RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

We apologize to our readers. If we had more time, this outline would be much shorter.

By

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II. BUSINESS INCOME AND DEDUCTIONS

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1. What happens when you cross § 199A (deduction for qualified business income) with § 280E (disallowance of deductions for trafficking in controlled substances)? Well, in this cannabis business case, your "QBI" may be "high" but your "W-2 wages" are a "downer," resulting in your § 199A deduction being *Savage*-ly reduced. Savage v. Commissioner, 165 T.C. No. 5 (9/11/25). The two individual taxpayers in this combined, reviewed decision (17-1) of the Tax Court were shareholders of three subchapter S corporations, two of which (Greenthumb, Inc. and Fillabong, Inc.) sold cannabis and cannabis-derived products. The deductions of Greenthumb and Fillabong attributable to the cannabis-related activities of the corporations generally were disallowed by § 280E for tax years 2018 and 2019; however, a portion of each corporation's deductions not attributable to the cannabis-related activities were allowable, including some wages paid to the individual taxpayer-shareholders. The third subchapter S corporation (Glass, Inc.) was not subject to § 280E for either 2018 or 2019, so its wages payable to the taxpayers were fully deductible. Specifically, as stipulated for purposes of the Tax Court's decision,[1] the breakdown of deductible versus nondeductible wages paid to the taxpayers across the three subchapter S corporations for taxable years 2018 and 2019 after application of § 280E was as follows:

	Tax Year 2018	
	Total W–2 Wages	*Deductible W–2 Wages*
Tru Greenthumb	$7,740	$3,991
Fillabong	605,955	148,782
Fillabong and Glass	-0-	-0-
Total	**$613,695**	**$152,773**
	Tax Year 2019	
	Total W–2 Wages	*Deductible W–2 Wages*
Tru Greenthumb	$168,134	$40,658
Fillabong	641,886	146,828
Fillabong and Glass	59,860	59,860
Total	**$869,880**	**$247,346**

On their individual returns for 2018 and 2019, the taxpayers claimed large § 199A deductions from their cannabis-related businesses. Basically, as explained further below, the taxpayers claimed a "high"—pun intended—amount of "qualified business income" under § 199A (due to cannabis-related trade or business deductions being disallowed at the S corporation level by § 280E) coupled with an equally "high" 50 percent wage limitation cap under § 199A(b)(2)(B)(i) (by counting total W-2 wages for purposes of the cap instead of deductible wages after application of § 280E). Put differently, the taxpayers applied § 280E for purposes of determining "qualified business income" under § 199A but did not apply § 280E for purposes of the 50% wage limitation cap (see § 199A(b)(2)(B)(i)) on the § 199A deduction. (Again, see below for further explanation.) Upon audit, the IRS challenged the amount of each taxpayer's claimed § 199A deductions on the grounds that § 280E limited their "W-2 wages" for purposes of computing the wage limitation cap in § 199A(b)(2)(B)(i) to the deductible portion for purposes of the § 199A deduction. Accordingly, the IRS decreased the taxpayers' respective § 199A deductions and assessed the following deficiencies for 2018 and 2019.

[1] The Tax Court decision contained an interesting and important footnote relating to the taxpayers' and the IRS's factual stipulations concerning deductible versus nondeductible trade or business expenses (including wages) under § 280E:

> In *Patients Mutual Assistance Collective Corp. v. Commissioner*, 151 T.C. 176, 198–99 (2018), *aff'd*, 995 F.3d 671 (9th Cir. 2021), we held that a single taxpayer could have multiple trades or businesses, some of which would be subject to section 280E and some of which would not, or a single trade or business consisting of multiple activities all of which would be subject to section 280E, even if the activities are undertaken through separate entities. The record does not disclose the precise trades or businesses of the three S corporations at issue, and we have no reason to believe that the parties' stipulations are inconsistent with the Court's caselaw on the proper delineation of trades or businesses for purposes of applying section 280E. *See Estate of Saia v. Commissioner*, 61 T.C. 515, 519 (1974) (explaining that, while the parties may agree to certain facts by stipulation, the Court is not bound to accept as controlling stipulations as to conclusions of law); *see also Estate of Sanford v. Commissioner*, 308 U.S. 39, 51 (1939) (same).

Deficiency Amounts		
Year	*Ms. Savage*	*Ms. Torres*
2018	$313,900	$292,759
2019	$187,325	$186,107

The taxpayers responded by timely filing petitions in Tax Court.

The law and the central issue. Section 199A is extremely complicated and technical, but we touch on some highlights here as background for the Tax Court's decision in this case. As readers know, § 199A provides a special deduction—which effectively operates as a rate reduction—on "qualified business income" (as defined and hereinafter "QBI") of individuals, including pass-through income from subchapter S corporations and partnerships. Generally speaking, the greater a taxpayer's QBI, the larger the taxpayer's § 199A deduction. Nonetheless, in addition to many other conditions and restrictions, § 199A(b)(2)(B)(i) limits the § 199A deduction to 50 percent of "W-2 wages" (as defined) from a taxpayer's "qualified trade or business" (as defined). Thus, oversimplifying considerably, the § 199A QBI deduction increases as QBI and "W-2 wages" increase (subject to a taxable income phase out in § 199A(b)(3)) but decreases as QBI and "W-2 wages" decrease. Section 199A(b)(4) defines "W-2 wages" as follows:

> (A) **In general**. The term "W–2 wages" means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) [total remuneration under § 3401(a) paid to an employee, subject to narrow exceptions not applicable in this case] and (8) [generally, elective deferrals to § 401(k) and 457 plans] of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.
>
> (B) **Limitation to wages attributable to qualified business income**. Such term shall not include any amount *which is not properly allocable* to qualified business income for purposes of subsection (c)(1) [defining "qualified business income"].
>
> (C) **Return requirement**. Such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

(Emphasis added.) The emphasized term above, "properly allocable," is not defined in § 199A. With respect to the other provision applicable in this case, § 280E, readers will recall that it disallows otherwise allowable deductions attributable to carrying on any trade or business consisting of trafficking in controlled substances, including cannabis. The issue in this case thus was whether the term "W-2 wages" as defined in § 199A(b)(4), which by virtue of § 199A(b)(2)(B)(i) [50 percent wage limit] restricts a taxpayer's § 199A QBI deduction, refers to wages paid *before* or *after* application of § 280E considering the proviso in § 199A(b)(4) that such "W-2 wages" must be "properly allocable" to the taxpayer's QBI.

The arguments. The taxpayers argued that the plain language of § 199A(b)(4)(A) (as quoted above) does not restrict "W-2 wages" to *deductible* wages and that the "properly allocable" proviso in § 199A(b)(4) refers to determining net QBI, not wages considered for purposes of the § 199A(b)(2)(B)(i) 50 percent wage limitation cap. In the taxpayers' view, the IRS was seeking to "add conditions and additional language not in [§ 199A] to limit W–2 wages to those wages allowed to be deducted by the business after application of § 280E." Moreover, in the taxpayers' view, allowing QBI to be "high" due to disallowed deductions (*see* § 199A(c)(3)(A)(ii) excluding deductions not "allowed in determining" taxable income) was consistent with Congress's purpose in enacting § 199A. But, applying § 280E to determine the amount of the wage limitation cap under § 199A(c)(3)(A)(ii) based only upon deductible "W-2 wages" was not Congress's intent. The IRS, on the other hand, argued to the contrary that the term "properly allocable" as used subsection (B) (quoted above) of § 199A(b)(4)'s definition of "W-2 wages" should be read to refer to deductible (not nondeductible) wages after application of § 280E in determining the § 199A(c)(3)(A)(ii) wage limitation cap on a taxpayer's QBI deduction under § 199A even if application of §280E results in an increase in QBI.[2] In short, the IRS was arguing that § 280E applies the same way for purposes of determining both net QBI and the wage limitation cap.

The majority's decision. Writing for the 17-1 majority, Judge Toro explained in his opinion that the taxpayers were attempting to read § 199A's definition of "W-2 wages" entirely by reference to § 199A(b)(4)(A) [the general description of "W-2 wages"] without giving meaning and effect to the "properly allocable" proviso in subparagraph (B) thereof (quoted above). Judge Toro reasoned, therefore, that the IRS's interpretation, which does give meaning and effect to the term "property allocable" in § 199A(b)(4)(B), is the better interpretation of § 199A. Furthermore, in the majority's view, "W-2 wages" must be deductible to be "properly allocable" to § 199A QBI. Moreover, the majority read the extensive regulations promulgated under § 199A as consistent with the IRS's interpretation of the statute. The majority also rejected the taxpayers policy arguments regarding § 199A's proper interpretation. Thus, Judge Toro's opinion sustained the IRS's asserted deficiencies against the taxpayers, concluding that only deductible "W-2 wages" (*i.e.*, after application of § 280E) should be considered for purposes of applying the 50 percent wage limitation in § 199A(b)(2)(B)(i) to the QBI deduction even if QBI is greater due to the application of § 280E in determining net QBI.

