Samantha are married and file jointly and have one son – Josh
  - Both spouses work for unrelated employers who offer $2,500 §128 plan contributions
  - Josh's Trump account receives $2,500 from Niko's employer and $2,500 from Samantha's employer
  - No further contribution may be made for that year
  - NOTE – even if both spouses worked for the same employer, the result would be the same – benefit is per employee, not per dependent

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Trump Account – Employer Payments



- **Example 3.**
  - **Jerry has two employers – Acme and Wile E – both of whom offer §128 plan contributions**
  - **Both employers contribute $2,500 to the Trump account of Sara, Jerry's daughter**
  - **The total $5,000 contribution is correct, but Jerry must include $2,500 in his taxable income because the maximum tax-free benefit is $2,500**

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Trump Account – Employer Payments



- **Example 4.**
  - **Jerry's employer – Acme – contributes $3,500 to Sara's (Jerry's dependent) Trump account**
  - **Acme excludes $2,500 from Jerry's income but includes the extra $1,000 as taxable wage income on Jerry's W-2**

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Trump Account – Employer Payments



- Employers who offer §128 plans must:
  - Have a formal, written, non-discriminatory plan
  - Not open the account – the parents have to do that
  - Notify employees of the plan's existence
  - Report contributions on employee W-2s
    - Tax free – W-2, box 12, code TA
    - Taxable – included in wages

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Trump Account – Employer Payments



- Excludable employees
  - Under age 21
  - Less than one year of service
  - Collectively bargained

- Employer contributions are tax-exempt for income tax only
  - Contributions are subject to FICA, FUTA, etc.

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Qualified Transportation Expenses



- Employers are allowed to help employees pay commuting expenses with tax free transportation benefits
  1. Commuter highway vehicle – commuter van
  2. Transit passes – mass transit passes
  3. Parking – employer provided parking
- The max benefit is $340 per month
- While benefits are tax-free for the employee, TCJA/OBBBA eliminated the deduction for employers

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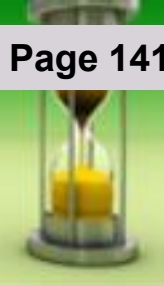
Disaster Related Payments (§139)



- Employers may make tax free payments to employees for "disaster relief payments"
- Disaster payments include
  - Reasonable personal, family, living or funeral expenses incurred due to disaster
  - Payments for residence rehab or repair or content replacement if result of disaster
  - Payments for furnishing transportation by a common carrier due to death or injury from disaster

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Disaster Related Payments (§139)



- IRS clarified 139 payment parameters – excludable payments include
  - Relocation expenses (e.g. hotels, meals, gas, etc.)
  - Pet boarding
  - Clothing and other personal items
  - Medical expenses
  - Prescription medication
  - One-time inconvenience fee of up $1,000
  - Certain compensation for those who sold homes after disaster
- Payments that replace income or are made to a business do not count

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Social Security Update

Social Security Rates and Limits		
	2026	2027
Wage limits	$184,500	$192,300
Early retirement earnings limit #1	$ 24,480	$ 25,560
Early retirement earnings limit #2	$ 65,160	$ 67,920
2027 COLA is 3.6% (2.8% for 2026)		

SSA Un-Limits Repayments

- Pre-March 2024 100% of Social Security until repaid
- March 2024, SSA limited Social Security repayments to greater of 10% of monthly benefit or $10
- Now we are back to the 100% payback rule!

SSA Un-Limits Repayments

Example. Jen started collecting SS benefits of $2,000 per month when she was 63 years old. In 2026, her first full year of retirement, Jen took a part-time job where she earned $44,480. The Social Security Administration (SSA) notified Jen in July 2027 that she had $20,000 of earnings more than the 2026 limit. Jen owed $10,000 ($20,000 x 50% (2 for 1)) back to SSA. The SSA notified Jen that they were going to withhold her checks starting in August 2027 until the $10,000 was repaid.

IRMAA
(Income-Related Monthly Adjustment Amount)

- Higher Medicare costs for higher MAGI
- MAGI = AGI plus tax-exempt interest
  - From two years prior (2026 IRMAA based on 2024 MAGI)
- Letter typically sent in last quarter of year prior to IRMAA taking effect
- Roughly 5.1 million taxpayers pay IRMAA in 2026
  - 7.5% of the total

Shark Attack Medicare Tax - IRMAA

2026 MAGI Range Single	Married Filing Joint	Part B	Part D
≤$109,000	≤$218,000	$202.90	None
>$109,000, ≤$137,000	>$218,000, ≤$274,000	$284.10	$14.50
>$137,000, ≤$171,000	>$274,000, ≤$342,000	$405.80	$37.50
>$171,000, ≤$205,000	>$342,000, ≤$410,000	$527.50	$60.40
>$205,000, ≤$500,000	>$410,000, ≤$750,000	$649.20	$83.30
≥$500,000	≥$750,000	$689.90	$91.00

IRMAA and Life Changing Events (LCEs)

- IRMAA appeals can be made for LCEs
- Includes
  - Marriage
  - Divorce
  - Spouse death
  - Income loss or retirement
  - Loss of retirement income
  - Employer settlement or payout of PTO

IRMAA and Life Changing Events (LCEs)

- Large capital gains are not appealable
- To appeal, taxpayer files Form SS-44
- If an amended return is filed with lower AGI, you have to call SSA
- Don’t forget to warn clients in the tax planning process

Employee v. Independent Contractor

- Historically very difficult to define
- Make matters worse, different departments of the Federal government have different rules
- DOL
  - Issued proposed regs in 2021 to clarify its position
  - Withdrew its proposed regs in 2024
  - Issued final regs setting its definition of employee

Employee v. Independent Contractor

- DOL says factors to consider are
  - Opportunity for profit or loss based on managerial skill
  - Investments made by the worker and potential employer
  - Permanence of relationship
  - Control over worker's duties
  - Extent worker's services are integral to employer's operations
  - Degree of skill and initiative involved

Employee v. Independent Contractor

- **IRS says to follow three broad categories**
  1. **Behavioral controls – Does the employer:**
     - **Dictate how, when, or where worker works?**
     - **Instruct worker what tools or equipment to use – who provides tools?**
     - **Instruct worker who to hire and how to manage employees?**
     - **Instruct worker where to buy tools, supplies, etc.?**
     - **Is training provided for worker?**

Employee v. Independent Contractor

- IRS say to follow three broad categories
  2. Financial controls
     - Who makes significant investment into business?
     - Worker reimbursed for out-of-pocket expenses?
     - Where do profits go, to the worker or employer?
     - Can worker suffer a loss?
  3. Relationship
     - Are worker benefits paid – health insurance, vacation pay, etc.
     - Is there a contract that spells out the relationship?

DOL FAQs

- DOL FAQ #6 explicitly states DOL rules have no bearing and are not binding on any other agency, including the IRS
- DOL rules only apply for interpretation under FLSA
- Then why is it here?
  - Reasonable cause gets TP out of penalties if workers are misclassified. If the agencies can't get on the same page, seems like reasonable cause to me

Act Section 530

- Congress enacted in the Revenue Act of 1978
- Sole purpose is to provide relief to employers who misclassify workers
- Originally was temporary but was made permanent by TEFRA
- Has not been substantially modified since 1996

Act Section 530

"IRS policy requires its employees to exercise strict impartiality in the conduct of their duties. Thus, you must approach the issue of worker classification in a fair and impartial manner and actively consider section 530 relief at the beginning of an examination. **This includes furnishing taxpayers with a summary of section 530 at the beginning of an examination.** Additionally, you may need to assist taxpayers in identifying facts which establish either worker classification."

Act Section 530

- Written notice required before IRS starts classification audit – see Pub 1976
- Also required to assess if Act Section 530 applies
  - If Act Sec 530 applies, then no misclassification tax or penalties may be assessed, and
  - No further analysis is allowed

Act Section 530 - Qualifications

- To qualify – two consistency rules:
  1. Reporting consistency – all 1099s filed
  2. Substantive consistency – all current and former employees treated the same
- And a reasonable basis – which can be proven by
  a. Prior audit – that addressed worker classification
  b. Judicial precedent – Federal court with similar fact pattern. Even one case is enough, even if other contradictory cases exist
  c. Industry practice
  d. Any other reasonable basis (e.g. state court case or DOL rules)

Act Section 530 - Qualifications

- **Burden of proof shifts to IRS if taxpayer**
  - **Relies on precedent, prior audit or industry practice and**
  - **Cooperates with IRS**

IRS Updates Act §530 Guidance

- For the first time in decades, IRS updates Act 530 guidance
- Employee definition includes
  - Corporate officers
  - Common law employees
  - Agent-drivers, commission drivers, FT life insurance sales people, home workers, and traveling sales workers
  - Indian Tribal workers covered by FICA
  - Officers, employees and elected officials of political subdivision

IRS Updates Act §530 Guidance

- For the first time in decades, IRS updates Act 530 guidance
- Information returns for filing consistency includes
  - All returns filed for all required periods
  - Reporting met on a period-by-period basis – not filing in one year does not preclude relief in a different year
  - Reporting consistency on an employee by employee basis – not filing for one employee doesn't preclude relief for another
  - Reporting consistency met, even if wrong form or wrong amount reported as long as good faith attempt is made

IRS Updates Act §530 Guidance

- **IRS updates Act 530 guidance Substantive consistency**
  - Treating worker as an employee doesn't preclude treating another worker as a contractor in an earlier period
- **Worker is treated as an employee if**
  - Income or FICA tax withheld
  - Payments reported on W-2, 941, 940, 944, or Sch. H
  - Contracted with 3rd party to provide workers for employer
  - Filing late PR tax returns or amended returns is not treating worker as an employee

IRS Updates Act §530 Guidance

- IRS updates Act 530 guidance
- Reasonable basis requirement – factors to consider
  - How income tax deductions were claimed for worker payments
  - Were any benefits paid to workers under employee fringe rules
  - Any employer credits claimed (family leave, ERC, etc.)
  - Federal and state labor laws followed – OT, min wage, pension, etc.
  - Worker part of a collectively bargained group
  - Worker participated in non-qualified comp plan
  - Worker provided unemployment, workers comp or other

IRS Updates Act §530 Guidance

- **See multiple examples on page 152**

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How to change the design

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Do not edit
How to change the design



Which comedian started his working career as an accountant?

