Recent Developments in Federal Income Taxation

Bruce A. McGovern
Professor of Law and Director, Tax Clinic
South Texas College of Law Houston
Houston, Texas

State Bar of Texas Tax Section
First Wednesday Tax Update
November 5, 2025

1

CLE Number for Today's Webcast:
174300415

2

I. Accounting

3

The Morning Star Packing Co., L.P. v. Commissioner, 134 A.F.T.R.2d 2024-6440 (9th Cir. 12/19/24)

Outline: item D.1, page 2

- Taxpayer was a calendar-year, accrual-method partnership.
  - Taxpayer was a large processor of raw tomatoes converted into bulk tomato paste and diced tomatoes sold and distributed to buyers in U.S. food market.
- Under the "all events" test that applies to accrual method taxpayers, a liability is incurred and taken into account in the TY in which (1) all events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred.
- Facts: At end of each harvest season (October), TP had to extensively "restore, recondition, and retest" tomato processing equipment before beginning of next harvest season (July). Annual cost during TYs in issue (2008-2001) ranged from $16.7 to $21 million.
  - Taxpayer established "production accrual reserve accounts" at end of harvest season (Yr1). Reserves used to fund the restoration, reconditioning, and retesting of equipment completed before next year's harvest season (Yr2).
  - TP had been audited previously but IRS had not challenged inclusion of "production accrual reserve accounts" in COGs for Yr1 as opposed to Yr2.

4

4

The Morning Star Packing Co., L.P. v. Commissioner, 134 A.F.T.R.2d 2024-6440 (9th Cir. 12/19/24)

Outline: item D.1, page 2

- Issue: Was the first part of the "all events" test (all events have occurred that establish the fact of the liability) met in Yr1 thereby allowing the taxpayer to include the reserves in COGS in Yr1?
  - IRS conceded that the other two parts of the all events test were satisfied in Yr1 (amount of the liability could be established with reasonable accuracy and economic performance had occurred).
- Held: No (2-1 decision). Tax Court affirmed.
- Rationale:
  - Although taxpayer had the obligation under loan agreements to keep its equipment in "good operating order and repair, reasonable wear and tear excepted," these loan documents did not explicitly require the reserves that taxpayer established.
  - Construing taxpayer's obligation to maintain equipment in good order except for reasonable wear and tear as requiring the establishment of reserves in Yr1 "strains credulity."
  - Intervening events (e.g., repayment of loan, sale, merger, liquidation, etc.) could obviate need to pay for restoration, reconditioning, and retesting costs.
- Dissent: Strongly objected, stating that "fact of liability" prong does not require "metaphysical certitude." Moreover, IRS had not raised issue during prior audits of taxpayer.

5

5

New § 1062 Effective TY Beginning After 7/4/2025 2025 OBBBA § 70437

Outline: item D.2, page 4

- New § 1062 (Gain From the Sale or Exchange of Qualified Farmland Property to Qualified Farmers).
- Taxpayer (individual or entity) may elect to pay in equal installments over four years the tax resulting from the sale or exchange of "qualified farmland property" to "qualified farmer."
  - "Qualified farmland property" must:
    1. Be located in U.S., and
    2. For the 10-year period ending on the date of the sale or exchange, either was (i) used by the taxpayer as a farm or for farming purposes, or (ii) leased to a "qualified farmer" for farming purposes, and
    3. Be subject to post-sale covenant restricting use of property to farming for ten years.
    - Farmland use is attributed to shareholders of selling S corporation or partners of selling partnership.
  - "Qualified farmer" means any *individual* actively engaged in farming [within meaning of subsections (b) and (c) of § 1001 of Food Security Act of 1986 (7 U.S.C. 1308–1(b) and (c)].
    - **Question:** May "individual" purchase and convey to LLC, partnership, or corporation immediately after purchase?
    - **Question:** What if "individual" is not "actively engaged" in farming until *after* the purchase?