The lone dissent. Judge Jenkins dissented and would have held for the taxpayers. Judge Jenkins reasoned that "Congress put some effort into drawing the line between qualified trades or businesses eligible for the [§ 199A] deduction" but "it did not include drug trafficking businesses in the list of businesses that are not eligible." 165 T.C. at ____. In Judge Jenkins's view, the term "properly allocable" in subparagraph (B) of § 199A(b)(4)'s definition of "W-2 wages" refers strictly to the determination of net QBI under § 199A, not that those wages must be deductible for purposes of the 50 percent wage limitation in § 199A(b)(2)(B)(i). After summarizing the overall statutory framework of § 199A, Judge Jenkins further explained: "Congress did not intend 'properly allocable to' in section 199A(b)(4)(B) to mean 'allowed in determining' because it did not use the phrase in subparagraph (B) of § 199(b)(4)'s definition of "W-2 wages," whereas Congress did use the phrase "allowed in determining" elsewhere in § 199A. *See* IRC § 199A(c)(3)(A)(ii) (relating to § 199A's definition of "qualified items of income, gain, deduction, and loss" for purposes of calculating QBI). Therefore, according to Judge Jenkins, by using different phrases in the same statute, Congress presumably intended different meanings and "properly allocable" should not be read as synonymous with "allowed in determining." Judge Jenkins also believed that Treasury regulations under § 199A, albeit not addressing the specific issue in the case, supported the taxpayers' interpretation of § 199A, not the IRS's interpretation as adopted by the majority. In particular, Judge Jenkins wrote in a rather long footnote:

> Treasury Regulation § 1.199A-3(b)(2)(ii)(H) underscores that the allocation of compensation deductions is to a trade or business and gross income therefrom, and not to qualified business income as defined in section 199A(c)(1). Furthermore, in prescribing when compensation "will *reduce* QBI" (emphasis added), and not just

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[2] The Tax Court explained in a footnote (*see* 165 T.C. at ____ footnote 10):

> We note that [the taxpayers] do not object to using wages limited by section 280E (that is, Deductible W–2 Wages) to calculate qualified business income for Tru Greenthumb and Fillabong. That is understandable, as using the lower wage number in this particular calculation produces greater qualified business income, and the potential for higher section 199A deductions for [the taxpayers]. But their interpretation of the statute produces an inconsistency: They ask us to use Deductible W–2 Wages for one aspect of the section 199A computation and Total W–2 Wages for another. The Commissioner's interpretation, by contrast, produces no such inconsistency.

> be taken into account in computing qualified business income or be allocable to qualified business income, it contradicts the understanding of the opinion of the Court of those concepts as being equivalent. *Compare* Treas. Reg. § 1.199A-3(b)(2)(ii)(H), *with* Treas. Reg. § 1.199A-3(b)(4) ("Expenses for all wages paid ... must be taken into account in computing QBI."), *and* Treas. Reg. § 1.199A-2(b)(4) ("W–2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI under § 1.199A-3."). And finally, by addressing the points separately, Treasury Regulation § 1.199A-3(b)(2)(ii)(H) also makes clear that the consideration of whether compensation is deductible for federal income tax purposes is separate and apart from the consideration of whether the compensation is properly allocable to a trade or business and thus the gross income and qualified business income therefrom.

Judge Jenkins also believed that, contrary to the majority, policy considerations supported the taxpayers' reading of 199A. Reciting that § 199A was enacted by Congress "to reduce the tax rate that applies to certain income from qualified trades or businesses" and create jobs (165 T.C. at ____), Judge Jenkins sought to rebut the majority's perception of an "inconsistency" in the taxpayers' position (*i.e.*, using only deductible W–2 wages for the QBI calculation but using total W-2 wages for the 50 percent wage limitation):

> [The taxpayers'] position is also supported by the rate reduction and job creation purposes of section 199A. Respondent argues, and the opinion of the Court apparently agrees, see op. Ct. note 10, that petitioners inappropriately seek to maximize the amount of their "W–2 wages" in order to maximize the amount of the deduction to which they are entitled. I appreciate the concern that petitioners are deducting the lower amount of wage expenses allowed after application of section 280E, thereby increasing their qualified business income under section 199A(c)(1), while seeking to take into account a higher amount of wage expenses unlimited by section 280E for purposes of the cap based on "W–2 wages." However, because the higher amount of "W–2 wages" is used only for purposes of the cap based on "W–2 wages," it does not allow the amount of the deduction to exceed 20% of qualified business income and taxable income (as determined for purposes of section 199A), which is higher simply by virtue of the application of section 280E. Accordingly, the drug-trafficking deterrence objective of section 280E is still furthered by the resulting overall tax burden relative to gross income, as compared to a business that is not subject to section 280E. And that is accomplished without a distorted reading of section 199A. Allowing a qualified business with meaningful wage expenses a deduction of up to 20% of taxable income, however taxable income is determined, is consistent with the goals of section 199A. Accordingly, I am not swayed by [the IRS's] equitable, policy-based argument [regarding consistency].

Finally, Judge Jenkins concluded that he would resolve the case in favor of the taxpayers because, when the words of a statute levying taxes are in doubt, the ambiguity should be resolved against the IRS and in favor of taxpayers. *Citing United States v. Merriam*, 263 U.S. 179, 187–88 (1923).

E. <u>Depreciation & Amortization</u>

F. <u>Credits</u>

G. <u>Natural Resources Deductions & Credits</u>

H. <u>Loss Transactions, Bad Debts, and NOLs</u>

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

1. You can't have your cake and eat it too, even if Bernie "Madoff" with the "ingredients" (i.e., the investments underlying your variable life insurance policy) Pascucci v. Commissioner, T.C. Memo. 2024-43 (4/15/24). This memorandum decision from the Tax Court (Judge Gustafson) illustrates one of the finer points of the theft loss deduction allowed by § 165(a) and (e). That is, to qualify for a deduction under § 165(a) and (e), the taxpayer himself, herself, or itself must be the victim of the theft, not merely suffer the collateral consequences of the crime. As Judge Gustafson recited in his opinion: "An individual claiming a theft loss deduction under § 165 must show for the taxable year in question that (1) a theft occurred, (2) there was no reasonable chance of recovery of the property, and (3) he *owned the property* at the time it was stolen." T.C. Memo. at ___ (emphasis added). Based upon stipulated facts and concessions by the IRS and the taxpayers in this case, the determinative issue was whether the taxpayers owned the investments underlying the taxpayers' private placement life insurance contracts.

Facts. The husband-and-wife taxpayers held numerous private placement variable life insurance policies. Essentially, a private placement variable life insurance policy is a portfolio of investments wrapped in a life insurance policy. Unlike a traditional life insurance policy, the premiums and the death benefit can fluctuate depending upon the "variable" performance of the investments underlying the policy. Further, the owner of the policy can, within limits set by the insurance carrier, direct the investments. Insurance carriers maintain separate accounts into which a policyholder's premiums are paid and invested. Nonetheless, the insurance contract must endow the carrier with ultimate ownership and control of the investments. In fact, the private placement memorandums in this case expressly stated that, for state law purposes, the carriers were the owners of the separately maintained accounts. Otherwise, § 72 (annuities and life insurance contracts) does not apply to protect the policyholder from being taxed on the income (the "inside buildup") generated by the investments. *See generally* Mancini & Sawyer, *Understanding Private Placement Life Insurance: Planning Opportunities and Pitfalls*, 162 Tr. & Est. 35 (2023). Here, the taxpayers' private placement variable life insurance policies became worthless in 2008 after investing with Bernie Madoff. Consequently, the taxpayers claimed an $8.2 million theft loss deduction for 2008 (under § 165(a) and (e)) and carried the loss back to 2005 and 2006. (Readers may recall that Madoff famously was convicted of theft in 2009 for running a sophisticated Ponzi scheme. Madoff was convicted and sentenced in 2009 to 150 years in prison, dying in 2021 while incarcerated.) The IRS examined the taxpayers' 2008 return and disallowed the 2008 theft loss deduction and carrybacks, issuing notices of deficiency totaling approximately $3.75 million for the taxpayers' taxable years 2005, 2006, and 2008. The taxpayers timely filed a petition in the Tax Court contesting the notices of deficiency.