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Corporations



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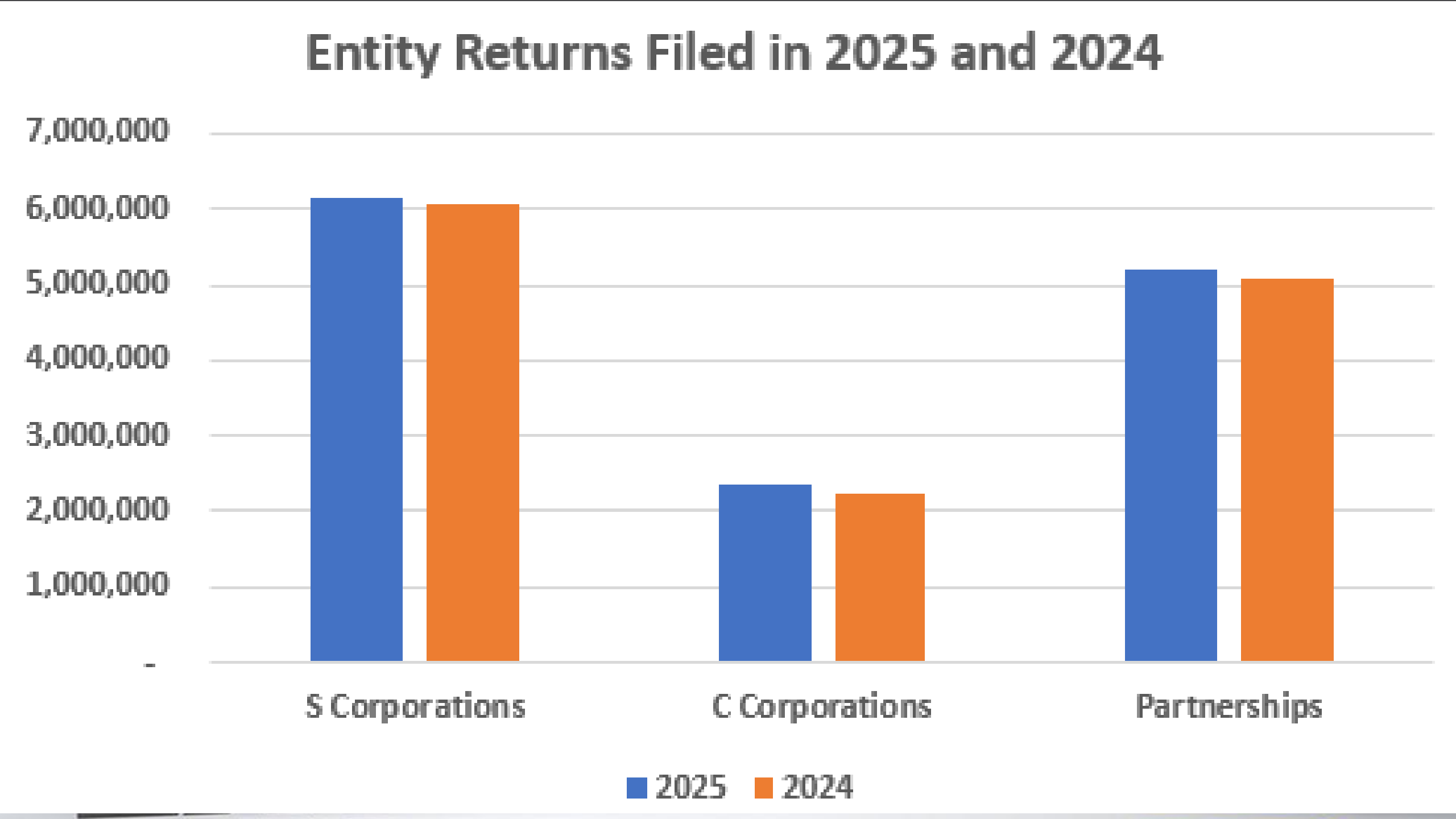
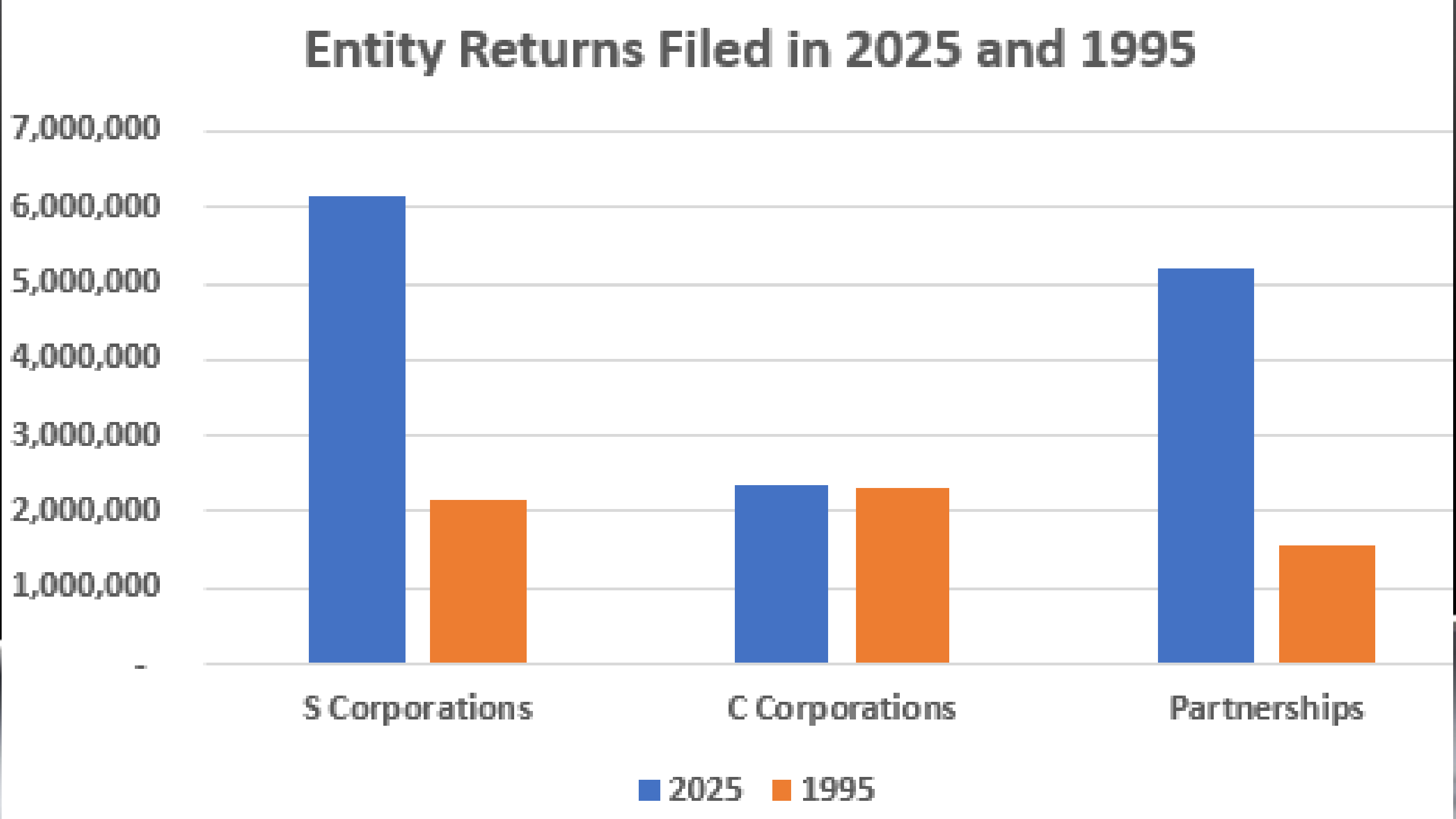

Entity Returns Filed in 2025 and 2024
7,000,000
6,000,000
5,000,000
4,000,000
3,000,000
2,000,000
1,000,000
-
S Corporations
C Corporations
Partnerships
2025
2024


Entity Returns Filed in 2025 and 1995
7,000,000
6,000,000
5,000,000
4,000,000
3,000,000
2,000,000
1,000,000
-
S Corporations
C Corporations
Partnerships
2025
1995

Business Entity Audits

Entity Type	Returns Filed	Returns Audited	%	Audits per 10,000 Returns
S corporations	5,440,879	1,058	.019%	1.9
C corporations	1,575,851	2,303	.146%	14.6
Partnerships	4,575,280	572	.0125%	1.25



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Corporate Transparency Act (CTA)

- CTA was passed in 2019 and was to take effect in 2024
- Treasury Dept announced in March 2025
  - It would not enforce BOI reporting rules
  - Future BOI reporting would only be enforced for foreign entities and their owners
  - For those who reported, domestic companies are not required to update existing information



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Corporate Transparency Act (CTA)

- FinCEN issued final regulations in August 2026
  - US companies are now exempt from reporting
  - For those who reported, domestic companies are not required to update existing information
  - FinCEN promises to delete all previously filed information that is now exempt
- NOTE – foreign entities are still required to report



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§1202 Stock

- Gains from the sale of Qualified Small Business Stock (QSBS) are not taxable
- To qualify, stock must be from a US "C" corp
  1. Less than $50 MM in assets when stock issued
  2. Must be acquired at original issue through purchase or taxable services
  3. 80% of assets must be active business
  4. Must be held 5 years
  5. 100% of gain excluded if acquired after 9/27/2010
  6. Gain exclusion greater of $10 million or 10 times basis