6

6

New § 1062 Effective TY Beginning After 7/4/2025
2025 OBBBA § 70437
Outline: item D.2, page 4

- Amount eligible for payment in four installments:
  - The portion of the "net income tax" of the taxpayer for the taxable year of the sale or exchange that is equal to the "applicable net tax liability."
  - Net income tax: defined in § 1062(d)(1)(B)—selling TP's regular tax liability reduced by certain credits.
  - Applicable net tax liability: the excess (if any) of the selling taxpayer's total "net income tax" for the taxable year of sale over the selling taxpayer's "net income tax" for the year of sale without taking into account gain recognized from the sale or exchange of the farmland property.
  - Example: taxpayer sells farmland and realizes a gain of $1 million. Taxpayer has other income of $3 million, for a total of $4 million of taxable income. Assume a 20% tax rate. Taxpayer's net income tax is $800,000 ($4 million * 20%). Without the land sale, taxpayer's net income tax would be $600,000 (3 million * 20%). Taxpayer's "applicable net tax liability" is $200,000 ($800,000 - $600,000).
- Election (and first tax payment) must be made by due date (without extension) of selling TP's return (and if selling TP is S corporation or partnership, at shareholder or partner level).
- Tax payments may be accelerated upon certain events (e.g., TP's failure to pay an installment, death, or for a C corporation, trust or estate, liquidation or sale of substantially all assets).

7

7

III. Investment Gain and Income

8

Expanded § 1202: "Qualified Small Business Stock"
2025 OBBBA § 70431
Outline: item A.1, page 6

- Since 1993, § 1202 has allowed the full or partial exclusion of gain from the sale or exchange of "qualified small business stock" ("QSBS") by noncorporate taxpayers if certain conditions are met, including (prior to amendment by OBBBA) the QSBS has been held for at least five years.
  - QSBS: Highly technical definition, but generally stock in a C corporation which (prior to amendments made by OBBBA) had "aggregate gross assets" of $50 million or less immediately before and after the issuance of QSBS.
- The full or partial exclusion is subject to cap equal to (prior to amendment by OBBBA) the greater of (i) $10 million reduced by gain attributable to the corporation's stock excluded by the taxpayer in prior years, or (ii) ten times the taxpayer's specially computed basis [see § 1202(i)] in the QSBS.
- OBBBA makes several important changes to § 1202 for QSBS issued after 7/4/2025 and sold in TYs beginning after 7/4/2025 (ordinarily, 2026 and thereafter) by expanding the scope of the § 1202 full or partial exclusion.

9

9

Expanded § 1202: "Qualified Small Business Stock"
2025 OBBBA § 70431
Outline: item A.1, page 6

- OBBBA makes several important changes to § 1202 for QSBS issued after 7/4/2025 ("Post-OBBBA QSBS") and sold in TYs beginning after 7/4/2025 (ordinarily, 2026 and thereafter) by expanding the scope of the § 1202 full or partial exclusion as follows:
  - New $75 million "aggregate gross assets" test: The issuing C corporation may have up to $75 million in "aggregate gross assets" immediately before and after the issuance of the QSBS.
  - New tiered holding period and exclusion rules: The minimum holding period is reduced to three years with a three- to five-year tiered exclusion amount:
    - 50% gain exclusion for Post-OBBBA QSBS held from three to less than four years.
    - 75% gain exclusion for Post-OBBBA QSBS held from four to less than five years.
    - 100% gain exclusion for Post-OBBBA QSBS held for five years or more.
  - Higher cap on excludable gain: The cap on excludable gain from the sale of Post-OBBBA QSBS is equal to greater of (i) $15 million (up from $10 million) or (ii) ten times the taxpayer's specially computed basis [see § 1202(i)].
  - Inflation adjustments for TYs beginning after 2026: For taxable years beginning after 2026, the $75 million "aggregate gross assets" test and the $15 million gain exclusion cap are adjusted for inflation.