The Arguments and Judge Gustafson's Opinion. The IRS's argument before Judge Gustafson was relatively simple: as required by § 72, the insurance carriers (either directly or through feeder fund partnerships in which they invested), not the taxpayer, owned the investments that were stolen by Madoff. The fact that the premiums were paid into, and the investments were segregated by, the carriers' separately maintained accounts did not make the taxpayers the owners of the investments. Thus, the insurance carriers (or the feeder fund partnerships in which they invested) were the victims of the theft, not the taxpayer. See, for example, authorities holding that the decline in value of stock, even if it is due to corporate theft, does not give rise to a theft loss deduction. Reg. § 1.165-4(a); *Marr v. Commissioner*, T.C. Memo. 1995-250; *Crowell v. Commissioner*, T.C. Memo. 1986-314; Notice 2004-27, 2004-1 C.B. 782; Rev. Rul. 2009-9, 2009-14 I.R.B. 735. The taxpayer made several counterarguments, none with success. We do not discuss here all of the taxpayer's unavailing arguments but instead focus on two that we find interesting. *One*, the taxpayers argued that, despite the fact they had never included in income the "inside buildup" of the policies (consistent with § 72), their limited ability to direct the carriers' investments among the feeder funds (including the exercise of certain voting rights and ultimately suffering the economic consequences of the funds' decisions) made them the "victims" of Madoff's theft. The taxpayers cited as support for their argument *Webber v. Commissioner*, 144 T.C. 324 (2015) (applying the "investor control doctrine" to treat the policyholder, not the carrier, of a private placement variable life insurance contract as the federal income tax owner of assets held in a segregated investment account underlying the policy). In other words, the taxpayers essentially were arguing that the variable life insurance wrappers should be disregarded notwithstanding the taxpayers' inconsistent position vis-à-vis the policies prior to 2008. Judge Gustafson's response to this argument essentially was that the taxpayers cannot have their cake and eat it too. Thus, even if the taxpayers via the carriers' separately maintained accounts may have had limited rights to pick among investment feeder funds (including concomitant voting rights), such rights were "typical rights contemplated by state law and do not qualify as an incident of ownership of the assets underlying the [p]olicies." T.C. Memo. 2024-43 at ___. *Two*, the taxpayers had qualified in 2018 for $202,766 in monetary relief from the Department of Justice's Madoff Victim Fund ("MVF"). The MVF was established by the DOJ to distribute more than $4 billion in forfeited assets to the "victims" of Bernie Madoff's Ponzi scheme. Judge Gustafson responded to this argument by clarifying that the MVF was "understood to be 'unique' (i.e., generous and broad) because of its focus on the 'ultimate investor' rather than on the feeder and mutual funds that had directly invested" with Madoff. T.C. Memo. 2024-43 at ___. Accordingly, qualifying for MVF relief was not determinative (or even particularly persuasive) that the taxpayers were "victims" of theft entitled to a deduction under § 165(a) and (e). Concluding his opinion, Judge Gustafson wrote: "The [taxpayers] are not entitled to a theft loss deduction under section 165 for the diminution in value of the assets in the separate accounts, because they did not own the assets at the time of the theft."

a. With zero fanfare, the Second Circuit affirms. Pascucci v. Commissioner, 136 A.F.T.R.2d 2025-6417 (2d Cir. 11/12/25), *aff'g* T.C. Memo. 2024-43 (4/15/24). The Court of Appeals for the Second Circuit has affirmed the Tax Court's decision in favor of the IRS and against the taxpayer in a brief, unpublished summary order. Wholeheartedly agreeing with Judge Gustafson's reasoning and opinion, the Second Circuit reiterated that the taxpayers had no state-law property interest in the assets underlying their variable life insurance policies. The court reassoned that, even assming for the sake of argument that the taxpayers possessed a sufficient property interest in the assets held in the separate accounts underlying their insurance policies, they "had no property interest in the funds ultimately stolen by Madoff." The separate accounts, the court noted, held limited partnership interests in a Delaware limited partnership that invested funds with Madoff. Under the Delaware limited partnership act (which is a version of the Revised Uniform Limited Partenrship Act), a partner has no interest in specific limited partnership property. For this reason, the taxpayers had no property interest in the money that the limited partnership invested with Bernie Madoff. Accordingly, the summary order closes as follows: "The Tax Court thus rightly concluded [the taxpayers] could not claim a theft loss deduction."

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. Individuals who are ages 60-63 will be able to make additional catch-up contributions to employer-sponsored plans beginning in 2025. Section 414(v) allows individuals who are age 50 and older to make so-called "catch-up" contributions to employer-sponsored retirement plans such as § 401(k) plans in addition to the basic amount ($22,500 in 2023) that individuals are allowed to contribute. The limit on catch-up contributions to employer plans other than SIMPLE plans is $7,500 in 2023, 2024, and 2025 and is adjusted annually for inflation. For SIMPLE plans, the limit on catch-up contributions is $3,500 in 2023, 2024, and 2025 and is adjusted annually for inflation. A provision of the SECURE 2.0 Act, Division T, Title I, § 109 of the Consolidated Appropriations Act, 2023, amended Code § 414(v)(2) to allow individuals who are ages 60 to 63 at the close of the taxable year to make larger catch-up contributions up to the "adjusted dollar amount," which is defined in new § 414(v)(2)(E). As defined, the adjusted dollar amount for employer plans other than SIMPLE plans is the greater of $10,000 or 150 percent of the regular catch-up contribution amount for 2024. For SIMPLE plans, the adjusted dollar amount is the greater of $5,000 or 150 percent of the regular catch-up contribution limit for 2025. The increased limits on catch-up contributions will be adjusted annually for inflation after 2025. This change is effective for taxable years beginning after 2024.

- The ability of those ages 60 to 63 to make larger catch-up contributions to employer-sponsored plans takes effect in 2025. In that year, the limit on such catch-up contributions for plans other than SIMPLE plans is the greater of $10,000 or 150 percent of the regular catch-up contribution limit for 2024. For SIMPLE plans, the limit on such increased catch-up contributions is the greater of $5,000 or 150 percent of the regular catch-up contribution limit for 2025. Because the regular catch-up contribution limit for plans other than SIMPLE plans is $7,500 in 2024, and 150 percent of that figure is $11,250, the larger catch-up contribution limit for those ages 60 to 63 in 2025 is greater than $10,000 in the first year it is effective. Similarly, because the regular catch-up contribution limit for SIMPLE plans is $3,500 in 2025, and 150 percent of that figure is $5,250, the larger catch-up contribution limit for SIMPLE plans for those ages 60 to 63 in 2025 is greater than $3,500 in the first year it is effective.

a. Final regulations provide guidance on the increased limits for catch-up contributions made by those ages 60-63. T.D. 10033, Catch-Up Contributions, 90 F.R. 44527 (9/16/25). Treasury and the IRS have finalized proposed regulations[3] addressing the increased limits for taxable years beginning after 2024 on catch-up contributions reflected in the amendments to Code § 414(v)(2) enacted by the SECURE 2.0 Act for those ages 60 to 63. Section 1.414(v)-1(c)(2)(i) of the regulations sets forth the increased limit on catch-up contributions for employer plans other than SIMPLE plans. This provision specifies that, for taxable years beginning after 2024, the limit on catch-up contributions for participants in plans other than SIMPLE plans who attain ages 60-63 during the year is $11,250 (150 percent of the $7,500 limit that was in effect for 2024). Section 1.414(v)-1(c)(2)(ii) of the regulations sets forth the increased limit on catch-up contributions for employer plans that are SIMPLE plans. This provision specifies that, for taxable years beginning after 2024, the limit on catch-up contributions for participants in SIMPLE plans who attain ages 60-63 during the year is $5,250 (150 percent of the $3,500 limit that is in effect for 2025). The regulations also provide that the $11,250 and $5,250 figures will be adjusted for inflation for taxable years beginning after 2025. Reg. § 1.414(v)(1)(c)(2)(iii)(B). According to Reg. § 1.414-1(i)(2)(i), the portions of the regulations providing for increased limits on catch-up contributions for those ages 60-63 apply to contributions in taxable years beginning after

[3] REG-101268, Catch-Up Contributions, 90 F.R. 2645 (1/13/25).

December 31, 2026, or, at the election of the taxpayer, taxable years beginning after December 31, 2024. Because the effective date of the statutory amendments that authorize increased catch-up contribution limits by those ages 60-63 are effective for taxable years beginning after 2024, the increased limits apply to contributions made in 2025.

