

2025 MID-YEAR INDIVIDUAL FEDERAL TAX UPDATE



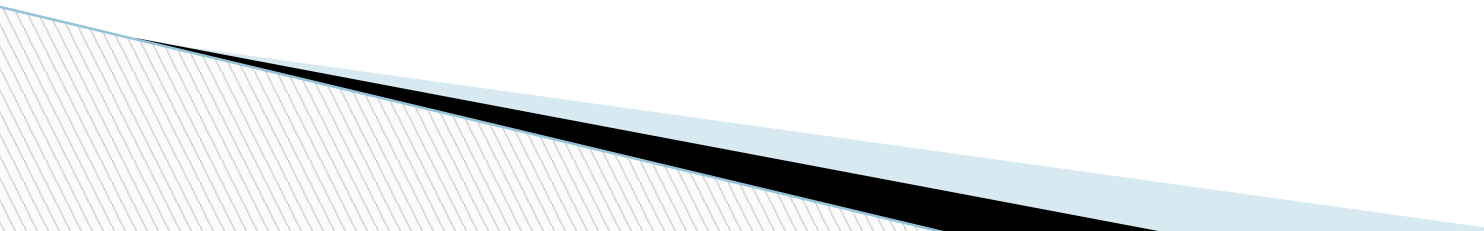
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Today's Instructor

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Disclaimer



The Big, Beautiful Bill!

Individual Changes

(Passed by the House of Representatives)

- **Sunsets Eliminated.** All references to provision of the Tax Cuts and Jobs Act of 2017 (“TCJA”) where changes by the TCJA were scheduled to sunset on December 31, 2025, have been repealed.
 - **In other words, the provisions scheduled to sunset have been made permanent.**
- **Ordinary Income Tax Rates.** The maximum rate of 37% for individuals is made permanent.
- **Standard Deductions.** For tax years of 2025 to 2028, the standard deduction is increased to \$26,000 for joint filers (from \$24,000), to \$19,500 for head of household filers (from \$18,000), and to \$13,000 for all other filers (from \$12,000).
- **Personal Exemption Elimination.** The personal exemption is repealed permanently.
- **Section 199A.** The deduction for qualified business income is increased to 23% and made permanent.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Enhanced Deduction For Senior Citizens.** Senior taxpayers will be allowed an increased standard deduction.
 - Additional \$4,000 deduction for seniors for taxable years 2025-2028.
 - Reduction of the additional amount by 4% for modified adjusted gross income exceeding \$75,000.
 - Requires social security numbers for tax returns to claim the deduction.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Itemized Deduction Limits.** Itemized deductions will be reduced by $\frac{2}{37}$ of the lesser of the itemized deductions or the excess of taxable income over the 37% tax bracket threshold.
 - This is a modified version of the old “Pease Limitations”.
 - **Point of Reference:** The 37% bracket begins at \$751,600 for married couples filing joint returns in 2025.
 - Effectively, this rule creates an additional 39% tax bracket equal to itemized deductions in excess of the 37% bracket threshold.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **SALT Deduction Cap Increased; SALT Denied for Various Service Professionals.** The State and Local Tax (“SALT”) deduction cap is made permanent and raised to \$30,000, going down to \$10,000 at a rate of 20% beginning at income of \$200,000 for single filers and \$400,000 for joint filers.
 - Pass-through entity tax (“PTET”) deductions are denied for individuals who perform services in the fields of health, law, accounting actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing services, investment management services, and trading or dealing in securities, partnership interests, or commodities, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.
 - Therefore, under the House Bill, asset managers who are partners in partnerships will not be permitted to deduct their share of state and local taxes.
 - In addition, the House Bill seems to disallow deductions for taxes imposed on the partnership (such as the New York City unincorporated business tax).

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Limitation on SALT Deductions.** The bill outlines new limitations on individual deductions for certain state and local taxes, including specific caps based on filing status and income levels.
 - The changes aim to phase down the deduction limits for higher-income taxpayers while defining various tax terms and exceptions.
 - No deduction allowed for disallowed foreign real property taxes.
 - Specified taxes deduction capped at \$15,000 for married individuals filing separately and \$30,000 for other taxpayers.
 - Phase down of deduction limits by 20% for modified adjusted gross income exceeding \$200,000 (married filing separately) or \$400,000 (other taxpayers).
 - Minimum deduction limits set at \$5,000 and \$10,000 for married individuals filing separately and other taxpayers, respectively.
 - Definitions provided for disallowed foreign real property tax, specified tax, excepted tax, and substitute payment.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Limitations on Deductions for Residential Interest.** This section extends the limitations on the deduction for qualified residence interest.
 - The amendments will apply to taxable years starting after December 31, 2025.
 - The limitation on the deduction for qualified residence interest is extended beyond January 1, 2026.
 - The effective date for these changes is for taxable years beginning after December 31, 2025.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Deductions for Tips.** Taxpayers earning \$160,000 or less in 2025 (adjusted in the future for inflation) will be permitted a deduction for cash tips from an occupation that “traditionally and customarily received tips” to the extent the gross receipts of the taxpayer from the trade or business of receiving the tips exceeds the sum of the cost of goods sold allocable to the receipts and other expenses, losses, or deductions properly allocable to those receipts.
 - This deduction is allowed for tax years 2025 through 2028.

Individual Changes (cont.)

(Passed by the House of Representatives)

• **Overtime Compensation Deductions.** A deduction will be allowed for qualified overtime compensation received by individuals, applicable to taxable years starting after December 31, 2024.