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§1202 Stock

- What about an LLC that elect corporate treatment?
  - GlobalTranz LLC was formed in AZ in 2003
  - The LLC was dissolved and the owners received C corp stock in return
  - Mike Leto sold his stock five years later and saved $528,000 under §1202 – on an amended return
  - The problem was that GT LLC elected to be taxed as an S corporation prior to dissolution
  - Court ruled prior S corp status meant stock was issued – so C corp stock was not original issue
  - Court stated ruling is not for all LLC conversions



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§1202 Stock

- Original issue
  - Stock must be acquired directly from the corp, not from another SH or secondary market
  - Stock may be acquired in exchange for cash, property and service (as long as taxable)
  - For stock acquired via gift, inheritance or partnership distribution, the recipient steps into the shoes of the transferor
- Options and warrants do not count



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§1202 Stock

- Disqualified businesses
  - Professional services – health law, engineering, architecture, accounting, actuarial, science, performing arts, consulting, athletics, financial services, etc.
  - Financial businesses – banking, insurance, financing, leasing, and investing
  - Natural resources & farming – farming, oil and gas, natural resource extraction
  - Hospitality – hotels, restaurants, etc.
  - Real property – ownership, dealing, or renting



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§1202 Stock

- Gain exclusion varies between 50%, 75% and 100%, depending on acquisition date
- 100% exclusion for stock acquired after September 27, 2010
- No exclusion is available for stock acquired before August 10, 1993



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§1202 Rules Over the Years

QSBS Acquisition Date	Minimum Holding Period	Gain Exclusion %
Aug. 11, 1993 to Feb. 17, 2009	5 years	50%
Feb. 18, 2009 to Sept. 27, 2010	5 years	75%
Sept. 28, 2010 July 4, 2025	5 years	100%
July 5, 2026 and beyond	3 years	50%
July 5, 2026 and beyond	4 years	75%
July 5, 2026 and beyond	5 years	100%

Recent Changes to §1202 Rules

- Changes for acquisitions after 7/4/2025
  - Exclusion limit is greater of $15 million or 10x basis
  - The $15 million is inflation adjusted after 2026
  - Gross asset limit at issue increased to $75 million
- Old rules still apply if acquired prior to 7/4/2025



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OBBBA Change	Pre-Enactment QSBS (issued on/before 7/4/25)	Post-Enactment QSBS (issued after 7/4/25)
Per-issuer gain exclusion cap	$10 million	$15 million (inflation-adjusted from 2027)
10x basis limit	Unchanged	Unchanged
Aggregate gross assets ceiling	$50 million	$75 million (inflation-adjusted from 2027)
Tiered holding periods (50%/75%)	Not available	Available (3 and 4 year holds)
AMT preference treatment	Excluded gain is NOT AMT preference	Excluded gain is NOT AMT preference
MFS halved cap	$5 million	$7.5 million

Other §1202 Rules

- Taxpayers with multiple stock purchases will have to track each purchase separately
- No other rules changed – e.g. non-qualified businesses
- Be sure to check the state rules – not all comply



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State	Conformity Status	Notable Detail
California	Does NOT conform	Full state tax up to 13.3%. No QSBS exclusion.
Pennsylvania	Does NOT conform	QSBS gain taxed at full PA rate.
Alabama	Does NOT conform	No state equivalent to §1202.
Mississippi	Does NOT conform	No state equivalent to §1202.
New Jersey	Conforms from 2026	Signed 6/30/25; effective for tax years beginning 1/1/26.
New York	Conforms	Federal exclusion generally respected for NY purposes.
Hawaii	Partial conformity	50% exclusion only, even when federal allows 100%.
Massachusetts	Partial conformity	Historically limited; verify current rules.
Texas / Florida	No state income tax	Federal exclusion = full exclusion.

§1202 Rules

- See §1202 stock checklist on page 163-165



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§1202 Rules - Example

Example – the $15 million cap, the 10x Limit, and multiple investors. Three investors – Haruto, Celine, and Raj – invested in TerraLoop Corp., a C corporation, in August 2025 (post-enactment QSBS). Haruto invested $500,000 for 5% of the stock; Celine invested $1,500,000 for 15%; Raj invested $200,000 for 2%. TerraLoop was acquired in 2031, resulting in the following gains:

Haruto: $3.5M (10x basis = $5M; cap = $15M; full gain excluded).
Celine: $10.5M (10x basis = $15M; cap = $15M; full gain excluded).
Raj: $1.4M (10x basis = $2M; cap = $15M; full gain excluded).

All three investors pay $0 Federal tax from the sale of their TerraLoop stock. The §1202 cap is per taxpayer per issuer – each investor has their own cap.

§1244 Ordinary Stock Loss

- Taxpayers allowed an ordinary deduction on losses from §1244 small business stock sales
- Qualifying stock must be issued by corporation
  - Created in the US
  - Aggregate capital is no more than $1 million when stock was issued
  - In five years prior to disposition more than 50% of revenue was from non-passive activities
  - Adequate records must be kept
- Max 1244 deduction is $50,000, $100,000 MFJ



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§1244 Ordinary Stock Loss

- Other items of note for §1244 stock
  - Common or preferred stock qualify
  - Stock must be acquired with cash or other property, not services
  - Shareholder incurring loss must be an individual who acquired stock from the corporation, not another shareholder
    - Partnerships may qualify to extent partners are individuals
  - Loss is reported on Form 4797



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§1244 Ordinary Stock Loss

- Scratch first example on page 167 – messed up
  - Marlena and Rob contributed property with FMV of $120,000 to Voss for stock
  - 3 years later Voss failed
  - Marlena and Rob's stock loss is $120,000
  - On their 2026 return, they recognize the $120,000 loss as
    - $100,000 ordinary loss on §1244 stock on Form 4797
    - $20,000 capital loss on Sch D



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§1244 Ordinary Stock Loss

- **Recordkeeping requirements – investors must maintain records to**
  1. **Distinguish §1244 stock from any other stock acquired**
  2. **Establish that stock was original issue to TP**
  3. **Show amount paid for stock and type of consideration**
  4. **Show corporation met the $1,000,000 cap**
  5. **Confirm corporation meets the 50% non-passive gross receipts test for five years preceding the loss**



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C Corp Charity Change

- C Corp charity deductions retain the old 10% charity deduction limit
- New threshold implemented for years after 2025
  - New 1% of taxable income floor in addition to the 10% of total income limit
- “Bunching” should now be considered by C Corps to minimize impact of 1% floor
  - Or moving all contributions to advertising?



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C Corp Charity Change

- **Steps to calculate contributions for C Corp now include:**
  1. **Calculate the 1% floor**
  2. **Calculate the maximum contributions**
  3. **Apply the 10% cap**
  4. **Calculate the deduction less the floor**
  5. **Calculate any carryforward**
  6. **Reduce taxable income**



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C Corp Charity Change

- **Example – Carefour's 2026 profit is $1,000,000**
  - **Carefour's 2026 charity donations were $80,000**
  - **Steps:**

1.	Calc floor ($1,000,000 x 1%)	$ 10,000
2.	Max deduction ($80,000 - $10,000)	$ 70,000
3.	Apply 10% of income cap	$100,000
4.	Calc the charity deduction	$ 70,000
5.	Calc carry forward	$ 0
6.	Reduce taxable income by deduction	$930,000

- **Note that with no carryforward, the 1% is lost**



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C Corp Charity Change

- **Example 2 – Carefour's 2026 profit is $2,000,000**
  - Carefour's 2026 charity donations were $280,000
  - Steps:

1.	Calc floor ($2,000,000 x 1%)	$ 20,000
2.	Max deduction ($280,000 - $20,000)	$ 260,000
3.	Apply 10% of income cap	$ 200,000
4.	Calc the charity deduction	$ 180,000
5.	Calc carryforward	$ 100,000
6.	Reduce taxable income by deduction	$1,820,000

- Note that carryforward includes the 1% floor
- Correct Preparer note bottom of page 169



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Other Corporate Items

- 2026 S corp K-1 draft on page 143 – not much new



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§355 Reorg Changes, But Not!

- Overview
  - §355 allows tax free corporate reorganizations
  - Three types of reorgs under IRC §355
    1. Spin-offs – prorata distributions of stock to SHs of controlling corp
    2. Split-offs – distributions of controlled corp stock to some (not all) SHs of the controlling corp
    3. Split-ups – liquidating distribution of controlled corp stock to SHs of liquidated corp



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§355 Reorg Changes, But Not!