2. Effective in 2024, all catch-up contributions to employer-sponsored plans must be deposited in a Roth account if the participant had wages in the preceding year of more than $145,000. A provision of the SECURE 2.0 Act, Division T, Title VI, § 603 of the Consolidated Appropriations Act, 2023, amended Code § 414(v) by adding new § 414(v)(7). New § 414(v)(7) provides that, if a participant in an employer-sponsored retirement plan had wages in the preceding calendar year from the employer sponsoring the plan that exceeded $145,000, then the participant cannot make catch-up contributions unless those contributions are designated Roth contributions. This $145,000 figure will be adjusted for inflation in tax years beginning after 2024. The legislation further provides that, if this new "Roth-only" rule applies to any participant for the year, then no participant in the plan can make catch-up contributions unless the plan offers all participants a Roth option. This rule effectively will force employer-sponsored plans to offer Roth options to their participants. These changes apply to taxable years beginning after December 31, 2023.

a. Apparently, the IRS can simply ignore the effective date of a legislative change. The IRS has announced a two-year "administrative transition period" that has the effect of delaying the effective date of the "Roth-only" rule for catch-up contributions until taxable years beginning after 2025. Notice 2023-62, 2023-37 I.R.B. 817 (8/25/23). In response to concerns expressed by taxpayers regarding the timely implementation of the new "Roth-only" rule (new § 414(v)(7)) enacted as part of the Consolidated Appropriations Act, 2023, for catch-up contributions by employees with wages in the preceding calendar year that exceeded $145,000, the IRS has effectively delayed the effective date of the Roth-only rule. As enacted, the Roth-only rule applies to taxable years beginning after December 31, 2023. In this notice, however, the IRS has announced a two-year "administrative transition period." Specifically, until taxable years beginning after December 31, 2025:

> (1) … catch-up contributions will be treated as satisfying the requirements of section 414(v)(7)(A), even if the contributions are not designated as Roth contributions, and (2) a plan that does not provide for designated Roth contributions will be treated as satisfying the requirements of section 414(v)(7)(B).

The notice also announces that the Treasury Department and the IRS plan to issue further guidance to assist taxpayers with the implementation of the new Roth-only rule. The guidance expected to be issued includes:

- "Guidance clarifying that section 414(v)(7)(A) of the Code would not apply in the case of an eligible participant who does not have wages as defined in section 3121(a) (that is, wages for purposes of the Federal Insurance Contributions Act (FICA)) for the preceding calendar year from the employer sponsoring the plan." Thus, a partner or other self-employed person, neither of whom receives wages from the business, would not be subject to the Roth-only rule.
- "Guidance providing that, in the case of an eligible participant who is subject to section 414(v)(7)(A), the plan administrator and the employer would be permitted to treat an election by the participant to make catch-up contributions on a pre-tax basis as an election by the participant to make catch-up contributions that are designated Roth contributions." Apparently, this approach would permit the plan administrator and the employer to treat an employee as having elected to make catch-up contributions to a Roth account even though the employee actually elected to make catch-up contributions on a pre-tax basis.

- "Guidance addressing an applicable employer plan that is maintained by more than one employer (including a multiemployer plan). The guidance would provide that an eligible participant's wages for the preceding calendar year from one participating employer would not be aggregated with the wages from another participating employer for purposes of determining whether the participant's wages for that year exceed $145,000 (as adjusted). For example, under that guidance, if an eligible participant's wages for a calendar year were: (1) $100,000 from one participating employer; and (2) $125,0000 from another participating employer, then the participant's catch-up contributions under the plan for the next year would not be subject to section 414(v)(7)(A) (even if the participant's aggregate wages from the participating employers for the prior calendar year exceed $145,000, as adjusted). The guidance also would provide that, even if an eligible participant is subject to section 414(v)(7)(A) because the participant's wages from one participating employer in the plan for the preceding calendar year exceed $145,000 (as adjusted), elective deferrals made on behalf of the participant by another participating employer that are catch-up contributions would not be required to be designated as Roth contributions unless the participant's wages for the preceding calendar year from that other employer also exceed that amount."

The Treasury Department and the IRS have invited comments regarding the matters discussed in the notice and any other aspect of the new Roth-only rule. Comments must be submitted on or before October 24, 2023.

b. Final regulations provide guidance on the requirement that catch-up contributions to employer-sponsored plans by participants who had wages over $145,000 in the preceding year must be designated Roth contributions. T.D. 10033, Catch-Up Contributions, 90 F.R. 44527 (9/16/25). Treasury and the IRS have finalized proposed regulations[4] addressing Code § 414(v)(7) enacted as part of the SECURE 2.0 Act. Section 414(v)(7) provides that, if a participant in an employer-sponsored retirement plan had wages in the preceding calendar year from the employer sponsoring the plan that exceeded $145,000, then the participant cannot make catch-up contributions unless those contributions are designated Roth contributions. This rule is reflected in Reg. § 1.414(v)-2(a). Section 1.414(v)-2(a)(4) of the regulations specifies, consistent with Code § 414(v)(7)(C), that this Roth-only rule does not apply to a SEP arrangement or a SIMPLE IRA plan. Among other guidance, the regulations set forth the rules that were previewed in Notice 2023-62:

- Section 1.414(v)-2(a)(2) of the regulations provides that the Roth-only rule does not apply in the case of an eligible participant who did not have wages as defined in section 3121(a) (that is, wages for purposes of the Federal Insurance Contributions Act (FICA)) for the preceding calendar year from the employer sponsoring the plan. Thus, a partner or other self-employed person, neither of whom receives wages from the business, would not be subject to the Roth-only rule. The regulations also clarify that the $145,000 wage threshold need not be prorated for the first year of hire. Thus, if an employee worked for the employer sponsoring the plan for only part of the preceding calendar year, the employee is subject to the Roth-only rule only if the employee had wages in the preceding year that exceeded the full $145,000 threshold.

- Section 1.414(v)-2(b)(4) and (b)(5) of the regulations provides that, if an applicable employer plan is maintained by more than one employer (including a multiemployer plan), then an eligible participant's wages for the preceding calendar year from one participating employer are not aggregated with the wages from another participating employer for purposes of determining whether the participant's wages for that year exceed $145,000 (as

[4] REG-101268-24, Catch-Up Contributions, 90 F.R. 2645 (1/13/25).

adjusted). Similarly, if an eligible participant is subject to the Roth-only rule because the participant's wages from one participating employer in the plan for the preceding calendar year exceed $145,000 (as adjusted), elective deferrals made from the participant's compensation from another participating employer that are catch-up contributions are not required to be designated as Roth contributions unless the participant's wages for the preceding calendar year from that other employer also exceed that amount.

- Sections 1.401(k)-1(f)(5)(iii) and 1.403(b)-3(c)(1) of the regulations provide that, in the case of an eligible participant who is subject to the Roth-only rule, the plan administrator and the employer are permitted to treat an election by the participant to make catch-up contributions on a pre-tax basis as an election by the participant to make catch-up contributions that are designated Roth contributions. This approach permits the plan administrator and the employer to treat an employee as having elected to make catch-up contributions to a Roth account even though the employee actually elected to make catch-up contributions on a pre-tax basis.
- Section 1.414(v)-2(a)(5) of the regulations provides that, if a participant subject to the Roth-only rule is permitted to make catch-up contributions to a Roth account, then the plan must permit all employees eligible to make catch-up contributions to make those contributions to a Roth account.

For plans that are not maintained pursuant to a collective bargaining agreement, these rules would apply to contributions in taxable years beginning after December 31, 2026. A slightly different effective date applies to plans that are maintained pursuant to a collective bargaining agreement. Nevertheless, all plans are permitted to apply these rules with respect to contributions in taxable years beginning after December 31, 2023. Prior to the applicability date of the final regulations, a reasonable, good faith interpretation standard applies with respect to the statutory provisions reflected in the final regulations.

3. Some inflation-adjusted numbers for 2026. Notice 2025-67, 2025-49 I.R.B. 761 (11/13/25).

- The 2026 limit on elective deferrals in §§ 401(k), 403(b), and 457 plans is increased to $24,500 (from $23,500) with a catch-up provision for employees aged 50 or older that is increased to $8,000 (from $7,500). For individuals who attain ages 60-63 in 2026, the limit on catch-up contributions is $11,250 (unchanged from 2025).

- The limit on contributions to an IRA is increased to $7,500 (from $7,000) with a catch-up provision for those aged 50 or older that is increased to $1,100 (from $1,000). The AGI phase-out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $81,000-$91,000 (from $79,000-$89,000) for single filers and heads of household, increased to $129,000-$149,000 (from $126,000-$146,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $242,000-$252,000 (from $236,000-$246,000) for an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered. The phase-out range for contributions to a Roth IRA is increased to $242,000-$252,000 (from $236,000-$246,000) for married couples filing jointly, and increased to $153,000-$168,000 (from $150,000-$165,000) for singles and heads of household.

- The limit on the annual benefit from a defined benefit plan under § 415 is increased to $290,000 (from $280,000).

- The limit for annual additions to defined contribution plans is increased to $72,000 (from $70,000).

- The amount of compensation that may be taken into account for various plans is increased to $360,000 (from $350,000), and is increased to $535,000 (from $520,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $80,500 (from $79,000) for married couples filing jointly, increased to $60,375 (from $59,250) for heads of household, and increased to $40,250 (from $39,500) for singles and married individuals filing separately.