- The deduction is limited to overtime pay exceeding the regular rate and excludes amounts received by highly compensated employees.
- This deduction is allowed for tax years 2025 through 2028.
- This deduction is allowed for qualified overtime compensation received during the taxable year.
- Qualified overtime compensation must exceed the regular rate as defined by the Fair Labor Standards Act.
- Excludes amounts received by highly compensated employees.
- Requires social security numbers for tax returns to claim the deduction.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Expansion of Childcare Credits.** Employer-provided childcare credits are further expanded from 25% to 40% (and up to 50% for eligible small businesses).
 - The maximum annual credit is also increased from \$150,000 to \$500,000 for employers (up to \$600,000 for eligible small businesses).
- **Deductions for Car Loan Interest.** Deductions (up to \$10,000) of interest payments on car loans
 - This deduction is allowed from 2025 through 2028.
 - This deduction is allowed for itemizers and non-itemizers.
 - The deduction phases out for single taxpayers earning \$100,000 (\$200,000 for joint returns).

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Adoption Tax Credits.** Up to \$5,000 of adoption tax credits are refundable, which makes the credit available to lower-income families who do not earn sufficient income to pay tax.
- **Scholarship-Granting Tax Credits.** Tax credits are allowed for contributions by individuals to scholarship-granting organizations.
 - The credits may not exceed the greater of 10% of the taxpayer's adjusted gross income for the taxable year, or \$5,000.
- **Expansion of Qualified Tuition Programs (529 Accounts).** Qualified tuition programs that are exempt from federal tax are expanded to include tuition and material expenses for elementary, secondary, and home school expenses.
 - Qualified higher education expenses are also expanded to include tuition and expenses in connection with a recognized postsecondary credential program.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Extension of Increased Alternative Minimum Tax Exemption from TCJA.** The increased exemptions and increased exemption phase-outs from the individual alternative minimum tax are made permanent.
- **The \$750,000 Limitation on Qualified Residence Interest Deduction Is Made Permanent.** The \$750,000 limitation on deductions for qualified residence interest is made permanent.
- **Personal Casualty Loss Relief Further Extended.** The requirement that personal casualty loss deductions exceed 10% of adjusted gross income for taxpayers to benefit from deductions is waived for qualified disasters that occurred between December 2019 until 2025 (extended from 2020) and allows taxpayers to claim both a standard deduction and qualified disaster-related personal casualty losses.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Qualified Bicycle Commuting Reimbursements Are Taxable.** Reimbursements of bicycle commuting expenses are subject to income tax.
 - Before the TCJA, the reimbursements were not taxable.
- **Reimbursements for Personal Work-Related Moving Expenses Are Taxable.** Before the TCJA, deductions were given to certain personal moving expenses for employment purposes and gross income did not include qualified moving expense reimbursements from employers.
 - The deductions are permanently repealed, and the reimbursements are permanently taxable.
- **Student Loan Discharged on Death or Disability Made Tax-Free Permanently.** Discharged student loans on the account of death or disability is extended permanently.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Child Tax Credits Made Permanent.** The child tax credit is made permanent, and the maximum child tax credit is temporarily increased to \$2,500 (from \$2,000) from 2025 to 2028 (subsequent years will be \$2,000).
 - Social security numbers for the child will be required to qualify for child tax credit benefits.
- **Creation of “MAGA” Accounts.** Money Account for Growth Advancement (“MAGA”) accounts are tax-exempt trust accounts that can be created for U.S. citizens under age 18.
 - The funds from the MAGA accounts can be used for qualified expenses of the beneficiary such as higher education and first-time home purchases.
 - The House Bill provides a one-time \$1,000 federal credit per eligible child born between 2025 and 2028, which will be deposited directly into the child’s MAGA account.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Amendments to Clean Vehicle and Energy Credits.** Several clean vehicle and energy credits are set to terminate or be amended, including the clean vehicle credit and the energy-efficient home improvement credit, with new expiration dates established.
 - These changes aim to streamline and phase out certain tax incentives.
 - Clean vehicle credit under Section 30D to terminate after December 31, 2026.
 - Energy-efficient home improvement credit under Section 25C to terminate after December 31, 2025.
 - Various credits for clean energy and vehicles will see phased reductions.

Individual Changes (cont.)

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 - Various credits for clean energy and vehicles will see phased reductions.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Increased Estate and Gift Tax Exemption.** The exemption amounts will increase.
 - The amendments will apply to taxable years starting after December 31, 2025.
 - The exemption amount is increased from \$5 million to \$15 million.
 - Cost of living adjustments will continue.
 - The effective date for these changes is for taxable years beginning after December 31, 2025.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Reforms to the Earned Income Tax Credit.** The bill addresses needed reforms to the Earned Income Tax Credit (EITC) certification process to prevent erroneous claims and improve integrity.
 - Establishment of an EITC certification program to verify qualifying children for tax credits starting after December 31, 2027.
 - Taxpayers must apply for an EITC certificate to claim the credit for a qualifying child.
 - Penalties for misstatements in applications and restrictions on taxpayers with prior penalties are outlined.
 - A task force is created to explore improvements in EITC administration and integrity.

Individual Changes (cont.)