10

10

Notice 2025-52, 2025-41 I.R.B. (9/22/2025)
Extended § 1033 Replacement Period for Livestock
Outline: item F.1, page 8

- Generally, § 1033(a) allows nonrecognition of gain from "involuntary conversions" (theft, seizure, requisition, or condemnation) of property if "similar or related in service or use" replacement property is acquired within a two-year period.
  - A downward adjustment to the basis of the replacement property preserves the gain that was not recognized in the involuntary conversion.
- Section 1033(e) contains a special rule permitting extension of the two-year replacement period to four years (and in certain cases even longer) for:
  - The sale of *excess* (i.e., would not be sold in the ordinary course of business) livestock held for "draft, breeding, or dairy purposes."
  - Excess livestock must be sold due to "drought, flood, or other weather-related conditions."
- Notice 2025-52 provides guidance on the four-year (or potentially longer) extension period and lists the U.S. counties that have experienced "exceptional, extreme, or severe drought" in the last twelve months leading up to August 31, 2025.
- Earlier guidance (Notice 2006-82): the replacement period may extend beyond four years until "the end of the taxpayer's first taxable year ending after the first drought-free year for the applicable region."

11

V. Personal Income and Deductions

12

Personal Casualty Loss Deductions Permanently Disallowed
2025 OBBBA § 70109
Outline: item D.1, page 9

- For 2018-2025, the 2017 Tax Cuts and Jobs Act :
  - Generally disallowed deduction of personal casualty losses.
    - Personal casualty losses are deductible to the extent of personal casualty gains
  - Allowed deduction of personal casualty losses in excess of personal casualty gains only in federally declared disaster areas.
- The rules enacted by the 2017 TCJA were scheduled to expire after 2025
- The 2025 OBBBA:
  1. Permanently extends the rules above to years after 2025, and
  2. Broadens allowable personal casualty losses by providing that personal casualty losses incurred in a State-declared disaster are deductible in TY beginning after December 31, 2025.
     - State-declared disaster: any natural catastrophe or, regardless of cause, any fire, flood, or explosion, which in the determination of the Governor of such State (or the Mayor, in the case of the District of Columbia) and the Secretary [of the Treasury] causes damage of sufficient severity and magnitude to warrant the application of the rules of this section.

13

13

Deduction of Tip Income
2025 OBBBA § 70201
Outline: item D.2, page 10

- New Code § 224(a) authorizes an individual to deduct the amount of "qualified tips" the individual receives.
  - Defined as the cash tips an individual receives in an occupation that "customarily and regularly received tips on or before December 31, 2024."
  - Proposed regs issued 9/22/25 (item a page 11): IRS published list of qualifying occupations
  - Amounts received by owners and employees in a specified service trade or business as defined in § 199A(d)(2) don't qualify
  - Tips must be reported on a W-2 or 1099 or on Form 4137
- Limits:
  - Maximum deduction is $25,000
  - Deduction is reduced by $100 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns).
- Available to those taking the standard deduction
- If married, must file jointly to take the deduction
- Effective for TY beginning after 12/31/2024. Ends after 2028.

14

14

Deduction of Tip Income
2025 OBBBA § 70201
Outline: item D.2, page 10

- Limits:
  1. Maximum deduction is $25,000
  2. Deduction is reduced by $100 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns).
  - If the taxpayer receives $25,000 or more in tips, the deduction is completely phased out when a taxpayer's modified AGI reaches $400,000 ($550,000 for joint returns).
  - If the taxpayer receives less than $25,000 in tips, then the first ($25,000) limitation does not apply but the second limitation does.
    - Example: assume a single taxpayer with MAGI of $200,000 receives $12,000 in tips.
    - The first ($25,000) limitation has no impact.
    - Because the taxpayer's MAGI exceeds $150,000 by $50,000, the taxpayer's deduction is reduced by $5,000 (50 * $100) to $7,000 ($12,000 in tips - $5,000 reduction).