The following table summarizes key figures from the notice:

Category	2024	2025	2026
Elective deferrals - 401(k) plans	$23,000	$23,500	$24,500
Catch-up contributions to employer-sponsored plans (age 50+)	$7,500	$7,500[5]	$8,000[6]
IRA contribution limit	$7,000	$7,000	$7,500
Catch-up contributions to IRAs (age 50+)	$1,000	$1,000	$1,100

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Standard deduction for 2026. Rev. Proc. 2025-32, 2025-45 I.R.B. 695 (10/9/25). The standard deduction for 2026 will be $32,200 for joint returns and surviving spouses (increased from $31,500), $16,100 for unmarried individuals and married individuals filing separately (increased from $15,750), and $24,150 for heads of households (increased from $23,625). For individuals who can be claimed as dependents, the standard deduction cannot exceed the greater of $1,350 (unchanged from 2025) or the sum of $450 (unchanged from 2025) and the individual's earned income. The additional standard deduction amount for those who are legally blind or who are age 65 or older is $2,050 (increased from $2,000) for those with the filing status of single or head of household (and who are not surviving spouses) and is $1,650 (increased from $1,600) for married taxpayers ($3,300 on a joint return if both spouses are age 65 or older).

[5] $11,250 if ages 60-63.

[6] $11,250 if ages 60-63.

The following table sets forth the standard deduction for each filing status a taxpayer might have:

Filing Status	2024	2025	2026
Single/MFS	$14,600	$15,750	$16,100
Head-of-Household	$21,900	$23,625	$24,150
MFJ and Surviving Spouses	$29,200	$31,500	$32,200

2. Some good news for workers who depend on tips: up to $25,000 of tip income can be deducted, at least through 2028. The 2025 One Big Beautiful Bill Act, § 70201, added new § 224 of the Code (and renumbered existing § 224 as § 225). New § 224(a) authorizes an individual to deduct the amount of "qualified tips" that the individual receives.

Qualified tips. The term "qualified tips" is defined in § 224(d)(1) as the *cash tips* an individual receives in an occupation that "customarily and regularly received tips on or before December 31, 2024," as provided in guidance to be published by the IRS. The legislation directs the Secretary of the Treasury to publish a list of such occupations not later than 90 days after the date of enactment. Because the date of enactment was July 4, 2025, the list should be published by October 2, 2025. A "cash tip," according to § 224(d)(3), includes "tips received from customers that are paid in cash or charged and, in the case of an employee, tips received under any tip-sharing arrangement." An amount received is not a qualified tip, under § 224(d)(2)(A), unless the amount is "paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor." Further, under § 224(d)(2)(B), an amount is not a qualified tip if it is received in a specified service trade or business as defined in § 199A(d)(2), even if the tip is received by an employee in the trade or business. Readers will recall that a specified service trade or business for this purpose includes most professional services, including the practice of law, medicine, and accounting. In addition, under § 224(d)(2)(C), an amount can be a qualified tip only if it meets any other requirements established by the IRS in published guidance. Finally, to be considered a qualified tip, an amount must either be reported on certain statements furnished to the individual, such as a W-2 or 1099 form, or be reported by the individual on Form 4137, which is the form used to determine Social Security and Medicare tax owed on tips the individual did not report to the individual's employer.

Self-employed individuals. Section 224(c) makes clear that the deduction is available not only to employees, but also to those who are self-employed. In the case of a self-employed individual, however, the deduction cannot exceed the amount by which the taxpayer's gross income from the trade or business for the year (including tip income) exceeds the deductions allocable to the trade or business. This effectively means that the deduction for tip income can reduce income from the trade or business to zero, but cannot create a loss. For example, if a self-employed individual has $150,000 of gross income from the trade or business, including $20,000 of tip income, and has $140,000 of other allowable deductions for the trade or business, the taxpayer's deduction for tips is limited to $10,000 ($150,000-$140,000). In addition, § 224(d) provides that any amount for which a deduction is allowed under § 224 is excluded from the taxpayer's qualified business income for purposes of § 199A. Thus, in the example just given, if the self-employed individual has $20,000 of tip income and is able to deduct $10,000 of it under § 224, then only the remaining $10,000 of the tip income is taken into account in determining the taxpayer's qualified business income.

Limitations on the deduction. There are two limitations on the deduction. First, § 224(b)(1) provides that the amount allowed as a deduction under new § 224 cannot exceed $25,000. Second, § 224(b)(2) provides that the amount allowed as a 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). This means that, 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). These amounts are not adjusted for inflation. If the taxpayer receives less than $25,000 in tips, then the first limitation does not apply but the second limitation does. For example, if a single taxpayer with MAGI of $200,000 receives $12,000 in tips, then the first ($25,000) limitation has no impact, but 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).

Deduction available to non-itemizers. The deduction authorized by new § 224 is *not* an itemized deduction on Schedule A. Instead, it is a deduction that is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction. The deduction necessarily will be taken on Form 1040, similar to the existing deduction for qualified business income under § 199A, and will *not* be taken on Schedule C for self-employed individuals.

Other requirements. If an individual is married, then, according to § 224(f), the deduction for tip income is allowed only if the individual files a joint return with his or her spouse. One situation in which this rule would not apply is when a married person is eligible for head-of-household filing status because they support a child and live apart (and file separately) from their spouse. Such an individual is treated as not being married under § 7703(b). In addition, to claim the deduction for tip income, an individual must have (and include on the return) a Social Security Number issued by the due date of the return. Therefore, an individual with an Individual Taxpayer Identification Number (ITIN) is not eligible for the deduction.

Will we see large amounts of income being reclassified as "tips"? Maybe. But § 224(g) directs the Secretary of the Treasury to "prescribe such regulations or other guidance as may be necessary to prevent reclassification of income as qualified tips, including regulations or other guidance to prevent abuse of the deduction allowed by this section."

Reporting by employers. The legislation directs employers reporting compensation to employees on Form W-2 and businesses reporting payments to independent contractors on Form 1099 to provide "a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in section 224(d)(1) of the person receiving such tips." For tips required to be reported for periods before January 1, 2026, employers "may approximate a separate accounting of amounts designated as cash tips by any reasonable method specified by the Secretary." Guidance on the reporting requirements should be forthcoming.

State tax considerations. Although new § 224 allows deduction of tip income (subject to the limitations and requirements described above), states that impose an income tax on individuals may not allow the deduction, which means that tip income could be subject to state taxation.

Effective date. New § 224 applies to taxable years beginning after December 31, 2024. According to § 224(h), no deduction is allowed under § 224 for any taxable years beginning after December 31, 2028.

a. Although employers are required to report the amount of an individual's qualified tips, the IRS has announced that there will be no changes to the 2025 Form W-2, Form 1099-NEC, Form 1099-MISC, or Form 1099-K to accommodate such reporting. IR-2025-82 (8/7/25). As previously discussed, the 2025 One Big Beautiful Bill Act, § 70201, added new § 224 of the Code, which authorizes an individual to deduct the amount of "qualified tips" that the individual receives. The legislation directs employers reporting compensation to employees on Form W-2 or to independent contractors on Form 1099 to provide "a separate accounting of any such amounts reasonably designated as cash tips and the occupation … of the person receiving such tips." The IRS has announced, however, that "Form W-2, existing Forms 1099, and Form 941 and other payroll return forms will remain unchanged for TY 2025." In other words, these forms, such as an employee's W-2, will not be modified for 2025 to provide a space in which employers could report the amount of an employee's qualified tip income. The IRS also announced that forms will be updated for 2026, including changes to how tips are reported.

b. Proposed regulations provide guidance on the § 224 deduction for tips, including a list of occupations that customarily received tips on or before December 31, 2024. REG-110032-25, Occupations That Customarily and Regularly Received Tips; Definition of Qualified Tips, 90 F.R. 45340 (9/22/25). As discussed above, new § 224(a), enacted as part of the 2025 One Big Beautiful Bill Act, authorizes an individual to deduct the amount of "qualified tips" that the individual receives. To constitute qualified tips, they must be received in an occupation that "customarily and regularly received tips on or before December 31, 2024," as provided in guidance to be published by the IRS. The legislation directed the Secretary of the Treasury to publish a list of occupations. These proposed regulations both identify occupations that customarily and regularly received tips on or before December 31, 2024, and provide a definition of ''qualified tips'' for purposes of the new deduction for qualified tips. The regulations are proposed to apply for taxable years beginning after December 31, 2024. Taxpayers can rely on the proposed regulations for taxable years beginning after December 31, 2024, and on or before the date these regulations are published as final regulations in the Federal Register, provided that taxpayers follow the proposed regulations in their entirety and in a consistent manner.