(Passed by the House of Representatives)

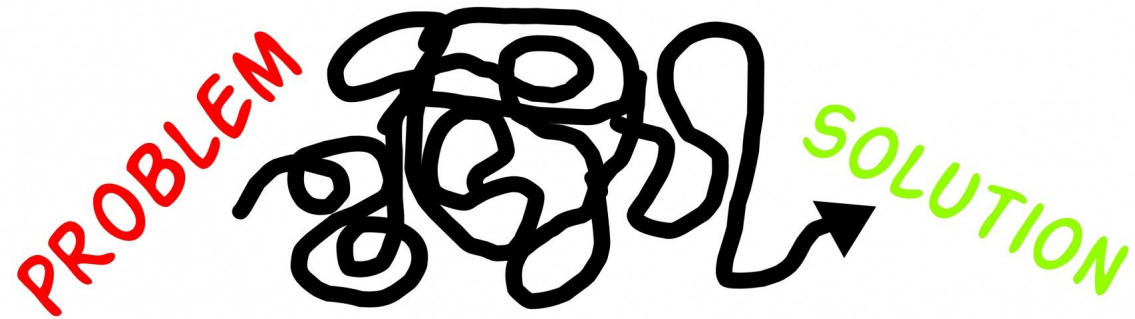
- **Postponement of Tax Deadline for Hostages.** The bill provides relief for U.S. nationals unlawfully detained abroad by postponing tax deadlines and allowing for refunds of penalties.
 - Tax deadlines are disregarded for individuals unlawfully detained abroad.
 - The Secretary of State and Attorney General will provide lists of applicable individuals to the Treasury.
 - Eligible individuals can apply for refunds of penalties and interest assessed during their detention.

Individual Changes (cont.)

(Passed by the House of Representatives)

- **Termination of Direct File Program.** The bill mandates the termination of the IRS Direct File program and the establishment of a task force to explore alternatives for free tax filing.
 - The IRS Direct File program must be terminated within 30 days of enactment.
 - A task force will be created to design a public-private partnership for free tax filing services.
 - The task force is allocated \$15 million for necessary expenses to report on the feasibility of the new approach.

Ex-Spouse
(or
soon-to-be
Ex-Spouse)
Issues



Preparing Tax Returns for Ex-Spouses

- Circular 230 §10.29, states that a practitioner may not represent potential conflicting interests in their practice.
- Dealings with spouses and ex-spouses can result in such conflicts of interest.
- Bigger risk is the attorney of one of the spouses.
- Good practice to only prepare one of the spouse's returns, and in some situations neither.
- If you feel you can provide your services without any conflict, it is strongly recommended that you obtain the consent of both spouses to disclose their tax return information to the other spouse.

Married Filing Separate

STANDARD OR ITEMIZED

- IRC §63(c)(6)(A) provides that a married individual filing a separate return where either spouse itemizes deductions shall have a standard deduction of zero.
 - Thus, if both spouse are filing MFS, if one itemizes the other cannot take the standard deduction.
 - Exception: That does not apply to a spouse filing as HH because that spouse is not considered married under IRC §7703(b).
 - Thus, that spouse can choose between the standard or Itemized deductions and is not required to itemize if the other spouse does.
 - Also, if the HH spouse itemizes then the MFS spouse must itemize.

Divorce Issues

DIVORCE



Tax Attributes - Divorce

- **Capital Loss Carryovers**

- Allocated to the spouse who originally incurred the loss
- Can be complicated
 - Acquired before or after marriage
 - Community or Separate property

- **Passive Loss Carryovers**

- Separately owned property: To the spouse that owns the property.
- Jointly owned or is community property:
 - Owned by both after the divorce, 50% to each spouse.
 - Where one spouse retains the property as part of a property settlement, 50% of the carryover becomes an adjustment to the basis of the property and the other 50% continues to be carryover for the spouse that retained the property.

Tax Attributes – Divorce (cont.)

- **Net Operating Loss (NOL) Carryovers**

- If married to each other in all NOL years – 50% to each.
- **If NOT**, the deduction may only be taken by the spouse who incurred the loss and only to offset income generated by that spouse in a carryback or carryforward year.

- **Joint Estimated Tax Payments**

- Made joint estimated tax but file separate returns:
 - Agree - Divide in any way on which they both agree.
 - Cannot agree – Prorate
 - Total estimated tax paid times the fraction which is the tax on their individual return divided by the sum of the tax shown on their individual returns for the year.

Tax Attributes – Divorce (cont.)

- **Transfers Incident to a Divorce**

- The recipient spouse's basis is the same as the transferor-spouse's adjusted basis. (IRC §1041(b)). This is the case even if:
 - The transaction is a sale between the spouses;
 - The transferee-spouse pays the transferor-spouse, per the divorce settlement) for the transfer of title to the property (Reg §1.1041-1T(a), Q&A-2); or
 - The adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of transfer.
 - Applies for purposes of determining loss as well as gain, upon later sale by the transferee (Reg § 1.1041-1T(d)).
- There are exceptions that may apply to certain transfers in trust (IRC §1041(e)) and transfers of installment obligations into a trust (IRC §453B(g)).

Basis Issues – Divorce

- Section 121 Home Gain Exclusion – If one of the spouses is awarded sole ownership of the couple's home that spouse assumes the community basis, and as such is responsible for the tax on any gain not excludable under IRC §121. Keep in mind the exclusion just dropped from \$500K to \$250K.
- Spousal Buy-Out Debt - In divorce situations, debt secured by the home to buy out a former spouse's interest in a home is acquisition debt.
- This rule is applied without regard to IRC §1041, which treats certain transfers of property between spouses incident to divorce as nontaxable events. (Notice 88-74, 1988-2 CB 385)

DEATH OF A TAXPAYER



Tax Attributes

- For married couples: Be sure to separate carryover losses and deductions between the decedent and the surviving spouse according to joint, individual and community property (where applicable) ownership before applying the following rules.
- **Medical Expenses**
 - Expenses paid up to the date of death itemized on final return.
 - Expenses paid by estate within one year of DOD, with executors' approval, can be itemized on the deceased's final return
 - Medical expenses cannot be claimed on a 1041.
- **Investment Interest Carryovers** – Lost if not used on the final 1040.
- **Net Operating Loss Carryover** – Lost if not used on the final 1040.
- **Charitable Carryover** – Lost if not used on the final 1040.
- **Capital Loss Carryover** – Lost if not used on the final 1040.