15

15

VII. Partnerships

16

JM Assets v. Commissioner
165 T.C. No. 1 (7/2/2025)
Outline: item F.1, page 12

- The Bipartisan Budget Act of 2015 § 1101, Pub. L. No. 114-74 ("BBA"), made sweeping changes to the partnership audit rules, allowing the partnership itself (rather than its partners) to be subject to "imputed underpayments" and assessed tax liability with respect to federal income tax attributable to its partners. The old TEFRA rules required assessment and collection at the partner level.
- Greatly oversimplifying, the IRS audits, issues a "notice of proposed partnership adjustment" (NOPPA), waits 270 days for the partnership to respond or waive the 270-day period (via its "partnership representative), and then issues a "notice of final partnership adjustment" (FPA).
- The NOPPA and FPA must be issued within the several (and very technical) statute of limitations periods set forth in § 6235(a).
- This case interprets the NOPPA and FPA limitations periods when the partnership has requested a modification (via IRS Form 8980) of the NOPPA due to partner-level mitigating factors (such as tax-exempt partners, corporate partners, etc.) who may owe less tax on their distributable shares of partnership income than other partners.

17

17

JM Assets v. Commissioner
165 T.C. No. 1 (7/2/2025)
Outline: item F.1, page 12

- The facts, law, and procedural posture of the case are complicated; however, the upshot is that the taxpayer-partnership in this case requested a modification of the NOPPA (via Form 8980), as allowed by § 6225(c), 250 days (**2/14/2023**) into the 270-day NOPPA period (which expired **3/6/2023**).
- The taxpayer's Form 8980 modification request was accepted by the IRS via letter on 6/5/2023.
- The IRS, relying upon Reg. § 301.6235-1(b)(2)(A), issued the FPA 270 days after **3/6/2023**, which was **12/1/2023**. Reg. § 301.6235-1(b)(2)(A) deems the modification request (Form 8980) to have been submitted at the end of the 270-day NOPPA period (in this case 3/6/2023) even if the Form 8980 is submitted to, and accepted by, the IRS prior to the end of the 270-day NOPPA period (in this case **2/14/2023**).
- Issue: Is Reg. § 301.6235-1(b)(2)(A) valid?
  - This provision deems the Form 8980 modification request to have been submitted on the last day of the NOPPA period (**3/6/2023** in this case) when § 6235(a)(2) [the applicable statute of limitations provision] states that the FPA must be issued within 270 days after "the date on which everything required to be submitted" pursuant to a Form 8980 modification request "is so submitted" (which, in this case, was **11/13/2023**, 270 plus two more because 270 days from 2/14/2023 fell on a Saturday, 11/11/2023).

18

18

JM Assets v. Commissioner
165 T.C. No. 1 (7/2/2025)
Outline: item F.1, page 12

- Issue: Is Reg. § 301.6235-1(b)(2)(A) valid?
- Held: No. In a reviewed decision, the Tax Court unanimously held (17-0) that Reg. § 301.6235-1(b)(2)(A) directly contradicts the language of the controlling statute, § 6235(a)(2), and is therefore invalid in part.
- Further held: The regulation is invalid to the extent it extends the period for the IRS's issuance of an FPA beyond 270 days after the date specified in § 6235(a)(2), which is "the date on which everything required to be submitted" pursuant to a § 6225(c) Form 8980 modification request "is so submitted."
- Further held: In this case, the IRS issued the FPA on **12/1/2023**, when it should have issued the FPA on **11/13/2023** (270 days plus weekend extension after 2/14/2023).
- Further held: The IRS proposed "imputed underpayment" against the taxpayer-partnership in this case is time-barred.
- Comment: Had the taxpayer not submitted the § 6225(c) Form 8980 modification request early (or not at all), then the IRS would have had until **12/1/2023** to issue the FPA.