c. Employers and other payors who fail to provide a separate accounting of qualified tips will not be subject to penalties for taxable year 2025 for failing to file correct information returns or failure to furnish correct payee statements, says the IRS. Notice 2025-62, 2025-48 I.R.B. 740 (11/5/25). As discussed above, new § 224(a), enacted as part of the 2025 One Big Beautiful Bill Act, authorizes an individual to deduct the amount of "qualified tips" that the individual receives. The legislation also directs employers reporting compensation to employees on Form W-2 or businesses reporting payments to independent contractors on Form 1099 to provide "a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in section 224(d)(1) of the person receiving such tips." In Notice 2025-62, the IRS has announced that taxable year 2025 will be a transition period. Specifically, for 2025, employers obligated to issue Form W-2, businesses that pay independent contractors and are required to issue Form 1099, and third-party settlement organizations required to issued Form 1099-K will not be subject to penalties if they fail to provide a separate accounting of the amount of qualified tips paid to the recipient or fail to provide the occupation of the recipient. The specific penalties waived are those imposed by § 6721 for failure to timely file a correct information return and those imposed by § 6722 for failure to timely furnish a correct payee statement to the recipient. The penalty relief is available only to the extent that the person with a reporting obligation otherwise files and furnishes a complete and correct return or statement. For this purpose, a complete return or statement must include the amount of qualified tips in the total amount reported. For example, in order to qualify for penalty relief, an employer required to issue Form W-2 must include the amount of qualified tips in the total compensation paid to the employee. Although those with a reporting obligation are not required to report the amount of qualified tips or the recipient's occupation for taxable year 2025, the notice provides that

> employers and payors are encouraged to provide employees and payees, particularly those in a tipped occupation, with the occupation codes and separate accountings of cash tips, such that the employee or payee has the information the employee or payee needs to determine whether the employee or payee can claim the deduction for qualified tips under section 224 for taxable year 2025. Employers are also encouraged to provide employees with information regarding whether the employer's trade or business is a specified service trade or business as defined in section 199A(d)(2). Employers and payors can make such information available to their employees and payees through an online portal, additional written statements furnished to the employees or payees, or other secure methods.

d. How can an employee or contractor determine the amount of their deduction for qualified tips for 2025 when employers and other payors are not required to separately account for qualified tips and Forms W-2 and 1099 may not include all necessary information? Here's how, says the IRS. Notice 2025-69, 2025-50 I.R.B. __ (11/21/25). As discussed above, new § 224(a), enacted as part of the 2025 One Big Beautiful Bill Act, authorizes an individual to deduct the amount of "qualified tips" that the individual receives. The legislation also directs employers reporting compensation to employees on Form W-2 or businesses reporting payments to independent contractors on Form 1099 to provide "a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in section 224(d)(1) of the person receiving such tips." The IRS previously announced (see Notice 2025-62, 2025-48 I.R.B. 740 (11/5/25)) that employers and other payors are not required to separately account for qualified tips for taxable year 2025. This means that Forms W-2 received by employees and Forms 1099 received by independent contractors for 2025 may not include the information individuals need to determine both their eligibility to deduct qualified tip income and the amount of their deduction. In Notice 2025-69, the IRS has provided guidance for individual taxpayers on how to satisfy the requirements for the deduction, including how to determine the amount of qualified tips for tax year 2025. The notice also provides transition relief for taxpayers regarding the requirement that qualified tips must not be received in the course of a trade or business that is a specified service trade or business.

How employees can determine the amount of qualified tips for 2025. The notice provides that, for taxable year 2025, employees can deduct the amount of their qualified tips even if the tips are not separately accounted for by their employer, provided that the tips are "properly reported" on the employee's Form W-2. Further, employees can determine the amount of their qualified tips in the following ways:

1. Use the total amount of Social Security tips reported in box 7 of the W-2;
2. Use the total amount of tips that the employee reports to the employer on Form 4070, *Employee's Report of Tips to Employer*, or on any similar substitute form;
    - Employees are required to report monthly to their employer on Form 4070 the amount of tips they receive for any month in which they receive $20 or more in tips while working for the employer. Employers use this information to determine the amounts to be reported on Form W-2 in boxes 1 (wages, tips, other compensation), 3 (Social Security wages), 5 (Medicare wages and tips), 7 (Social Security tips), and 8 (allocated tips), and to determine the appropriate withholding of income and employment taxes.
3. Use the amount of the employee's cash tips that an employer voluntarily reports in box 14 of Form W-2 or on a separate statement;
4. In addition to the three options discussed above, an employee can also include in the amount of qualified tips the amount of tips that the employee failed to report to the employer that the employee lists on line 4 of Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, which is a form the employee files with their return for the year.

How non-employees can determine the amount of qualified tips for 2025. The notice provides that, for taxable year 2025, non-employees[7] can deduct the amount of their qualified tips even if the tips are not separately accounted for by the payor on Forms 1099-MISC, 1099-NEC, or 1099-K, provided that the non-employee's cash tips are included in the total amounts reported as other income on Form 1099-MISC, as nonemployee compensation on Form 1099-NEC, or as payment

[7] The notice consistently uses the term "non-employee," which seems like an odd choice. It's unclear why the notice avoids using the term "independent contractor."

card/third-party network transactions on Form 1099-K. Further, non-employees can determine the amount of their qualified tips

> using earnings statements or other documentation such as receipts, point of-sale system reports, daily tip logs, third party settlement organization records, or other documentary evidence that corroborates the calculation of the total amount of tips that are qualified tips for tax year 2025. . . Non-employee payees may also consult with the payor regarding any available information that may assist in determining and documenting the amount of qualified tips.

Employees and contractors must be in an eligible occupation to claim the deduction for tips. The notice reminds employees and contractors that, even if the payor does not report to the recipient the recipient's occupation (a requirement that is waived for 2025 as previously discussed), recipients are responsible for determining whether they received the tips in an occupation that customarily and regularly received tips on or before December 31, 2024.

Temporary waiver of the rule that those receiving tips in a specified service trade or business cannot deduct tip income. The notice temporarily waives for both employees and contractors the requirement that a deduction for tips is not allowed if the tips are received in a specified service trade or business as defined in § 199A(d)(2), provided that the recipient is in an occupation that customarily and regularly received tips on or before December 31, 2024. This waiver is in effect until January 1 of the first calendar year following the issuance of final regulations regarding whether a trade or business is a specified service trade or business for purposes of § 224 and associated employer reporting. The notice mentions that Treasury and the IRS intend to issue proposed regulations and seek comment on these issues before issuing final regulations.

Examples. The notice provides helpful examples, including the following:

> **Example 2.** Employee B is a bartender. During tax year 2025, B reports $20,000 in tips to B's employer on Form 4070. B's 2025 Form W-2 reports $200,000 in box 1, an amount in excess of the social security wage base, and $15,000 in box 7. Additionally, B reports $4,000 of unreported tips on Form 4137, line 4, and includes this amount in income on B's Form 1040. B may use either the $15,000 in box 7 of the Form W-2, or the $20,000 of tips reported to B's employer on Forms 4070 in determining the amount of qualified tips for tax year 2025. Regardless of the option chosen, B may also include the $4,000 of unreported tips from Form 4137, line 4, in determining the amount of qualified tips.
>
> **Example 3.** Individual D is a self-employed travel guide who operates as a sole proprietor. In 2025, Individual D receives $7,000 in tips from customers paid through a third-party settlement organization as defined in section 6050W(b)(3). For tax year 2025, Individual D receives a Form 1099-K from an online booking platform that is a third-party settlement organization as defined in section 6050W(b)(3) showing $55,000 of total payments. The Form 1099-K does not separately identify the tips. However, Individual D keeps a log of each tour that shows the date, customer, and tip amount received. Because Individual D has daily tip logs substantiating the $7,000 tip amount, D may use the $7,000 tip amount in determining qualified tips for tax year 2025.

3. ♪♫ You get up every morning from your alarm clock's warning, Take the 8:15 into the city … Taking care of business and working overtime, work out.♫♪ Individuals can deduct up to $12,500 ($25,000 if MFJ) of overtime income, at least through 2028. The 2025 One Big Beautiful Bill Act, § 70202, added new § 225 of the Code (and renumbered existing § 225 as § 226). New § 225(a) authorizes an individual to deduct the amount of "qualified overtime compensation" that the individual receives and that is reported on certain statements furnished to the individual, such as a W-2 or 1099 form.

Qualified overtime compensation. The term "qualified overtime compensation" is defined in § 225(c)(1) as "overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act of 1938 *that is in excess of the regular rate* (as used in such section) at which such individual is employed" (emphasis added). Section 7 of the Fair Labor Standards Act (FLSA) requires that non-exempt employees be paid at least 1.5 times their regular rate for hours worked over 40 hours during the week. Thus, if a covered employee's regular rate of pay is $10 per hour, the employee must be paid at least $15 per hour for any hour worked over 40 hours. The language of new § 225(c)(1) indicates that only the amount in excess of the regular rate, i.e., $5 in this example, is qualified overtime compensation that can be deducted. Any amount that is a qualified tip within the meaning of new § 224(d), discussed earlier in this outline, is excluded from the category of qualified overtime compensation. Because qualified overtime compensation is defined as compensation required under the FLSA, any overtime compensation that is required by state law but not required by the FLSA would not qualify for the deduction.