- IRS proposed to increase reporting of §355 transactions
  - Instead of attaching a statement in the year of the reorg, new regs proposed annual filing on New Form 7216 for five years
- IRS withdraws proposed regs and goes back to previous regs with no changes (RP 2025-30)
  - Form 7216 is no longer required
- Original rules of RP 2018-53 and RP 2017-52 are reinstated



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S Corp PTE Payments

- State income tax paid by entity at individual tax rates even though entity is pass-through
  - Creates Federal tax deduction at entity level
- Partner/SH receives K-1 and pays tax at 1040
  - But, also receives tax credit from entity
- Each state may handle differently
- OBBBA made it permanent at the Federal level



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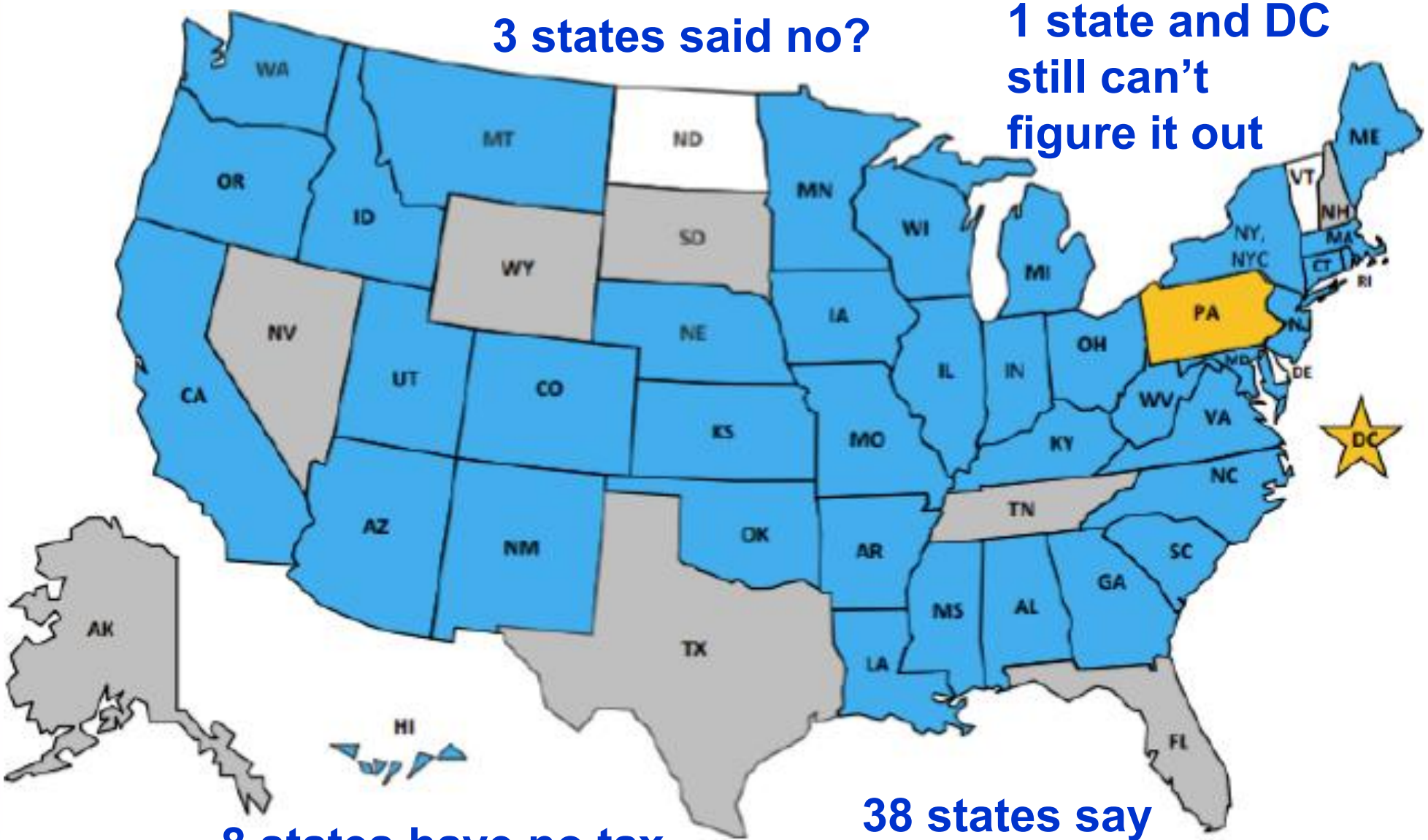
PTE Deduction

3 states said no?

1 state and DC still can't figure it out



8 states have no tax

38 states say absolutely!

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S Corp PTE Final Thoughts

- Even with a $40,000 SALT limit, a pre-AGI deduction is almost always better
- With higher standard deductions, many non-itemizers out there
- Caution – Some states allow individual owner to elect in or out of PTE – IRS has not issued any guidance on the unequal distributions this may create
- See example on page 175



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Constructive Dividends

- Corporate payment to owner disguised as deductible expense
- If IRS disallows, result is increase in corporate income and dividend taxable to SH
- See chart on page 176 of most common constructive dividends



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Constructive Dividends

Category	Description	Key Requirements to Avoid Reclassification
Below-market loans to shareholders	Interest-free or below-AFR loans; imputed interest treated as distribution	Written note; stated interest at AFR; documented repayment schedule; actual payment history
Cancellation of shareholder debt	Forgiven shareholder loans treated as distributions	Must document business purpose for forgiveness; distinguish from gifts
Below-FMV transfers of corporate property	Selling corporate property to shareholders below FMV	Sales at documented FMV; independent appraisal for significant assets

Personal expenses paid by corporation	Food, fuel, personal travel, home improvements, personal vehicle, club dues	Accountable plan with business connection; proper documentation; repayment of non-business amounts
Unreasonable rents paid to shareholder	Corporation paying above-FMV rent to shareholder-owned property	Lease at documented market rent; independent comparison
Unreasonably high compensation to shareholder-employees	Salary exceeding FMV of services — excess reclassified as dividend	Independent investor test; multi-factor analysis; compensation study
Management fees to related entities with no economic substance	Fees paid to related companies for services not actually rendered	Written contracts; invoices; evidence services were performed
Corporate payment of personal life insurance premiums	Corporation paying premiums on policies owned by or benefiting shareholder personally	Deductible only if corporation is NOT a beneficiary and amount is reasonable compensation

Constructive Dividends

- **Factors used to determine if loans are dividends**
  1. **Written note or other document**
  2. **Interest charged**
  3. **Fixed repayment schedule**
  4. **Collateral given**
  5. **Repayments made**
  6. **Did borrower reasonably expect to repay loan**
  7. **Did lender have funds to make the loan**
  8. **Parties conducted themselves as if loan existed**



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Constructive Dividends

- Court case – taxpayer held criminally liable
  - Albert Hee owned Waimana Inc., which
    - Paid significant personal expenses for Hee and treated as business expenses
    - Paid Hee's children wages although they didn't work
    - Court assessed back tax and civil penalties for 2007 – 2012, plus criminal penalties



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Constructive Dividends

- See also
  - David Alioto, whose corporation paid personal meal and fuel costs
  - Walter Prezioso, where significant personal expenses were claimed as corporate expenses – criminal penalties assessed



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Other Misc Corporate Developments

- Beneficial ownership – Andrew Berry
  - Ron and Andrew Berry owned and operated Phoenix Construction, Inc. (PHI), an S corp
  - IRS audited PHI's 2016 return and found $154,000 unreported income
  - Andrew argued he was removed as a corp officer in early 2016 and had no knowledge of the unreported income so, therefore, he was not a beneficial owner
  - The Court acknowledged that legal owner may not be a beneficial owner, but ruled being removed as an officer is not enough – he owed tax on his share



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Which of the following was invented by an accountant?

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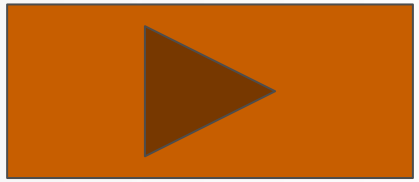
LLCs & Partnerships

Partnership Checklist

- See the 1065 prep checklist on page 180
- Broken into two sections
  1. Accounting, pre-return
  2. Tax Return Preparation



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Partnership Checklist

1. Accounting – pre-return
   - Line 4 – confirm 754 election
   - Line 7
     - Equipment purchase documents
     - Loan docs
     - Inventory – their number
     - Auto info – mileage if required
   - Line 9 – bank statements and payroll tax returns
   - Line 12 – Pension and health insurance info

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Partnership Checklist

1. Accounting – pre-return
   - Line 16 – depreciation
     - Consider $2,500 election
     - Check for disposals
   - Line 19 – consider other state nexus
   - Line 21 – consider ownership changes

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Partnership Checklist

2. Tax Return Prep

- Line 1 – confirm SOS status
- Line 6 – consider accounting methods, etc. if under $32 million GR
- Line 7 – review prior year returns, look for carryforwards
- Line 8 – review guaranteed payments – necessary?
- Line 10 – input into software after accounting checklist is complete
- Line 13 – review elections

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Partnership Checklist

2. Tax Return Prep

- Last things before sending on:
  1. Line 15 – analytical review with prior year
  2. Line 16 – Review the client letter
  3. Line 17 – Clear all diagnostics

- Note – Taxspeaker has digital Elections, Checklists and Letters available online or via USB

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Partnership Forms

- **No significant changes to the Form 1065 for 2026 at time of publishing**

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Basis Reporting Form

- Form 7217 is used by partners who receive property distributions to report basis of distributed property
  - Required for all §732 distributions (non-cash distributions)
  - Separate form required for separate distributions
  - This is a partner level obligation, not a partnership obligation
  - Partners must attach Form 7217 to their annual tax return (e.g., Form 1040)
    - Form must be filed by the extended due date

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Basis Reporting Form

- Form 7217 is not required if
  - Distribution consisted solely of money or marketable securities
  - Distribution was for services rendered by the partner
  - The transfer is treated as a disguised sale under §707

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Basis Reporting Form

- Additional distribution codes were added K-1, line 19 to alert partner and IRS that Form 7217 is required
- Distribution codes
  - B & G – partnership's basis of distributed property, including adjustments
  - A & F – marketable securities info and related adjustments
  - D & F – cash distributions

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Hot Asset Transfer Reporting

- Partnerships must report transfers of a partnership interest if underlying assets include §751 assets (hot assets)
- IRS Form 8308 was created to provide reporting consistency
- Form 8308 is required if the partnership:
  1. Receives written notice there was a transfer of an interest in the partnership; and
  2. At the time of the transfer, the partnership had unrealized receivables or inventories

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Hot Asset Transfer Reporting

- Form 8308 is not required if §751 does not apply
- If required, Form 8308 includes names, addresses, and ID numbers of seller, purchaser and partnership, and the date of sale
- Form 8308 must be provided to each partner named on the form
- Selling partners are required to notify the partnership of the sale within 30 days of the transaction
- Final regulations were issued in 2026

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LLC Members and SE Tax

- Background
  - LLCs and related SE tax continues to be a question for tax pros and their clients
  - SE income defined to include all trade or business income unless specifically exempt - §1402
  - 17 exemptions provided in §1402(a)
  - LLCs not addressed in the Code or §1402
  - Limited partners are exempt under §1402(a)(13)
  - So, the question is, are LLC members limited partners for Federal tax purposes?