Tax Attributes (cont.)

- **Business Credit Carryovers** – Accelerated on decedent's final return.
- **Foreign Tax Credit Carryovers** – Can be used by the decedent's estate or heirs.
- **Passive Loss Carryover** - When a passive interest is transferred due to death, the accumulated suspended losses are deducted on the decedent's final return.
 - However, the deduction amount is limited to the excess of the basis of the property in the hands of the transferee (heir) over the decedent's adjusted basis in the property just before death.
- **Minimum Tax Credit Carryovers** - Lost if not used on the individual's final return.
- **Passive Activity Tax Credit** - Effectively lost if not used on final return.
- **Unrecovered Investment in Pensions** - Allowed as a tier 1 miscellaneous deduction on the decedent's final return. If an annuity for joint lives, only deductible on the 1040 of the last to die.

Tax Attributes (cont.)

- **Cancellation of Debt Income**

- COD income is reportable on the decedent's return if it occurred prior to death.
- If married and surviving spouse is also personally liable, the spouse would report the COD income on his or her 1040.
- If a debt is cancelled after death, the COD income is income to the estate or the non-grantor trust of the decedent and reportable as income on the 1041 return to the extent the estate/trust is solvent.

- **Income in Respect of a Decedent (IRD)**

- Is income included in estate's gross income (on Form 1041) and is also taxable to the beneficiary. As a result, it is taxed twice.
- Thus, a beneficiary gets a Tier 1 miscellaneous deduction equal to the estate tax paid on the IRD income.
- With the estate tax exclusion currently \$13,610,000 (2024), few estates are paying any tax, so a very rare deduction.
- Typical types of IRD include amounts received after the decedent's death as compensation for his or her personal services, retirement plan distributions, investment income, and income from installment notes.

Tax Attributes (cont.)

- **Insolvent Estate**

- Tax liability must be paid first.
- Executor is liable for the taxes if they fail to exercise due care in determining if such tax obligations existed before distribution of the estate's assets.
- So, don't distribute any assets before paying the tax liability.

FOREIGN RELATED REPORTING ISSUES



FinCEN Form 114 (“FBAR”)

- U.S. Persons with a financial interest in or signature authority over any foreign financial accounts that exceed a sum of \$10,000 at any time during the calendar year have a FBAR filing requirement.
- Accounts to watch out for:
 - Online gambling accounts (located in a foreign country).
 - Family accounts – Where a family member resides in a foreign country and puts a U.S. taxpayer’s name on the account.
 - Business accounts.
 - Foreign retirement accounts.
 - Inherited accounts.
 - Temporary gift accounts.

FinCEN Form 114 (“FBAR”) (cont.)

- **Due Date:** April 15 of the subsequent year.
- **Automatic Extension:** October 15
- **Where Filed:** FBARs are filed online at <https://www.fincen.gov/>
- **Penalties:** Penalty is inflation adjusted.
 - Non-willful violations: For 2025, the maximum penalty is \$16,536 per violation.
 - Willful violations: For 2025, the penalty is the greater of \$165,353 or 50% of the account balance.
 - Apply to FBAR filing not per foreign account. Bitner vs U.S. (SCOTUS 21-1195).
- **Statute of limitations** - Either willful or negligent failure to file 6 years from the due date of the FBAR report.
- **1040 Sch. B Questions** – Be sure to check the box(es).
- **NOTE:** OPR has made it clear that practitioners have a responsibility to comply with FBAR reporting rules.

IRS Form 8938 (Reporting Foreign Assets)

- Form 8938 is required if the total value of specified foreign financial assets is greater than the amounts shown in the above table, either as of the end of the tax year or at any time during the tax year, based on marital status and residency in the U.S. or abroad.

FORM 8938 – REPORTING REQUIREMENT – INDIVIDUALS WITH FOREIGN ASSETS (SEC 6038(D))				
	Living in The U.S.		Living Abroad	
Filing Status	Year-End Value	During Year Value	Year-End Value	During Year Value
Married Filing Joint	\$100,000	\$150,000	\$400,000*	\$600,000*
Others	\$50,000	\$75,000	\$200,000	\$300,000
<i>*Applies even if only one spouse lives abroad</i>				

Foreign Rental Properties

- **Depreciation**
 - Building (placed in service before 2018): 40 years
 - Placed in service after 2017: 30 years
- **Passive Loss Rules** – Same as U.S. rental.
- **RE Professional** – Difficult to qualify for.
- **1031 Exchange** – Foreign and domestic rentals are not like kind
- **Sec 199A Deduction** – Not qualified.
- **FBAR** – Not for the rental, but perhaps operating bank account.
- **Form 8938** – Not for the rental itself but perhaps entity owning it

Foreign Pensions

- **Taxable Amount** - Generally is the Gross Distribution minus the Cost (investment in the contract) unless there is a tax treaty provision covering the pension.
- **Tax Treaties:**
 - **General Rule** - most tax treaties allow the country of residence to tax the pension or annuity under its domestic laws.
 - **Special Treaty Rules** – Practitioners need to check the tax treaty for special treatment.
 - **Foreign Social Security Pensions** - Unless specified otherwise in a tax treaty, foreign SS is generally taxed like foreign pensions or annuities.