Limitations on the deduction. Section 225(b) provides that the amount allowed as a deduction under new § 225 cannot exceed $12,500 ($25,000 for joint returns). This limit 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). This means that the deduction is completely phased out when a taxpayer's modified AGI reaches $275,000 ($550,000 for joint returns). These amounts are not adjusted for inflation.

Deduction available to non-itemizers. The deduction authorized by new § 225 is *not* an itemized deduction on Schedule A. Instead, it is a deduction that is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction. The deduction necessarily will be taken on Form 1040, similar to the existing deduction for qualified business income under § 199A.

Other requirements. If an individual is married, then, according to § 225(e), the deduction for overtime compensation is allowed only if the individual files a joint return with his or her spouse. One situation in which this rule would not apply is when a married person is eligible for head-of-household filing status because they support a child and live apart (and file separately) from their spouse. Such an individual is treated as not being married under § 7703(b). In addition, to claim the deduction for overtime compensation, an individual must have (and include on the return) a Social Security Number issued by the due date of the return. Therefore, an individual with an Individual Taxpayer Identification Number (ITIN) is not eligible for the deduction.

Administrative guidance to be issued. Section 225(f) directs the Secretary of the Treasury to "issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance to prevent abuse of the deduction allowed by this section."

Reporting by employers. The legislation directs employers issuing Form W-2 to employees to include "the total amount of qualified overtime compensation (as defined in section 225(c)." Similarly, the legislation directs those making payments to persons not treated as employees for tax purposes to provide "a separate accounting of any amount of qualified overtime compensation (as defined in section 225(c)." For overtime compensation required to be reported for periods before January 1, 2026, employers "may approximate a separate accounting of amounts designated as qualified overtime compensation by any reasonable method specified by the Secretary." Guidance on the reporting requirements should be forthcoming.

State tax considerations. Although new § 225 allows deduction of overtime compensation (subject to the limitations and requirements described above), states that impose an income tax on individuals may not allow the deduction, which means that overtime compensation could be subject to state taxation.

Effective date. New § 225 applies to taxable years beginning after December 31, 2024. According to § 225(g), no deduction is allowed under § 225 for any taxable years beginning after December 31, 2028.

a. Although those paying qualified overtime compensation are required to report the amount of such compensation, the IRS has announced that there will be no changes to the 2025 Form W-2, Form 1099-NEC, Form 1099-MISC, or Form 1099-K to accommodate such reporting. IR-2025-82 (8/7/25). As previously discussed, the 2025 One Big Beautiful Bill Act, § 70202, added new § 225 of the Code, which authorizes an individual to deduct the amount of "qualified overtime compensation" the individual receives and that is reported on certain statements furnished to the individual, such as a W-2 or 1099 form. The legislation directs employers issuing Form W-2 to employees to include "the total amount of qualified overtime compensation (as defined in section 225(c)." Similarly, the legislation directs those making payments to persons not treated as employees for tax purposes to provide "a separate accounting of any amount of qualified overtime compensation (as defined in section 225(c)." The IRS has announced, however, that "Form W-2, existing Forms 1099, and Form 941 and other payroll return forms will remain unchanged for TY 2025." In other words, these forms, such as an employee's W-2, will not be modified for 2025 to provide a space in which employers could report the amount of an employee's qualified overtime compensation. The IRS also announced that forms will be updated for 2026, including changes to how overtime pay is reported.

b. Employers and other payors who fail to provide a separate accounting of qualified overtime compensation will not be subject to penalties for taxable year 2025 for failing to file correct information returns or failure to furnish correct payee statements, says the IRS. Notice 2025-62, 2025-48 I.R.B. 740 (11/5/25). As discussed above, new § 225 of the Code authorizes an individual to deduct the amount of "qualified overtime compensation" the individual receives and that is reported on certain statements furnished to the individual, such as a W-2 or 1099 form. The legislation directs employers issuing Form W-2 to employees to include "the total amount of qualified overtime compensation (as defined in section 225(c)." Similarly, the legislation directs those making payments to persons not treated as employees for tax purposes to provide "a separate accounting of any amount of qualified overtime compensation (as defined in section 225(c)." In Notice 2025-62, the IRS has announced that taxable year 2025 will be a transition period. Specifically, for 2025, employers obligated to issue Form W-2 and businesses that pay independent contractors and are required to issue Form 1099 will not be subject to penalties if they fail to provide a separate accounting of the amount of qualified overtime compensation paid to the recipient. The specific penalties waived are those imposed by § 6721 for failure to timely file a correct information return and those imposed by § 6722 for failure to timely furnish a correct payee statement to the recipient. The penalty relief is available only to the extent that the person with a reporting obligation otherwise files and furnishes a complete and correct return or statement. For this purpose, a complete return or statement must include the amount of qualified overtime compensation in the total amount reported. For example, in order to qualify for penalty relief, an employer required to issue Form W-2 must include the amount of qualified overtime compensation in the total compensation paid to the employee. Although those with a reporting obligation are not required to report the amount of qualified overtime compensation for taxable year 2025, the notice provides that

> employers and payors are encouraged to provide employees and payees with separate accountings of overtime compensation such that the employee or payee has the information the employee or payee needs to determine whether the employee or payee can claim the deduction for qualified overtime compensation under section 225 for taxable year 2025. Employers and payors can make such information available to their employees and payees by including it in box 14 of the employee's Form W-2, or through an online portal, additional written statements furnished to the employees or payees, or other secure methods.

c. How can an employee or contractor determine the amount of their deduction for qualified overtime compensation for 2025 when employers and other payors are not required to separately account for overtime and Forms W-2 and 1099 may not include all necessary information? Here's how, says the IRS. Notice 2025-69, 2025-50 I.R.B. __ (11/21/25). As discussed above, new § 225 of the Code authorizes an individual to deduct the amount of "qualified overtime compensation" the individual receives and that is reported on certain statements furnished to the individual, such as a W-2 or 1099 form. The legislation directs employers issuing Form W-2 to employees to include "the total amount of qualified overtime compensation (as defined in section 225(c)." Similarly, the legislation directs those making payments to persons not treated as employees for tax purposes to provide "a separate accounting of any amount of qualified overtime compensation (as defined in section 225(c)." The IRS previously announced (see Notice 2025-62, 2025-48 I.R.B. 740 (11/5/25)) that employers and other payors are not required to separately account for qualified overtime compensation for taxable year 2025. This means that Forms W-2 received by employees and Forms 1099 received by independent contractors for 2025 may not include the information individuals need to determine the amount of their deduction. In Notice 2025-69, the IRS has provided guidance for individual taxpayers on how to satisfy the requirements for the deduction, including how to determine the amount of their qualified overtime compensation for tax year 2025.

How employees and contractors can determine the amount of qualified overtime for 2025. The notice provides that, for taxable year 2025, employees and contractors can deduct the amount of their qualified overtime compensation even if it is not separately accounted for by the payor, provided that the overtime compensation is "properly reported" on the recipient's Form W-2, 1099-NEC, or 1099-MISC. Generally, according to the notice, individuals can

> base the determination of the amount of qualified overtime compensation (subject to the other limitations and requirements for qualified overtime compensation in section 225 of the Code) on other documentation such as earnings or pay statements, invoices, or similar statements that support the determination, using a reasonable method described below to determine the amount of the qualified overtime compensation. Individuals who had multiple employers during 2025 may use different methods for each employer.

The methods that the notice describes as reasonable are as follows:

1. *Individuals receiving overtime compensation at 1.5 times their regular rate who receive a statement identifying the overtime premium (.5 portion of 1.5).* An individual who is paid overtime at 1.5 times their regular rate for hours worked over 40 hours during the week and who receives a statement that covers the entire 2025 tax year that separately accounts for the overtime premium (the .5 portion of the 1.5 times their regular rate) can use the amount identified on the statement.
    - <u>Example 1 from the notice</u>: Individual A has access to a payroll system that shows totals of amounts paid to Individual A in 2025, including the FLSA Overtime Premium paid during 2025. In 2025, Individual A is last paid wages on December 22, 2025, for the payroll period beginning on November 30, 2025, and ending on December 13, 2025. The payroll system shows $5,000 as the "overtime premium" that Individual A was paid during 2025. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual A may include $5,000 (the FLSA Overtime Premium).
2. *Individuals receiving overtime compensation at 1.5 times their regular rate who receive a statement reporting total overtime compensation (including regular pay).* An individual who is paid overtime at 1.5 times their regular rate for hours worked over 40 hours during the week and who receives a statement that covers the entire 2025 tax year that does <u>not</u> separately account for the overtime premium (the .5 portion of the 1.5 times their regular

rate), but that does report the total amount of overtime compensation, can use one-third of the total amount of overtime compensation identified on the statement.