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LLC Members and SE Tax

- 1997 Proposed regulations
  - IRS drafted proposed regulations in 1997 to define who is a limited partner under §1402(a)(13)
  - Regs said limited partner:
    1. Cannot be involved in a professional business
    2. Must work less than 500 hours per year
    3. Is not allowed to execute contracts on behalf of LLC
    4. Is not personally liable for the debts for the LLC
- Congress reacted harshly and said proposed regs cannot be finalized

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LLC Members and SE Tax

- **Soroban decision (2025) – Hedge fund partnership claims founding partners are limited partners not subject to SE tax**

Year	2015	2016
Total K-1 income	$78,449,000	$64,512,000
Income reported as SE income	$ 2,037,000	$ 1,901,000
Under reported SE income	$76,412,000	$62,611,000

- **The under reported tax** **$2,903,700** **$2,379,200**

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LLC Members and SE Tax

- Soroban decision (2025) – the Court ruled
  - History of §1402 was to exclude investors from receiving SS credits
  - Limited partner is not defined in the IRC
  - Law is clear that exemption from SE tax only applies to limited partners who function as limited partners
  - Function test applied – the Court noted there is nothing in the law to allow working members to avoid SE tax – the limited partner exception applies only to a partner who is functioning as a limited partner
  - State classification is not binding in Federal law

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LLC Members and SE Tax

- Soroban decision (2025) – the Court ruled partners subject to SE tax on 100% of passthrough profit

- NEW UPDATE – on September 17th, the 2nd Circuit CA affirmed the tax court in Soroban – 100% SE tax taxable

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LLC Members and SE Tax

- Sirius Solutions (aka: K Alain, LLLP) and the 5th Circuit CA
- LLP with a 1% corporate general partner and 99% limited partners
- Sirius partners worked full-time exclusively for Sirius and
  - Provided client services and billed hours
  - Developed new business and negotiated client engagements
  - Supervised staff and made hiring/firing decisions
- The corporate GP didn't provide any services

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LLC Members and SE Tax

- For 2014-2016, Sirius excluded 100% of its ordinary business income from SE tax
  - 2014 – $5,829,000
  - 2015 – $7,243,000
  - 2016 – $490,000 loss
- The IRS concluded all the earnings were subject to SE tax

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LLC Members and SE Tax

- Court ruled three times
  1. The Tax Court sided with the IRS and determined that 100% of the ordinary income was subject to SE tax
     - The Tax Court cited Soroban and the function test to support it's conclusions
  2. The 5th Circuit CA ruled in January 2026:
     - A limited partner under the IRC is a person with limited liability
     - Rejected the function test used by the 2nd Circuit CA, and
     - Effectively created a bright-line test governed by state limited liability laws

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LLC Members and SE Tax

- Court ruled three times

3. The partnership changed its name from Sirius Solutions to K Alain LLLP.

– Then the 5th Circuit CA ruled again:

- Withdrew its own January opinion in full and decided to rehear the case based on its own petition in August 2026
- Abandoned the state limited liability test, and adopted an "original public meaning" test
- Ruled that the original meaning of limited partner in 1977 is someone who plays no significant role in management or running the business

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LLC Members and SE Tax

- The Court further noted and ruled:
  - A limited partner could perform some services, but loses the exclusion from SE tax if the services provided become managerial
  - 100% of the income was subject to SE
- Then the Court reiterated that the 2nd Circuit is still wrong to use its "function test"
- Yeah, a lot of wrong going around here!

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LLC Members and SE Tax

- See also:
  - Denham capital, where investment firm partners of an investment partnership were assessed SE tax on their share of profits – currently in appeals
  - See Renkemeyer and Castigliola, where working attorneys were determined to be active, not limited, partners
  - But, CCA 201640014 and Stephen Hardy (2017)?
  - Point72 Asset Management, Riverstone Equity Partners LP, and MKP Capital Management LP – all in Tax Court now

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LLC Members and SE Tax

- Final notes
  - If you want certainty, make the S election
  - If a partner has management duties, probably subject to SE
  - If argument can be made return of capital and no management, you can still win
  - Spouse owned, with one involved and one not, you can win
  - Does it matter? If not the income is not subject to SE tax, isn't it subject to NII tax?

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IRS Regs Issued to Combat Conservation Easement Fraud

- Congress added two new provisions in the IRC for partnerships and S corps who pass through conservation easement deductions
  1. Include a statement with their return stating that a conservation easement deduction was claimed
  2. There is a disallowance provision unless certain specific conditions are met
- Deductions made without complying with these new laws are treated as tax-avoidance transactions

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IRS Regs Issued to Combat Conservation Easement Fraud

- Worst example yet – Hancock County Land Acq. (HCLA)
  - HCLA bought 1700 acres in rural Mississippi
  - After purchase, HCLA granted a conservation easement on 236 acres
  - HCLA claimed a conservation easement deduction of $180,000,000 ($763,462 per acre)
  - Before HCLA bought it, the land had changed hands three times in the prior 13 years at prices between $895 and $2,356 per acre

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IRS Regs Issued to Combat Conservation Easement Fraud

- Worst example yet – Hancock County Land Acq. (HCLA)
  - After HCLA was audited, and before it went to court, it agreed to reduce the conservation easement value to $18 million ($78,962 per acre)
  - Tax Court ruled
    - HCLA wasn't purchasing land, it was purchasing tax deductions
    - Investors were promised $7,477 of tax deduction for every $1,000 invested
    - No rational buyer would pay $78,962 per acre when property in the area regularly sold for $1,731 to $8,000 per acre
    - The conservation easement value was actually $2,183,000 ($9,250 per acre)

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IRS Regs Issued to Combat Conservation Easement Fraud

- The new regulations also provide
  - Anti-abuse rule – property must be held for at least one year before a conservation easement contribution is made
  - Partners or S corp SHs who are allocated non-cash contributions must
    - Attach Form 8283 to their return
- IRS Office of Conservation Easements has been established
  - Purpose is to centralize expertise on conservation easements

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Partnership Election Out

- Recent regs address partnerships electing out of partnership taxation (§761(a))
- Elect out is allowed if
  - Primarily engaged in investment activities
  - Used for joint extraction, production, or use of property
- Election must be made by due date, including extensions
- Caution – election is that you are not really operating a trade or business, but more of an investment – what about QBI?

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Partnership Election Out

- Election out is made by attaching a statement to Form 1065 that you are electing out and checking box on Form 1065

- Statement must contain
  - Name and address of person filing return and/or organization
  - Names, ID#s, addresses of member/owners
  - Statement that organization qualifies to elect out under §761(a)
  - Statement that all members elect out
  - A statement where the operating agreement is located – if oral then who is the contact

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Partnership Election Out

- **Form 1065 has a line to make the election – Sch B, line 32 – see page 195**

Schedule B	Other Information *(continued)*	Yes	No
b	Under the covered surrogate foreign corporation rules?		
	If "Yes" to either (a) or (b), complete Form 7208. See the Instructions for Form 7208.		
30	At any time during this tax year, did the partnership (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or financial interest in a digital asset)? See instructions		
31	Reserved for future use		
32	Check this box if an election out of subchapter K under section 761 is being made. See instructions . . . . ☐		
33	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions		
	If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3		
	If "No," complete Designation of Partnership Representative below.		

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Partnership Election Out

- If formal election is not made, IRS may agree to deemed election – facts and circumstances

- Indicators include
  1. At time of organization members all agree to opt out
  2. Members all report their share of income, profits, etc.

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Partnership Elections

- **See most applicable partnership elections on page 208-209**

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POST OBBBA OPPORTUNITY ZONES

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Opportunity Zones - Review

- Originally added to the law in response to Hurricane Katrina
- TCJA temporarily made available to everyone in 2018
- OBBBA made them permanent
  - TCJA version expires at the end of 2026
  - OBBBA mostly becomes effective January 1, 2027

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Opportunity Zones 1.0 and 2.0 - Comparison

Description	QOZ 1.0	QOZ 2.0
Applicable dates	1/1/18 through 12/31/26	January 1, 2027 and beyond
Designating qualifying locations	Governors nominated low-income census tracts in the fall of 2018.	Governors nominate potential QOZs every 10 years starting in fall/winter of 2026.
Qualifying locations	Up to 25% of low-income census tracts in a state may qualify. Plus small number of contiguous tracts.	Up to 25% of a state's low-income census tracts plus rural communities. Contiguous tracts no longer qualify.
Gain deferral benefits	Reporting of current capital gains deferred until 2026	Reporting of current capital gains deferred five years
Basis step-up on current capital gain	10% basis step-up for assets sold if QOZ property is held for 5 years, 15% step-up if held 7 years.	10% basis step-up if QOZ property is held 5 years, 30% if QOZ property is qualified rural OZ property.
QOZ gain exclusion	Permanent exclusion if QOZ property held at least 10 years	Permanent exclusion if QOZ property held at least 10 years
QOZ tax free appreciation	Ends December 31, 2047	Rolling 30-year period
QOF substantial improvement requirements	QOF has 30 months to invest 100% or more of the adjusted basis of property purchased	Same as QOZ 1.0 except if qualifying property acquired in "rural zone," the requirement is 50%, not 100%

Opportunity Zones - Definitions

- Qualified Opportunity Funds (QOFs) and Qualified Rural Opportunity Funds (QROFs) – 90% QOZP test
- Qualified Opportunity Zones (QOZs) – geographic area
- Qualified Opportunity Zone Property (QOZP) is either:
  1. QOZ Stock
  2. QOZ Partnership Interest
  3. QOZ Business Property (QOZBP)
- Qualified Opportunity Zone Business (QOZB)