Foreign Gift Reporting

- If aggregate foreign gifts by a U.S. person exceeds the following amounts, then the U.S. person must report the following gifts:
 - More than \$100,000 from a nonresident alien individual or foreign estate.
 - More than \$19,750 (2025 inflation-adjusted amount) from foreign corporations or foreign partnerships (including foreign persons related to such foreign corporations or foreign partnerships) that are treated as gifts.
- Amounts do not include any qualified tuition or medical payments made on behalf of a U.S. person (same as normal gift tax rules).
- Penalties – 5% per month, 25% maximum
 - Excused for reasonable cause.

Foreign Gift Reporting - Forms

- 1040 Schedule B – Individuals with foreign gifts need to answer the line 8 question correctly at the bottom of the Schedule B.
- Form 3520 - Complete the identifying information on page 1 of Form 3520 and Part IV. See the instructions for Part IV.
 - Due date: April 15.
 - Not filed with the 1040. See instructions for filing address.
 - 6-month extension with Form 7004.
- FBAR - Taxpayers may also be required to file FinCEN Form 114 if the conditions of transfer and account balance require it.
- Form 3520 is also used:
 - By a U.S. Person or the executor of the estate of a U.S. Person to report ownership in a foreign trust; or
 - Transactions carried out with a foreign trust.

Foreign Gift Reporting – Forms (cont.)

- Form 3520-A is used by a U.S. owner to satisfy annual information reporting requirements.
- Form 709 is used by a non-resident alien if subject to gift tax when they make a gift of real or tangible personal property situated in the U.S.
- Form 5471 is an information return of U.S. persons with an ownership interest, voting power, officer or director of a foreign corporation.

Cryptocurrency



Broker Reporting – Beginning 2023

- Crypto exchange reporting will be like stock brokerage accounts.
- Form 1099-B at the end of the year.
- Tax Treatment – Reported on Form 8949/Schedule D .
- Reporting - Gain or loss must be determined for each transaction:
 - If it is held for investment, then capital gain; or
 - If held as inventory for sale to others, then ordinary income.
- Foreign reporting issues (if held in foreign accounts):
 - May have an FBAR and Form 8938 reporting requirement.

Tax Reporting

- Tax Treatment – Like property transactions; reported on Form 8949/Schedule D .
- Reporting - Gain or loss must be determined for each transaction.
- Capital Gain or Ordinary Income?
 - If it is held for investment, then capital gain.
 - If held as inventory for sale to others, then ordinary income.
- Foreign reporting issues (if held in foreign accounts):
 - FBAR - FinCEN's opinion is the FBAR is not required. But Tax Court overturned their “opinion” related to FBAR and online gambling accounts.
 - Form 8938 - Cryptocurrency held in foreign exchanges requires reporting on Form 8938 if the reporting threshold is reached.

Other Issues

- Employee payments – Subject to tax and FICA withholding and W-2 reporting as normal and reporting in U.S. Dollars.
- Independent Contractor Payments – Subject to 1099-NEC reporting in U.S. dollars.
- 1040 Question – Don't overlook the Yes/No question on page 1 of Form 1040.
 - **Could face penalties or even criminal charges if caught lying.**

Income Issues



Marginal tax brackets

RATE	2024		2025	
	SINGLE FILER	MARRIED FILING JOINTLY	SINGLE FILER	MARRIED FILING JOINTLY
37%	>\$609,350	>\$731,200	>\$626,350	>\$751,600
35%	>\$243,725	>\$487,450	>\$250,525	>\$501,050
32%	>\$191,950	>\$383,900	>\$197,300	>\$394,600
24%	>\$100,525	>\$201,050	>\$103,350	>\$206,700
22%	>\$47,150	>\$94,300	>\$48,475	>\$96,950
12%	>\$11,600	>\$23,200	>\$11,925	>\$23,850
10%	≤\$11,600	≤\$23,200	≤\$11,925	≤\$23,850

2024 and 2025 Ordinary Income Tax Brackets

Long-term Capital Gains Tax Rates - 2025

Tax Rate	Single	Married
0%	\$0 - \$48,350	\$0 - \$96,700
15%	\$48,350 - \$533,400	\$96,700 - \$600,050
20%	\$533,400+	\$600,050+

2025 capital Gain and Qualified Dividend Rates

Schedule D Transaction Strategies

- **Gift Appreciated Stock:**

- To provide support for low-income parent(s), instead of (adult) child selling stock and using after-tax cash.
 - Parent's basis is the child's basis.
 - Parent(s) pays the tax on the stock appreciation.
 - Tax may be zero because of the large standard deduction and zero capital gains tax bracket.
 - Child avoids the capital gains tax while providing support.

- **Offset Short-Term Capital Gains with Long-Term Capital Losses:**

- Short-term capital gains are taxed at regular rates.
- Long-term capital losses if used to offset LTCG reduce 10% or 15% income.
- Therefore, taxpayers achieve a better overall tax benefit if they can arrange their transactions so as to offset short-term capital gains with long-term capital losses.

Schedule D – Zero Tax Long-term Capital Gain

- **Example:**

- Suppose a married couple is filing jointly and has projected taxable income for the year of \$50,000.
- From tax rates for 2025, we find that the 15% capital gains tax bracket threshold for married joint filers is \$96,701.
- That means they could add \$46,701 ($\$96,701 - \$50,000$) of long-term capital gains to their income and pay zero tax on the capital gains.