19

19

IX. Exempt Organizations and Charitable Giving

20

Corporate Charitable Contribution Deduction Modifications Effective TYs Beginning After 12/31/2025
2025 OBBBA § 70426 (Code § 170(b)(2)(A))
Outline: item B.1 page 16

- Current law:
  - Individuals can deduct *as an itemized deduction* charitable contributions under § 170(a).
  - Limit: cash contributions to public charities are allowed to extent they do not exceed 60% (2025) of an individual's contribution base (generally, AGI). §170(b)(1)(G)
  - Any contribution in excess of the limit can be carried forward 5 years. §170(d)(1)).
- OBBBA modifications effective TYs beginning after 12/31/2025:
  - Individuals who do *not* itemize deductions can deduct up to $1,000 ($2,000 for joint returns) of cash contributions to public charities
  - Individuals who *do* itemize are subject to a .5% floor (§170(b)(1)(I)) so that charitable contributions are deductible only to the extent they exceed .5% of the contribution base (AGI).
    - Thus, after 2025, individual charitable contributions by itemizers are deductible only to the extent they:
      - Exceed .5% of AGI, and
      - Do not exceed 60% of AGI

21

21

Corporate Charitable Contribution Deduction Modifications Effective TYs Beginning After 12/31/2025
2025 OBBBA § 70426 (Code § 170(b)(2)(A))
Outline: item B.1 page 16

- OBBBA modifications effective TYs beginning after 12/31/2025:
  - Individuals who do *not* itemize deductions can deduct up to $1,000 ($2,000 for joint returns) of cash contributions to public charities
  - Individuals who *do* itemize are subject to a .5% floor (§170(b)(1)(I)) so that charitable contributions are deductible only to the extent they exceed .5% of the contribution base (AGI).
    - Thus, after 2025, individual charitable contributions by itemizers are deductible only to the extent they:
      - Exceed .5% of AGI, and
      - Do not exceed 60% of AGI
    - Contributions disallowed by the .5% floor can be carried forward 5 years, but only from years in which the 60% limitation is exceeded.
  - For individuals in the in the 37 percent rate bracket, the benefit of charitable contributions for itemizers is capped at 35%. Thus, if an individual in the 37 percent rate bracket contributes $100,000 to a public charity, the donation will save the taxpayer only $3,500 in tax rather than $3,700.

22

22

Corporate Charitable Contribution Deduction Modifications Effective TYs Beginning After 12/31/2025 2025 OBBBA § 70426 (Code § 170(b)(2)(A))

Outline: item B.1 page 16

- Current law:
  - Corporations can deduct charitable contributions under § 170(a).
  - Limit: allowed to extent they do not exceed 10% of corporation's taxable income. §170(b)(2)(A)
  - Any contribution in excess of the limit can be carried forward 5 years. §170(d)(2)(A).
- OBBBA modifications effective TYs beginning after 12/31/2025:
  - Adds a 1% floor (§170(b)(2)(A)(i)) so that corporate charitable contributions are deductible only to the extent they exceed 1% of taxable income.
  - Thus, after 2025, corporate charitable contributions are deductible only to the extent they:
    - Exceed 1% of taxable income, and
    - Do not exceed 10% of taxable income.
  - Carryovers:
    - Deductions exceeding the 10% limit can be carried forward 5 years, but
    - Deductions not exceeding the 1% floor carried forward only from years in which 10% limit is exceeded.

23

23

Corporate Charitable Contribution Deduction Modifications Effective TYs Beginning After 12/31/2025 2025 OBBBA § 70426 (Code § 170(b)(2)(A))

Outline: item B.1, page 15

- Example 1: Corporation X has taxable income of $100,000. In year 1, X makes a deductible charitable contribution of $15,000.
  - 1% floor = $1,000 (first $1,000 is not deductible).
  - 10% limit = $10,000.
  - Only $9,000 can be deducted in year 1 ($10,000 limit - $1,000 floor).
  - The remaining $6,000 can be carried forward to years 2-6.
- Example 2: Corporation X has taxable income of $100,000. In year 1, X makes a deductible charitable contribution of $8,000.
  - 1% floor = $1,000 (first $1,000 is not deductible).
  - 10% limit = $10,000 (not an issue).
  - Only $7,000 can be deducted in year 1 ($8,000 - $1,000 floor).
  - The remaining $1,000 cannot be carried forward to years 2-6.
- Planning strategies: Bunching deductions into one TY? Deducting under § 162 instead of § 170?

24

24