- Example 2 from the notice: Individual A has access to a payroll system that shows the total amount of overtime compensation paid to Individual A in 2025. In 2025, Individual A is last paid wages on December 22, 2025, for the payroll period beginning on November 30, 2025, and ending on December 13, 2025. The payroll system shows total overtime compensation of $15,000. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, the individual may include $5,000 (the FLSA Overtime Premium, computed by dividing $15,000 by 3).

3. *Individuals receiving overtime compensation at more than 1.5 times their regular rate who receive a statement identifying the overtime premium (amount in excess of regular rate).* An individual who is paid overtime at a rate exceeding 1.5 times their regular rate for hours worked over 40 hours during the week (such as 2 times their regular rate) and who receives a statement that covers the entire 2025 tax year that separately accounts for the overtime premium (the portion in excess of their regular rate) can multiply that separate amount by an appropriate fraction to approximate the FLSA Overtime Premium. For example, if overtime is paid at a rate of 2 times the regular rate, the appropriate fraction is one-half. The result is that, if the employee is paid overtime at a rate that exceeds the "1.5 times regular pay" required by the FSLA, the employee can deduct only the overtime premium required by the FSLA and not more than that.

   - Example 3 from the notice. Individual B's employer has a practice of paying overtime at a rate of two times an employee's regular rate of pay and Individual B was paid $20,000 in overtime pay under that practice, although [the FSLA] only requires Individual B's employer to pay at one and one-half times the employee's regular rate. Individual B's last pay stub for 2025 shows "overtime premium" of $10,000 paid in 2025 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include $5,000 ($10,000 divided by 2).

4. *Individuals receiving overtime compensation at more than 1.5 times their regular rate who receive a statement reporting total overtime compensation (including regular pay).* An individual who is paid overtime at a rate exceeding 1.5 times their regular rate for hours worked over 40 hours during the week (such as 2 times their regular rate) and who receives a statement that covers the entire 2025 tax year that covers the entire 2025 tax year that does not separately account for the overtime premium (the amount in excess of their regular rate), but that does report the total amount of overtime compensation, can multiply the total amount of overtime compensation by an appropriately smaller fraction. For example, if overtime is paid at a rate of two times the regular rate, the appropriate fraction is one-fourth.

   - Example 4 from the notice. Individual B's employer has a practice of paying overtime at a rate of two times an employee's regular rate of pay and Individual B was paid $20,000 in overtime pay under that practice, although [the FSLA] only requires Individual B's employer to pay at one and one-half times the employee's regular rate. Individual B's last pay stub for 2025 shows a total "overtime" amount of $20,000 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate of pay combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include $5,000 (the FLSA Overtime Premium, computed by dividing $20,000 by 4).

5. *Individuals who receive a statement reporting total overtime compensation (including regular pay) but for whom methods 2 or 4, above, would underestimate their qualified overtime compensation.* If the method for determining the amount of qualified overtime compensation described in methods 2 or 4, above, would result in underestimating the employee's qualified overtime compensation (for example, because the individual's regular rate is increased by a nondiscretionary bonus), the individual may adjust the method described to take the difference into account.
6. *Individuals who do not receive a statement that separately accounts for overtime.* Individuals who do not receive a statement that separately accounts for either the overtime premium or total amount of overtime compensation can use "a reasonable method" that takes into account the individual's regular rate of pay and their hours of service in excess of 40 hours in a workweek or "a reasonable approximation if the individual does not have records of actual hours of service." For this purpose, "[a] reasonable method includes requesting information from the individual's employer and using the information provided by the employer for purposes of calculating the deduction."
7. *Individuals whose overtime is determined differently under the FLSA.* The overtime compensation of certain categories of employees, including those in fire protection and law enforcement, certain government employees, and employees of hospitals or certain residential care facilities, is not determined on the basis of hours worked in excess of 40 hours per week, but instead is determined on a different basis. In such cases:

    > the individual must compute the amount of overtime compensation by operation of the different overtime rules used in the relevant provision of [the FLSA] that apply to the individual and may use any reasonable method contained in this notice that takes those alternative overtime rules into account.

    - <u>Example 5 from the notice</u>. Individual C works in law enforcement and is paid $15,000 of total annual overtime pay on a "work period" basis of 14 days that complies with section 207(k) of the FLSA. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual C may include $5,000 ($15,000 divided by 3).[8]
    - <u>Example 6 from the notice</u>. Individual D works for a State or local government agency that gives compensatory time at a rate of one and one-half hours for each overtime hour worked under 29 USC 207(o) [the FLSA]. In 2025, Individual D was paid wages of $4,500 with respect to compensatory time off taken in accordance with section 207(o). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual D may include $1,500, one-third of these wages for purposes of determining qualified overtime compensation under section 225(c).

Finally, the notice recognizes that determining the amount of qualified overtime compensation for 2025 may be difficult and seems to grant some leniency:

> The Treasury Department and the IRS are aware that documents such as earnings statements and pay stubs take a variety of forms, and employers and other service recipients provide overtime compensation in a variety of ways (including, for example, combining State-required and FLSA-required overtime). Individuals may use the amounts reported as overtime compensation on earnings statements, pay stubs, and other documentation provided by payors to calculate the FLSA Overtime Premium for 2025. For example, individuals may approximate the amounts of FLSA Overtime Premium by using overtime amounts reported on a pay statement

[8] The notice provides a link to a fact sheet from the Department of Labor that indicates that law enforcement personnel are due overtime after 106 hours worked during a 14-day period.

or similar document that covers all wages paid in 2025. See Example 1. In all cases, individuals must maintain copies of any documents they rely on in accordance with IRS recordkeeping requirements.

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

1. Congress has made the increased exemption amounts and increased phaseout thresholds for the individual AMT permanent, but also made other changes that will cause more individuals to become subject to the AMT in 2026. The 2025 One Big Beautiful Bill Act, § 70107, amended Code § 55(d)(4) to make permanent the increased AMT exemption amounts for non-corporate taxpayers and the increased thresholds at which the exemption amounts phase out that were enacted in the 2017 Tax Cuts and Jobs Act. The 2017 Tax Cuts and Jobs Act, § 12002, amended Code § 55(d) by adding § 55(d)(4), which increases the AMT exemption amount for non-corporate taxpayers as well as the thresholds for alternative minimum taxable income above which the exemption amount phases out. These changes applied to taxable years beginning after 2017 and before 2026; the figures are adjusted for inflation for taxable years beginning after 2018. The TCJA did not change the exemption amount or the phase-out threshold for trusts and estates. The 2025 One Big Beautiful Bill Act removed from § 55(d)(4) the scheduled ending date of taxable years before 2026, which has the effect of making these increased figures permanent. However, the OBBBA also modified the phase-out thresholds for the exemption amount in two ways that will adversely affect taxpayers. *First*, the phase-out thresholds for 2026 will revert to the levels initially enacted in the 2017 TCJA and will be adjusted for inflation for years after 2026. *Second*, the phase-out of the exemption amount will be accelerated beginning in 2026. Under the rules enacted in the 2017 TCJA for 2018-2025, § 55(d)(2) provides that the exemption amount is reduced by an amount equal to *25 percent* of the amount by which the taxpayer's alternative minimum taxable income exceeds the phase-out threshold. The OBBBA modified the phaseout to provide that, for taxable years beginning after 2025, the exemption amount is reduced by an amount equal to *50 percent* of the amount by which the taxpayer's alternative minimum taxable income exceeds the phase-out threshold. This will result in higher-income taxpayers losing their exemption amount more quickly than under current law. The effect of both changes combined will be to make more non-corporate taxpayers subject to the AMT. The relevant figures for 2025 and 2026 are shown in the following tables:

AMT Exemption Amount		
Filing Status	**2025**	**2026[9]**
Married Filing Separately	$68,500	$70,100
Single and HOH	$88,100	$90,100
Married Filing Jointly and	$137,000	$140,200

AMTI Phase-Out Thresholds		
Filing Status	**2025**	**2026[10]**
Married Filing Separately	$626,350	$500,000
Single and HOH	$626,350	$500,000
Married Filing Jointly and	$1,252,700	$1 million

[9] *See* Rev. Proc. 2025-32, § 4.10, 2025-45 I.R.B. 695 (10/09/25).

[10] *See* Rev. Proc. 2025-32, § 4.10, 2025-45 I.R.B. 695 (10/09/25).

Surviving Spouses		
Estates and Trusts	$30,700	$31,400

Surviving Spouses		
Estates and Trusts	$102,500	$104,800

VI. CORPORATIONS

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

XIII. TRUSTS, ESTATES & GIFTS