- **Potential Side Issues:**

- Based on projected income (best late in the tax year)
- Numerous AGI based tax limitations
- ACA premium tax credit (based on household income)
- Medicare premiums (based on 2 years prior AGI)
- SS Taxation

Deduction Issues



DEDUCTIBLE

2024 and 2025 Standard Deductions

Standard Deductions

Filing Status	2024	2025
Single	\$14,600	\$15,000
Married Filing Jointly	\$29,200	\$30,000
Head of Household	\$21,900	\$22,500

Unusual Medical Expenses

- **Acupuncture**
- **Alcoholism**
 - Inpatient treatment including meals & lodging
 - Travel – AA Meeting
- **Adoption Medical**
 - Child is a dependent when services are rendered or paid.
 - Natural mother's childbirth expenses are not allowed.
- **Birth Control** – Prescribed by a doctor
- **Body Scan** – Even if not experiencing any symptoms
- **Chiropractor**
- **Christian Science Practitioner**
- **Cosmetic Surgery**
 - Improving appearance – No!
 - Correcting a deformity - Yes!

Unusual Medical Expenses (cont.)

- **Disabled Dependent Care**
 - Can be used either as medical, or
 - The dependent care credit
 - No double dipping allowed
- **Egg Donor Expenses** – Cost of obtaining eggs plus legal expenses and donor expenses directly related to obtaining the eggs.
- **Elderly Devices** – Deductible without prescription if they meet the definition of a medical device.
 - Phones with big buttons
 - Medical alert devices
 - Amplifiers for hard of hearing
 - But not over the counter magnifying glass
 - Other items like glasses, TTY devices, etc., may require an prescription

Unusual Medical Expenses (cont.)

- **Fertility Enhancement**

- Procedures such as in vitro fertilization (including temporary storage of eggs or sperm).
- Surgery, reverse prior surgery that prevented the person from having children.

- **Guide Dog**

- For visually, hearing, or disabled person is allowed.
- Emotional support animals do not, unfortunately, qualify.

- **Gender Identity Disorder** - The costs of gender reassignment surgery and hormone replacement are considered qualified medical expenses for persons with gender identity disorder.

- **Genetic (DNA) Testing** - PLR allocation.

- Cost of a kit must be allocated between ancestry and health services using a percentage (cost of the health services/total cost of ancestry plus health services) using a reasonable method of allocation.

- **Health Care Ministry** – **NOT** Deductible as medical insurance

Unusual Medical Expenses (cont.)

- **Household Help as a Medical Expense** - The cost of household help cannot be included in medical expenses, even if such help is recommended by a doctor. **But see nursing services later.**
- **Kidney Transplant** - Kidney donor's surgical, hospital, and transportation expenses paid by kidney recipient are deductible by recipient. Rev Rul 68-452
- **Self-employed Health Insurance**
- **Impairment Related Expenses**
 - Special equipment installed in the home, only to the extent it does not increase the value of the home.
 - Some home impairment modifications do not increase the value of the home and are fully deductible.

Unusual Medical Expenses (cont.)

- **Insurance Premiums**

- Medical, hospital, dental and limited long-term care.
- Lost or damaged contact lenses, prescription drugs, insulin.
- Medicare-B, Medicare-D and additional part C.
- Marketplace premiums net of PTC.
- Medical insurance premiums (and other medical expenses) paid by flexible spending arrangement are not deductible because they are paid with pre-tax dollars.

- **Learning Disability** (Special Education)

- Tutoring fees recommended by a doctor (teacher trained to work with severe learning disabilities).

- **Medical Marijuana** (Controlled Substance) – Is not allowed.

Unusual Medical Expenses (cont.)

- **Non-Hospital Institutions**

- Private Home - All amounts to maintain mentally disabled son in a specially selected private home (qualified as an “institution”) by recommendation of the psychiatrist.
- Hotel meals and lodging - Taxpayer received nursing service in the hotel, after appendicitis and being discharged from the hospital because it needed his hospital room. Attending physician said taxpayer was too weak to travel home. (*Kelly, Daniel vs. Com. (1971)*)
- Halfway House - Paid to maintain a child at a halfway house, including room and board. Required the recommendation of a psychiatrist and continued psychiatric supervision during the stay.

- **Nursing Home** - Inpatient care at a hospital or similar institution if the main reason is to receive medical care. Includes meals and lodging.

- **Nursing Services** - Services need not be performed by a nurse if the services are of a kind generally performed by a nurse.

- These services can be provided in the home or another care facility.
- If the attendant also provides personal and household services, these amounts must be allocated.
- If incurred to allow taxpayer to work, may qualify for dependent care credit, but no double dipping

Unusual Medical Expenses (cont.)

- **Physical Exam** - Even though not experiencing any symptoms of illness, is allowed.
- **Pregnancy Test** - The costs of self-administered pregnancy tests are deductible.
- **Marketplace Insurance less the Premium Tax Credit**
- **Schools and Education – Special** – Payments to a special school for a mentally impaired or physically disabled person if the main reason for using the school is its resources for relieving the disability.
 - Disciplinary Programs - Do not include the cost of sending a problem child to a special school or program.
- **Smoking-Cessation Programs**
 - Programs - Smoking-cessation programs and prescribed drugs designed to alleviate nicotine withdrawal are eligible medical expenses.
 - Nonprescription drugs, such as nonprescription nicotine gum and certain nicotine patches, are NOT deductible.

Unusual Medical Expenses (cont.)

- **Spouse - Prior or Current** – medical expenses paid for a prior or current spouse provided the taxpayer was married to the spouse either at:
 - The time the spouse received the medical services or
 - At the time the taxpayer paid the medical expenses.
- **Stem Cell Therapy and Storage**
 - Cord blood contains stem cells that doctors may use to treat disease. Thus, expenses for banking cord blood to treat an existing or imminently probable disease may qualify as deductible medical expenses.
 - Banking cord blood as a precaution to treat a disease that might possibly develop in the future does not satisfy the existing legal standard and is not deductible.
- **Sterilization** - The cost of a legally performed sterilization is deductible.