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QOZ Step by Step

1. Every 10 years, state governors nominate QOZs
   - US Treasury then certifies or denies
   - Once certified, certification lasts 10 years
   - First nominating period started July 1, 2026
   - First new 10-year QOZ period starts January 1, 2027
2. Eligible taxpayer realizes a capital gain and elects to defer tax, starting the 180-day countdown
   - Eligible taxpayer includes individuals, partnerships, corporations (C and S), estates and trusts
     - Starts 180 day countdown

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QOZ Step by Step

3. Taxpayer finds or creates a QOF or a QROF and reinvests the gain within the 180-day window
4. The QOF then invests in Qualified Opportunity Zone Property or Business or (QOZB) within a reasonable period of time
5. Taxpayer maintains its investment in the QOF at least 5 years, when it recognizes the original gain
   - Taxpayer receives a 10% (30% QROF) basis step-up
6. Taxpayer holds the QOF investment 10 or more years to receive tax-free future appreciation

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Opportunity Zones – 3 Tax Benefits

- **Under the OBBBA, the permanent tax benefits for investing in QOZs are**
  1. **Delay – Defer recognition of realized capital gains for up to 5 years after the gain is realized**
  2. **Exclude – Permanently exclude at least 10% of realized capital gain**
  3. **Exclude – Exclude all QOF investment appreciation if the QOF is held at least 10 years – up to 30 years**

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QOZ Example

- Evan realizes a $1,000,000 gain from the sale of a small apartment complex for $2,500,000
- Evan invests $1,000,000 in a QOF, well within the 180-day time limit, and elects to defer the gain
  - Evan's reinvestment is split, $500,000 into OppFund, Inc. and $500,000 OppToo, Inc. As long as the entire $1,000,000 is invested within 180 days, there is no limit in the number of investments
- Evan retains the $1,500,000 of the sales price to do whatever he wishes to do – only the gain is reinvested

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Tax Benefit #1 – Capital Gain Deferral

- **Tax on capital gains invested in QOF may be deferred until the earlier of:**
  1. **The date there is an inclusion event, or**
  2. **Five years after the date the QOF investment was made.**
- **An inclusion event occurs to the extent:**
  - **The investors equity interest in the QOF is reduced;**
  - **Some property distributions from the QOF;**
  - **Taxpayer claims deduction for worthless stock in the QOF**
  - **The QOF loses its status as a QOF**
  - **The QOF is terminated**
  - **The QOF is transferred via gift or divorce**

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Tax Benefit #1 – Capital Gain Deferral

- The death of the investor is not an inclusion event
  - This includes transfers to the investor's estate, surviving spouse, and other death related transfers
  - The surviving beneficiary steps into the decedent's QOF position regarding the 5-year and 10-year rule – the gain must be recognized by the beneficiary or heir
- Deferred gain for an investment in a QOF is treated as IRD

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Tax Benefit #2 – 5 Year Basis Step-up

- Investments held at least 5 years receive a basis step-up equal to 10% of the deferred gain
  - Step up was 10% or 15% under QOZ 1.0
- QOZ 2.0 provides a 5-year rolling deferral, beginning on the date the QOF investment is made
  - Note it is tied to the QOF investment date, not the sale date
- For investments made in "Qualified Rural Opportunity Funds", the basis step-up is increased to 30%
- Deferred gains retain their original character when realized

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Tax Benefit #2 – 5 Year Basis Step-up

- **Example – Olivia realizes $1,000,000 gain in Sept 2027, which she invests in a QOF on January 30, 2028**
  - **Realized gain is deferred to 2033 – 5 years after investment was made**
  - **Olivia receives basis step-up of $100,000 and pays tax on $900,000**
- **Assume the facts same except Olivia invests in a QROF**
  - **Realized gain is still deferred to 2033**
  - **Olivia receives basis step-up of $300,000 (30% for QROF) and pays tax on $700,000**
- **Note that any basis step-up is basis for all purposes (e.g. loss deductions, carry forward losses, etc.)**

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Tax Benefit #3 – 10 Year Tax Free Appreciation

- **Taxpayers who hold their QOF investment 10 or more years receive a basis step upon sale to either:**
  1. **If QOF is held >30 years, the FMV at the 30-year anniversary of the QOF investment**
  2. **If the QOF is held <30 years, the FMV on the date it is sold**
- **Bottom line, up to 30 years of tax-free appreciation**

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Tax Benefit #3 – 10-Year Tax Free Appreciation

- **Example – same Olivia facts as before except Olivia sells her QOF investment in 2043 for $3.5 million.**
- **Olivia's gain on the sale of the QOF is calculated:**

• Original basis – from $1,000,000 investment	$ Zero
• Basis step-up after five years	$ 100,000
• Basis from recognizing deferred gain	$ 900,000
• Total basis after five years	$1,000,000
• Basis step-up upon sale – 15 years	$2,500,000
• Total basis upon sale of QOF	$3,500,000
• Sale price	$3,500,000

- **Recognized gain on sale** **$ Zero**

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Tax Benefit #3 – 10-Year Tax Free Appreciation

- So bottom line, Olivia
  - Realizes a gain of $1 million in 2027
  - Pays tax on recognized gain of $900,000 in 2033 after subtracting her stepped up basis of $100,000
    - Tax paid is approximately $215,000 (23.8%)
  - Realizes a gain of $2,500,000 in 2043 on which she paid no tax
  - Her net tax rate for all the gain is 6.1% ($215,000 ÷ $3,500,000)

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QOZs – Who?

- "Eligible taxpayers" include
  - Individuals
  - Corporations (C and S)
  - REITs and RICs
  - Partnerships and LLCs
  - Trusts and Estates

- For pass-through entities, the entity or the partner/shareholder/beneficiary may make the election

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QOZs – Who?

- Example
  - HB LLC realizes a $6,000,000 capital gain and decides not to reinvest in a QOF
  - Partner Sidney is allocated $2,000,000 of the gain
  - Partner Sidney may make the election on her own for her $2,000,000 allocable gain

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QOZs – What?

- "Eligible gains" include
  - Capital gains (short and long-term gains)
  - §1231 gains (but not ordinary income recapture under §1245 or §1250)
  - Net §1256 gains
  - Collectible gains
  - Related party sales do not count

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QOZs – What?

- "Eligible gains" include
  - Installment sale gains – taxpayer may elect
    1. To use one 180-day period for all payments received during the year – if chosen, the 180-day reinvestment period start December 31st
    2. Choose separate 180-day investment period for each installment received – begins the day payment is received

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QOZs – When?

- The 180-day rule begins on the day the gain would have been recognized – normally the sale date
- But, the following exceptions
  - §1231 and §1256 gains netted on the last day of the year
    - Even if there was only one 1231 gain for the entire year
  - Passthrough entities follow normal rules, but owner/beneficiaries have 3 options
    1. Default – reinvestment period starts last day of entity's year
    2. May elect to use the date the gain was realized by the entity
    3. May elect to start the 180-day period on the due date of the entity's tax return, without extensions

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QOZs – When?

- Transition between QOZ 1.0 and 2.0
  - QOZ 1.0 – all deferred gains are recognized in 2026
  - IRS regs say taxpayers whose 180-day window ends in 2027, and reinvests in 2027, is subject to the QOZ 2.0 rules
  - All QOZ 2.0 would apply
- Example – Cruz realizes $1,000,000 cap gain on September 30, 2026.
  - Cruz has until March 28, 2027 to invest in a QOF and defer the gain.
  - If Cruz waits to invest until 2027, QOZ 2.0 rules will apply

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Partner Options Example

- BCA LLC realizes $4 million gain March 15, 2027 and does not elect to defer and invest in a QOF
- Partner Jessi
  - Elects to invest her pass through $2 million gain into a QOF
  - She may choose to start 180-day window
    - March 15, 2027 – expires September 11, 2027
    - December 31, 2027, or
    - March 15, 2028
  - Finds QOZP that is 25% undervalued in August 2027 that she knows will sell fast
  - Forms QOF by September 11th (reinvestment complete) and then the QOF buys the property in October 2027

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QOFs and the Details

- A QOF is a partnership or corporation that is organized to:
  1. Invest in QOZP
  2. In the US, DC or US territories, and
  3. At least 90% of its assets are QOZP (the 90% test)
  - The entity's organizing docs must state the entity's purpose is to invest in QOZBP and should include a description of the QOZB
  - Pre-existing entities may be QOFs, but they must meet all the requirements
  - There has to be an entity – taxpayers may not simply invest

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QOFs and the Details

- **QOZP is either:**
  1. **QOZ stock – stock in domestic corp, acquired by original issue from the corp in exchange for cash after the reinvestment date, and 90% of the QOF holding period the corp qualified as a QOZB**

  2. **QOZ Partnership Interest – capital or profits interest in a domestic partnership acquired solely for cash. The partnership was QOZB at the time interest was acquired and 90% of the holding period the partnership was a QOZB**

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QOFs and the Details

- **QOZP is either:**
  3. **QOZ Business Property (QOZBP) is tangible property used in a trade or business if**
     a. **Property was acquired by the QOF by purchase after the date of reinvestment in the QOF**
     b. **Original use of property in the QOZ commenced with the QOF or the QOF substantially improved the property**
     c. **During the QOF's holding period "substantially all" of the use of the property was in a QOZ**
        a. **Note "substantially all" for this purpose is 70% by value or greater**

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QOFs and the Details

- QOZ Business (for the corporate and partnership tests above) must not be a businesses operated for
  a) Private or commercial golf course or country club
  b) Massage parlor
  c) Hot tub facility
  d) Suntan facility
  e) Racetrack or other gambling facility
  f) Any store where the principal business is the sale of alcoholic beverages for off site consumption

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QOFs and the Details

- 90% test – at least 90% of a QOF's assets are invested in QOZBP
  - Calculated on the last day of the first 6-month period of the QOF's tax year, and
  - The last day of the QOF's tax years
  - The totals are averaged to figure if the 90% test is met
- If the 90% test is failed, the QOF is penalized, but retains its status as a QOF
  - This means the taxpayer may continue with its investment