Unusual Medical Expenses (cont.)

- **Surrogate Mother Expenses**

- The Code does tell us that medical expenses are only deductible for the taxpayer, spouse and dependents.
- Definition of a dependent for medical purposes (medical dependent) ignores the gross income and joint return tests.
- If not a dependent, the expenses are NOT deductible.
- An unborn fetus is not a dependent until born.

- **Weight-Loss Programs**

- To be deductible, the program must be undertaken as treatment for a specific disease (including obesity) diagnosed by a physician.
- Costs that are NOT deductible:
 - Weight-loss programs for general health or appearance.
 - Diet food item costs.
 - Gym, health club, or spa membership dues.

Unusual Medical Expenses (cont.)

- **Medical Dependent**

- Medical expenses paid for dependents may be deducted
- An individual may be a medical dependent even if their gross income precludes a dependency exemption.

Example – The taxpayers' adult son was seriously injured in a motorcycle accident and did not have medical insurance. His parents paid all of his medical expenses for the year. Their son meets all of the dependent qualifications except for the gross income test. However, under the exception, the parents can still deduct the medical expenses on their 1040.

- **Divorced Parents** – Both parents can deduct the expenses they pay regardless of who claims their child.

- **Medical Reimbursement**

- Same year – Reduces year's expenses.
- Later year – Report as income, but not to extent of medical expense that was not deductible in the prior year because of the AGI limit; not taxable if claimed standard deduction.

“SALT” Limitations (Tax Deductions)

- **State and Local Taxes (SALT)** are limited to \$10,000. This includes:
 - Domestic real property tax,
 - Foreign income tax (if not claimed as a tax credit),
 - State and local income tax OR sales tax, and
 - Personal property taxes
- **Attempts to Circumvent** - States and some local governments attempted to circumvent the SALT limitation by giving taxpayers credit against their state or local tax by making a charitable gift to a state or local charity and then having an unlimited charitable contribution.
 - However, the states overlooked the 1986 Supreme Court holding where the taxpayer receives something in return (quid pro quo) for a contribution, making the contribution not tax deductible.
- Thus the \$10,000 limitation still applies pending any law change.
- **IRS Notice 2020-75** – Confirmed the viability of an entity’s state tax being deductible at the entity level without the SALT limitation.
- **States Reactions** – Several states have passed legislation to take advantage of Notice 2020-75.

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Stock Options

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Supplement 1 – Employee Stock Options



Employee Stock Options

NONSTATUTORY OPTIONS

- When a non-statutory option is exercised:
 - The difference between exercise price and option price is treated as wages and employer includes it in the employee's W-2 income and Box 12 as code V.
 - Difference is subject to usual withholding including FICA.
 - The basis in the purchased stock is the amount paid + the amount included in income when exercised.
 - Holding period begins on the date of exercise.
- Employees will generally exercise and sell on the same day. Sale is usually handled by a brokerage firm and will result in a loss equal to the sales costs



Employee Stock Options

RESTRICTED STOCK UNITS (RSUs)

- Employer will grant a specific number of shares to an employee.
- Stock is not issued until the employee satisfies vesting requirements.
- Vesting requirements can include both time and performance.
- If the vesting requirements are not met, the stock goes back to the company.
- When the stock is issued, the tax treatment is the same as a nonqualified option.
- Holding period begins when stock is issued.
- Short- or long-term capital gain depending upon holding period.



Employee Stock Options

RESTRICTED OPTIONS (and IRC §83b Election)

- Where an employer compensates an employee for services with stock, the excess of the FMV of the stock over any amount paid for the stock is treated as income when the stock is received.
- If the stock can't be sold or is at substantial risk, the income is deferred until the earlier of:
 - When it is no longer subject to that risk, or
 - It becomes transferable free of the risk.
- If the IRC §83(b) election is made within 30 days of the transfer of the restricted stock, the income recognized is the FMV of the shares on the date of grant less any amount the employee paid for the stock. This amount becomes the basis of the stock.



Employee Stock Options

INCENTIVE (STATUTORY) OPTIONS – PART ONE

- **Income Recognition** - Generally no income recognized at the time the option is exercised if the stock is held for:
 - More than 1 year after the option was exercised, and
 - More the 2 years after the option is granted.
- **AMT** – However, an AMT deferral preference applies in the year of exercise.
 - The preference income is equal to fair market value of the stock at exercise over the exercise price.
- **Payroll Tax** - The exercise is not subject to FICA or the extra 0.9% Medicare tax.
- **Dual Basis:**
 - Regular Tax Basis: exercise (option) price
 - AMT Basis: FMV at date of exercise



Employee Stock Options

INCENTIVE (STATUTORY) OPTIONS – PART TWO

- **Big Problem** – The AMT in the year of exercise will in many cases create a significant tax liability without the stock sale proceeds, thus creating a cash flow problem for most.
 - Can be overcome by selling in small quantities to avoid the AMT.
 - Many forego the incentive option treatment and sell the stock upon exercise; in which case it is treated like a nonqualified option.
- For sales where there is an AMT, an AMT Credit carryover will be created.



Supplement 2 – Home Sale Issues





Home Sale

HOME GAIN EXCLUSION QUIRK

Question - Unmarried couple living together for several years, but only one of them owns the home they are living in. They decide to get married and sell the home. Does it make any difference if they sell the home before or after they get married?

- Oh yes, a big difference.
 - If sold before they marry the max exclusion is limited to \$250,000.
 - If they wait until married the exclusion is \$500,000 if:
 - **Either** the taxpayer or spouse meets the **ownership test**.
 - **Both** the taxpayer and spouse meet the **use test**.
 - During the 2-year period ending on the date of the sale, neither excluded gain from another sale.

A 3D model of a house, rendered in a metallic gold color, is positioned on the left side of the slide. The house has a simple, geometric design with a gabled roof and a small chimney. It sits on a dark, reflective surface. In the background, there is a blurred image of a financial candlestick chart with yellow and blue bars, suggesting a connection to real estate and finance.

Home Sale

RENTAL CONVERTED TO PRINCIPAL RESIDENCE

- Must still meet 2 out 5 years use and ownership tests.
- Non-qualified periods are periods of time the home was rented.
- Gain attributable to non-qualified periods is not excludable
- Non-qualified periods do NOT include:
 - Periods before January 1, 2009.
 - Periods after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period), and
 - Not to exceed two years that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.



Home Sale

INHERITED HOME

- **Basis** – The basis of an inherited home is generally the FMV of the home at the date of decedent's death.
- **Appraisal** – If sold almost immediately to an unrelated party, the basis can generally be justified to be the sales price. Otherwise, a certified appraisal is appropriate.
- **Gain/Loss** – A sale of an inherited home rarely results in a gain because:
 - Sales price and basis generally are either the same or nearly the same and
 - Sales expenses will often cause a loss.

A 3D model of a house, possibly made of metal or plastic, is positioned on the left side of the slide. The house is a simple geometric shape with a chimney. The background of the slide features a blurred financial chart with various colored lines and bars, suggesting a market or investment theme.

Home Sale

LOSS ON THE SALE – INHERITED HOME

Is a Loss Deduction Allowed?

- Generally, a beneficiary will sell the residence through a broker and will have substantial sales costs which usually equates to a loss.
- A frequent question is whether a loss is allowed on the sale.
- The answer to that question depends upon the beneficiary's use of the property after inheriting it.
- Campbell (1945) TC 272 – Loss allowed if the beneficiary immediately attempts to rent or sell the property.
- Crawford (1951) TC 678 - Loss allowed if the beneficiary indicates his intention to move and does so as soon as he can locate other quarters.

A 3D model of a house, rendered in a metallic gold color, is positioned on the left side of the slide. The house has a simple, geometric design with a gabled roof and a chimney. It sits on a dark, reflective surface. In the background, there is a blurred image of a financial candlestick chart with yellow and blue bars, suggesting a connection to real estate and finance.

Home Sale

EXCEPTIONS TO USE TEST

Individuals with a Disability

- If, during the 5-year period before the sale of the home the taxpayer:
 - Becomes physically or mentally unable to care for themselves, and
 - Owned & lived in the home as their main home for at least 1 year.
 - Taxpayer is considered to have lived in the home during any time that they owned the home and lived in a licensed facility (including a nursing home).
 - Living with a friend or relative in their home won't qualify.
 - Must still also meet the ownership requirement.
- **Temporary Absence** – Short temporary absences, such as for vacation or other seasonal absence (even though accompanied with rental of the residence), are counted as periods of use.

A 3D model of a house, rendered in a metallic gold color, is positioned on the left side of the slide. The house has a simple, geometric design with a gabled roof and a chimney. It sits on a dark, reflective surface. In the background, there is a blurred image of a financial chart with various colored lines and bars, suggesting a market or investment theme. The overall lighting is warm, with a golden glow emanating from the house.

Home Sale

EXCEPTIONS TO USE TEST - Continued

- **Home Used as Rental After Home Use** – Where an individual uses a home and then subsequently rents it before sale, the sale will still qualify for the IRC §121 exclusion if the individual meets the ownership and use periods.
- **Depreciation** – Of course any gain attributed to depreciation cannot be excluded by IRC §121.
- **CAUTION** – This does not apply if the rental period occurs before the use as the taxpayer's primary residence. If that occurs, then the non-qualified use provisions apply as previously discussed.

A 3D model of a house, rendered in a metallic gold color, is positioned on the left side of the slide. The house has a simple, geometric design with a gabled roof and a chimney. It sits on a dark, reflective surface. In the background, there is a blurred financial chart with various colored lines (yellow, blue, green) and data points, suggesting a connection to real estate and finance.

Home Sale

ADDITIONAL ISSUES

- **Buyer defaults** – Upon reacquisition of the home the excluded amount will be taxable as a LTCG. (*Debough, 2014 TC17*)
- **Out-spouse** – Where an ex-spouse retains the home for a period before selling, the out-spouse's use period mirrors that of the ex-spouse and thus will qualify for an exclusion when the home is sold.
- **Home Jointly Owned** – Unmarried Taxpayers - Each can qualify for a \$250K exclusion if otherwise qualified.
- **Sale of Partial Interest** – If an individual sells a part interest in a home and the exclusion is less than the maximum allowed, the balance can be used in a subsequent sale.
- **Sale of Vacant Land Adjacent to a Home** – Is a sale of a partial interest if: the land is part of the home, not used for non-residential purposes and the other IRC §121 qualifications are met.



Home Sale

ADDITIONAL ISSUES - Continued

- **Home Held in a Revocable Trust** – Can qualify for an exclusion.
- **Home Held in an Irrevocable Trust** – A private ruling reveals a potential pitfall where a married couple transfers their residence to a revocable trust which becomes irrevocable at first spouse's death – the \$250,000 home sale exclusion may be completely lost or available only to a limited extent even though the surviving spouse has the continued right to occupy the residence.
- **Mixed Use Property (Home & Business)**
 - Same structure – The exclusion applies to entire gain except for gain as the result of depreciation. A loss is not allowed.
 - Separate structure – Treat as two sales. The exclusion only applies to the home structure. If the business portion results in a loss, it is deductible.