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Example 1. Sara sells bare land on December 10, 2027, and realizes a gain of $5,000,000. Sara forms ITU, a corporation, on January 1, 2028, and contributes the $5,000,000 in exchange for 100% of ITU's outstanding stock. Sara intends for ITU to be a QOF, and she plans to defer the tax on the $5,000,000 gain from the land sale. ITU uses $4,500,000 of its cash to purchase bare land located in a QOZ on June 1, 2028, and immediately begins construction of an apartment complex on the land it purchased. ITU uses debt to fund the apartment complex construction. ITU has no other assets. For 2028, ITU's assets are summarized for purposes of the 90% test:

	June 30th	December 31st	Average
Cash	$ 500,000	$ 500,000	$ 500,000
Buildings (in progress)	$2,500,000	$ 7,500,000	$ 5,000,000
Land	$4,500,000	$ 4,500,000	$ 4,500,000
Total assets	$7,500,000	$12,500,000	$10,000,000

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Working Capital Exceptions

- QOF must limit its non-qualified financial property to less than 5% of its assets
- But, reasonable working capital is not counted as non-qualified financial property if:
  1. Amount is designated in writing for development of QOZ trade or business
  2. Reasonable written schedule showing need
     - For start up capital, generally allowed 31-month start-up schedule
  3. Property consumption is consistent with written plan
     - Delays beyond 31 months okay if due to government delays

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Real Property and QOFs

- IRC defines most rental property as a trade or business for the QOF tests as long as the real property
  - Is acquired by purchase within the statutory period (i.e. after the entity is established)
  - Original use of the property commenced with the QOF
  - During the holding period, the property's use was in a QOZ
- Exceptions may occur if real property is leased under a triple-net lease arrangement – facts and circumstances test

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Real Property and QOFs

- Existing QOZ buildings generally do not qualify as they don't meet the original use test
- But, the building may qualify if it is "substantially improved"
  - Substantial improvement requires 100% of the building's original cost be invested in the building – the 100% test
    - Note that any value allocated to land is excluded from this equation

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Real Property and QOFs

- Example – BZW buys building and land for $8,000,000
  - The land is valued at $4,800,000
  - The building is valued at $3,200,000
- BZW spends $4,000,000 to modernize and update the building
- As more than the original cost was spent to improve the building, the substantial improvement test is met. The building is QOZBP

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Real Property and QOFs

- QOZ 2.0 reduced the substantial improvement test to 50% of the original cost for QROF investments

- Example – In our previous example, if BZW invests in a QROF, it only needs to spend $1,600,000 (50% of $3,200,000) to improve the building and the substantial improvement test is met.

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Real Property and QOFs

- **Unimproved land – if located in a QOZ is not required to be substantially improved**
  - **By definition, original use of land begins when the land is developed. This means that the land counts as QOZBP as long as it is used in a QOZ trade or business**
  - **Unimproved land held for speculation would likely not qualify**
  - **It would be wise to have development plans in place when the land is acquired**

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Mixed Funds

- Tax attributes for investing in a QOF only apply to deferred capital gain investments, not to any other investment
- Example – Josh sold his business in 2027 for $5 million and realized a $1,000,000 gain. Josh invested $1,500,000 in a QOF
  - Josh may defer the entire $1,000,000 gain and receives a $100,000 (10%) basis step up if he holds the QOF for 5 years
  - If Josh holds the QOF 10 years, only 66.7% of future appreciation is tax free – remaining 33.3% will be fully taxable

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Mixed Funds

Attributable to	100% Total	66.7% Deferred Gain	33.3% Josh Gain
Sale price	$ 3,500,000	$2,333,333	$1,166,667
Basis on original purchase	($ 500,000)	($ - 0 -)	($ 500,000)
Basis at 5 year point	($1,000,000)	($1,000,000)	($ - 0 -)
Gain on sale	$ 2,000,000	$1,333,333	$ 666,667
Exclude gain due to basis step up	($1,333,333)	($1,333,333)	($ - 0 -)
Taxable gain	$ 666,667	$ - 0 -	$ 666,667

The portion of the gain derived from the non-capital gain investment in OppFund LLC is fully taxable. Of course, presumably Josh could start over and invest the $666,000 in a new QOF!

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Establishing Designated QOZs

- Every 10 years, governors of each state propose QOZs to the Treasury Department
- Treasury then certifies accepted QOZs for the coming 10 years
- The selection period is the six months prior to the start of each QOZ 10-year period
  - July 1st – December 31st, 2026
  - July 1st – December 31st, 2036
  - July 1st – December 31st, 2046, etc.

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Reporting Requirements

- Investors – report QOF investments and related capital gains
  - Year of sale – file Form 8949 and using Code Z to notify the IRS of the QOF investment and to exclude the gain
  - Annually file Form 8997, Initial and Annual Statement of QOF Investment. This form must be filed even if the investment is disposed of during the year
- QOF – files Form 8996, Qualified Opportunity Fund annual reporting – used to self-certify the entity meets the 90% test or to calculate the penalty if not

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Business Credits

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Description	Pre-OBBBA	OBBBA	Effect Date
FICA Tip Credit (§45B)	FICA tip credit allowed for food and beverage industry businesses	FICA tip credit expanded to be available to beauty service industry.	2025
Employer Dependent Care Credit (§45F)	Employers who provide dependent care qualify for 25% credit of up to a maximum of $150,000	Employer dependent care credit increased to 40%, maximum credit of $500,000. Small employers may jointly operate a care facility	2026
Employer Credit for Paid Family and Medical Leave (§45S)	Up to 25% credit for employers who provide paid FMLA to employees	Credit made permanent and modified to allow credit for insurance policies or wages	2026
New Markets Tax Credit (§45D)	Credit for investing in low-income communities through 2025	New Markets Tax Credit made permanent	2026

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Low-Income Housing Credit (§42)	Fed funded, state issued credits for low-income housing projects	12% increase in funding higher bond financing requirement	2026
New Energy Efficient Home Credit (§45L)	Credit for contractors who build energy efficient home	Repealed	July 1, 2026
Advanced Manufacturing Production Credit (§45X)	10% credit for manufacturers of US solar, wind, battery, inverters, etc. equipment	Earlier phase-out dates apply to various provisions	Various
Advanced Manufacturing Investment Credit (§48D)	25% credit for advance manufacturing facility investments	Credit increased to 35%	2026
Commercial Clean Vehicle Credit (§45W)	Credit of up to $40,000 for purchase of qualified clean energy commercial vehicle	Commercial Clean Vehicle credit repealed	October 1, 2025

Description	Pre-OBBBA	OBBBA	Effect Date
Clean Fuel Production Credit (§45Z)	Most of these credits are related to "green" or alternative energy tax credits. Most of these credits have been repealed, or the expiration dates were accelerated. A couple of the credits were modified and will continue for a more extended period of time. Due to the relatively few taxpayers that are expected to claim any of these credits, the author felt no further discussion was warranted. For those who may want additional information, the IRC sections are cited and the internet links should work.		
Clean Electricity Production Credit			
Clean Hydrogen Production Credit			
Carbon Oxide Sequestration Credit			
Zero-Emission Nuclear Power Credit			
Clean Electricity Investment Credit (§48E)			
Qualified Advanced Energy Property Credit			
Alternative Fuel Vehicle Refueling Credit (§30C)	Credit allowed for installation costs of alt fuel refueling site	Credit repealed as of June 30, 2026	June 30, 2026

FICA Tip Credit

- Historically food and beverage employers allowed a credit for FICA taxes paid on employee tips
  - Qualifying - servers, bartenders, chefs, bussers, hosts, dishwashers, prep workers and bakers (per Tip Deduction Regs)
- Form 8846 is used by employers to calculate the credit
  - Pass-through owners are not required to file the form
- Credit is equal to 100% of the employer FICA tax on tips received by employees
  - But, any FICA paid on tips used to meet the minimum wage are not credit eligible

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Changes Tip Credit

- Definition of eligible employers expanded
- Starting in 2025, tip credit industries, in addition to food and beverage, include
  - Barbering and hair care
  - Nail care
  - Esthetics, and
  - Body and spa treatments
- These professions are specifically listed in the IRC

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Employer Dependent Care Credit

- Employers receive a credit for helping cover costs of dependent care for employees
- Credit is equal to
  - 40% (50% for small businesses) of the qualified child or dependent care expenses, plus
  - 10% of qualified childcare resource and referral expenses
  - Maximum credit is $500,000 ($600,000 for small businesses) per year

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Employer Dependent Care Credit

- **Qualifying childcare expenses include:**
  - **Up to 40% of costs to acquire, construct, rehab, or expand property used for a childcare facility, excluding the employer's residence**
  - **Up to 40% of the costs to operate a childcare facility, including pay to childcare workers, training, and scholarship programs**
  - **Up to 10% of costs to contract for childcare resource and referral services for employees**
- **Basis of assets or expense amounts are reduced by the amount of the credit – no double dipping is allowed**

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Employer Dependent Care Credit

- **Example – Howlin Jack is a small business with 25 employees with young kids in 2026. Howlin spends $400,000 to contract with a daycare provider, $60,000 to remodel its building, $40,000 rent and $20,000 to hire a daycare consulting firm**

• $400,000 x 50% =	$200,000
• $ 60,000 x 50% =	$ 30,000
• $ 40,000 x 50% =	$ 20,000
• $ 20,000 x 10% =	$ 2,000
• Total credit	$252,000

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Employer Dependent Care Credit

- **Credit Recapture**
  - **Recapture for building costs occurs if**
    - **Building ceases to be a daycare facility**
    - **Change in ownership and new owner refuses to assume recapture liability**
    - **See chart on page 105**

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Dependent Care Credit Recapture

If the recapture event occurs in:	The applicable recapture percentage is:
Years 1–3	100
Year 4	85
Year 5	70
Year 6	55
Year 7	40
Year 8	25
Years 9 and 10	10
Years 11 and thereafter	0.

Paid Family & Medical Leave Credit

- Family and Medical Leave Act (FMLA) allows a credit to employers who provide family or medical leave
- To qualify, the employer must
  1. Have a written family leave policy that
     - Annually provides full-time employees with at least two weeks paid family leave
     - Provides part-time employees with a prorated leave amount
  2. Pay at least 50% of normal base pay during leave
  3. Only include employees who earn 60% or less of the highly compensated threshold ($96,000 in 2025)

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Paid Family & Medical Leave Credit

- **Family and Medical Leave Act is leave for**
  1. **Birth or adoption of a child**
  2. **Care for child, spouse, or parent with serious illness or is a military service member**
  3. **Serious health condition prevents work**
  4. **Urgent need or demand for spouse, child or parent is in military and on active duty**
- **Other paid leave (e.g. vacation, OT reimb., etc.) or leave required by state or local law don't count**

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Paid Family & Medical Leave Credit

- **Calculating the credit**
  1. **12.5% of qualifying wages**
  2. **Increased by .25% for each percent pay is above 50% of wages**
  3. **Maximum credit is 25%**
  - **Example – Sam's employer, GHT, pays Sam $52,000 a year. Sam's wife has a new baby and Sam takes four weeks off work. GHT pays Sam $2,000 while he is off, 50% of his normal pay. GHT receives a credit of $250 ($2,000 x 12.5%)**
  - **GHT must reduce its wage deduction by $250 and Sam's $2,000 may not be used to calc other credits**

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Enhancements to PFML Credit

- FMLA credit is permanent
- Allows employers to claim the credit for:
  - Wages actually paid to employees, or
  - For insurance premiums paid to cover wages paid for employees taking FMLA time off
- The credit percentages remain 12.5% to 25% for up to 12 weeks of pay
- Wages are reduced by any FMLA payments made

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OBBBA Repeals Energy Efficient Home Credit

- Credit of up to $5,000 per home for contractors who build new energy efficient homes
- OBBBA repealed the credit for homes sold after June 30, 2026

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Advanced Manufacturing Investment Credit

- Credit equal to 25% of cost of advanced manufacturing facility
  - Primary purpose is manufacturing of semiconductors or semiconductor manufacturing equipment
  - Must be in US and not owned by a foreign entity
  - Doesn't apply to portion of building used for sales, admin, or non-manufacturing functions
- OBBBA increased credit percent to 35% for property placed in service after 2025
  - Construction must begin before January 1, 2027 – no change

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R&D Credit

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Research and Development Credit (§41)

- **Overview**
  - **First enacted as a temporary provision since 1981**
    - **Made permanent in 2016**
  - **Purpose is to encourage US companies to increase research activities**
  - **Allows qualifying companies a credit of up to 20% of qualifying research expense (QRE)**
  - **In general, allowed as a percentage of QRE expenses**

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OBBBA Changes to R&D Credit

- R&D Credits only available for domestic R&D
- R&D Credit reduces R&D expense unless lower credit % is elected – no double dipping

Research and Development Credit (§41)

- **Qualified small businesses (QSB) may offset FICA taxes with R&D credit**
  - **QSB has less than $5 million gross receipts in current year, and**
  - **No gross receipts more than 5 years prior (2020 for 2025)**
  - **Form 8974 used to claim**
  - **May only be elected for five years**
  - **Does not require reduction of payroll tax deduction**

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Research and Development Credit (§41)

- **Qualified Research Expenditures (QRE) – Includes in-house and contract research**
  - **In-house includes**
    - **Wages for those engaged in qualified research and those who provide direct supervision**
    - **Supplies and materials**
    - **Amount paid for computer use and some limited in-house software**
  - **Contract research includes**
    - **65% of amounts paid to non-employees for qualified research**
    - **75% for amounts paid to qualified research consortium (scientific nonprofit organization operated to conduct scientific research)**

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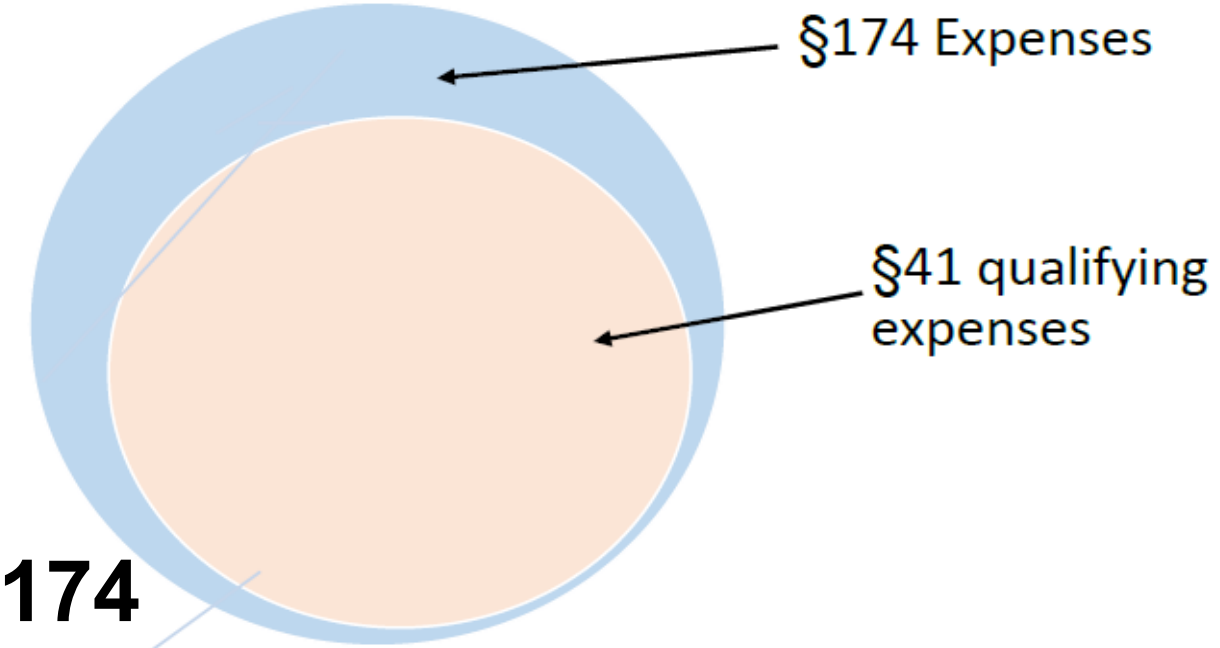
Research and Development Credit (§41)

- **Defining QRE – interaction between §174 and §41**
- **Each section has its own definition, but**
- **§41 definition starts with the §174 definition – you can have §174 that doesn't qualify for §41 but not the other way around**



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Research and Development Credit (§41)

- **Four Requirements of QRE**

1. **Expenditures paid in connection with taxpayer's trade or business in an experimental or laboratory sense**

2. **QRE is done to discover info technological in nature – process of experimentation fundamentally relies on physical or biological sciences, engineering or computer science**

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Research and Development Credit (§41)

- **Four Elements of QRE**

3. **Substantially all QRE includes a process of experimentation related to a new or improved function, performance, reliability, or quality**
   - **Substantially all means 80% or more spent on experimentation**
4. **QRE is intended to be useful for the development of a new product or to improve a current component of an existing product**
   - **Does not include style, taste, cosmetic, or seasonal design**

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Extra

Research and Development Credit (§41)

- **Technology defined – The use of scientific knowledge for practical purposes or applications**
  - **Includes everything from the wheel to computers to medicines to zippers and buttons on clothes**
- **Documentation is the key!**

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Research and Development Credit (§41)

- **Keep the big picture in mind**
  1. **What did we make?**
  2. **What makes it R&D?**
  3. **How much did it cost?**

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Research and Development Credit (§41)

- All four tests must be applied to each project separately – there is no spill over between projects
- QRE does not include
  - Research after commercial production begins
  - Adapting existing product to a customer's needs
  - Reproduction of an existing product
  - Efficiency surveys, management studies, etc.
  - Computer software except for software for internal use
  - Conducted outside the US, Puerto Rico or possession
  - Research in social sciences, humanities, or arts
  - Research funded by grant, contract, etc.

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Research and Development Credit (§41)

- See R&D list for various industries starting page 245
- Examples from list
  - Ag
    - New crop hybrids
    - New automation processes
  - Construction – new energy saving products
  - Food – new product tastes and textures or developing specialized tools or prototype machines
  - Healthcare – new medical devices
  - Tech – new AI applications
  - Etc.

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Research and Development Credit - Cases

- **Betz/Lincoln v. Comm USTC – lack of documentation case**
  - **CPI designed and supplied air pollution control systems**
  - **CPI claimed R&D credits of $501,000 from 19 projects which passed through to Betz and Lincoln**
  - **CPI didn't use time tracking software and had no other evidence of time spent – Court disallowed all wages**
  - **Court also ruled no evidence products were actually modified in a QRE sense. Similar products had previously been sold to the same customers**
  - **Note – the credit calcs were prepared by Alliant Group**

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Research and Development Credit – Cases

- **Kapur v. Comm USTC – another Alliant Group case**
  - **Alliant argued QRE could be calculated for all projects using sampling from some projects**
  - **Court ruled sampling improperly relieves taxpayer of its burden of proving entitlement to the R&D credit and it was reasonable for the IRS to ask for detailed records for all projects**
  - **Court says if non-sampled cases were inconsequential, then feel free to leave them out!**

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Research and Development Credit (§41)

- Two methods to calculate the R&D credit

1. Regular calculation method

2. Alternative simplified method

- See details page 248 – 250

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Research and Development Credit (§41)

- **Credit may be claimed on original or amended returns, but more info required on amended return, including**
  1. **Identify all business components to which credit is claimed**
  2. **For each component, all research activities performed**
  3. **For each component, name of persons who performed R&D**
  4. **For each component, information each person sought to discover**
  5. **Total wages, supplies, and contract expenses for R&D**

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Thanks for being here!

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