2025-2026 TAX PLANNING

Every year we have inflation adjustments that impact tax tables and allowable deductions. This year's increase is about 2.8%. However, the big news for 2025 and 2026 is passage of the One Big Beautiful Bill Act (OBBBA).

Major OBBBA provisions for 2025 and 2026

- **Deduction for Seniors:** If 65 or older, you may be eligible for a $6,000 deduction, whether you itemize or not. The deduction begins to phase out for modified adjusted gross income (MAGI) over $75,000 if single and $150,000 if married filing jointly.
- **SALT Limit Increased:** The limit on deduction of state and local taxes (SALT) increases from $10,000 to $40,000 ($40,400 in 2026). However, deductions are reduced by 30% for MAGI that exceeds $500,000 ($505,000 for 2026).
- **No Tax on Tips:** Up to $25,000 of tip income can be excluded, but this is phased-out for those earning $150,000 ($300,000 for joint return). Other limitations and reporting requirements apply.
- **No Tax on Overtime:** You can exclude up to $12,500, but this is phased-out for MAGI exceeding $150,000 ($300,000 for joint return). Other limitations and reporting requirements apply.
- **No Tax on Car Loan Interest:** The maximum deduction is $10,000, but is phased-out for those earning $100,000 ($200,000 for joint return). Other limitations and reporting requirements apply.

OBBBA changes starting in 2026

- **Charitable Donations Limit: D**onations will be deductible only after they exceed 0.5% of a taxpayer's adjusted gross income (AGI). For example, if a couple's AGI is $300,000, their first $1,500 ($300,000 x 0.005) of charitable donations won't be eligible for an itemized deduction.
- **Charitable Deduction If You Don't Itemize:** Up to $1,000 in cash contributions, if single and $2,000, if married filing jointly are deductible. Non-cash contributions and contributions to donor-advised funds or private non-operating foundations are not eligible for this deduction.
- **Itemized Deduction Limit:** For taxpayers in the top 37% bracket, total itemized deductions will be reduced by 2/37 of the lesser of total itemized deductions, or the amount of taxable income that exceeds the 37% bracket threshold.
- **Clean Energy Tax Credits:** Energy Efficient Home Improvement Credit and Residential Clean Energy Credit both end December 31, 2025. The Clean Energy Vehicle Credits ended September 30, 2025.
- **Increase for 529 Account Withdrawals:** Distributions for K-12 expenses are allowed up to $20,000, up from $10,000.
- **Alternative Minimum Tax:** The income phase-out level for the AMT exemption drops to $1 million for joint returns, $500,000 for singles and the phase out rate increases to 50%, up from 25%.

Following is a summary of *current* tax law and some planning suggestions based on what we know at this time:

Tax Rates

For 2025 and 2026, there remain 7 individual tax brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%. Long-term capital gain and qualified dividend rates still receive special treatment, and those rates are unchanged at 0%, 15% and 20%. The Medicare surtax on Net Investment Income (NII) remains 3.8%.

Itemized or Standard Deduction

It is estimated that only about 9% of taxpayers itemize their deductions. However, the determination of whether you should use the standard deduction or itemize is no longer a straightforward calculation, and whatever was best last year, may not apply in the future. There has been a limit on medical expenses for more than 80 years, but now there are complex calculations for state and local taxes and charitable contributions based on your level of income. Our best advice is to keep track of all possible itemized deductions, so that a detailed computation can be prepared.

The standard deduction for married couples is $31,500 for 2025, increasing to $32,200 in 2026. For single taxpayers, the standard deduction is $15,750 in 2025, increasing to $16,100 in 2026. Those over 65 and married each receive an additional $1,600 in 2025. Increasing to $1,650 in 2026. For single taxpayers over 65, the additional deduction is $2,000 in 2025 increasing to $2,050 in 2026. The potential $6,000 senior deduction is in addition to these amounts.

If the total of your itemized deductions is short of the standard deduction, you may be a good candidate for "bunching." Bunching involves doubling up on some deductions, allowing you to claim itemized deductions every other year and the standard deduction in intervening years. Here are some good candidates for bunching:

- Medical expenses, like elective surgery, eye exams and dental procedures can be shifted.
- Property taxes can generally be paid in December or January, allowing a double-up opportunity. However, this doesn't work if you are subject to the SALT limitation.
- Mortgage payments are based on when your check is received. Eleven payments could be processed in one year and 13 payments in another.
- Charitable gifts normally sent in December, could be paid in January, allowing a double-up in the following year.

Tax Credits

- The Child Tax Credit (CTC) is $2,200 per child under 16 for 2025. Starting in 2026 this amount will be indexed for inflation. For other dependents over 16, the credit of $500 remains unchanged. Eligibility for the credit depends on Adjusted Gross Income (AGI). The full amounts begin to phase out at AGI of $400,000 for joint filers and $200,000 for single filers.
- The Premium Tax Credit (PTC) reduces the monthly cost of health insurance purchased on an exchange, and involves a calculation based on the premium cost as a percentage of household income. Without Congressional action, these credits will expire at the end of 2025.
- The Earned Income Tax Credit (EITC) for low and moderate-income workers depends on income and the number of children. Those without children can also qualify. For 2025, the EITC ranges from $649 to a maximum of $8,046 for qualifying taxpayers with three or more children. For 2026, the range is $664 to $8,231.

Other Tax Strategies/Changes

Educator Expenses: Allows eligible educators to deduct qualified expenses, such as books and classroom supplies. This deduction is $300 in 2025. For 2026, educators can use a combination of the "above-the-line" deduction and unlimited deductions if itemizing.

Adoption Expenses: For 2025 adoptions, the maximum adoption credit is $17,280 per child and increases to $17,670 for 2026. A portion of the credit is refundable; $5,000 for 2025 and $5,120 for 2026. The credit begins to phase out for families with Modified Adjusted Gross Income above $259,190 in 2025 and $265,080 in 2026.

Roth Conversions: For those who believe they will be subject to a higher tax rate in the future, converting traditional IRA assets to a Roth IRA means paying tax on the conversion at today's lower rate.

Qualified Charitable Distributions (QCDs): Instead of writing a check to your favorite charity, you can send your donation directly from your IRA. The donation counts toward your required minimum distribution and reduces taxable income for purposes of the net investment income tax and various other tax computations and credits. You must be 70½ or older to qualify and the maximum allowed is $108,000 in 2025 and $111,000 in 2026.

Charitable Giving If Itemizing:

- Charitable contributions help reduce your tax burden. Cash and non-cash donations are the most common. Also, for charitable activities, miles you log on your vehicle are deductible at 14 cents a mile.
- Gifts of appreciated securities (stocks and mutual funds) from non-retirement accounts can be an important tax saving tool. The charity receives a valuable gift, you earn a tax deduction for the market value of the security, and both you and the charity avoid paying tax on the capital gain. For this to work, you must have owned the security for at least one year.

Income Shifting:

- If you expect to be in a higher tax bracket in 2026, accelerating income into 2025 could help. We often recommend converting some of your Traditional IRA into a Roth IRA, which reduces future Required Minimum Distributions. But this comes with a caution - if you convert too much, causing you to move into a higher tax bracket, you cannot reverse the transaction, as recharacterizations are no longer permitted.
- If you expect to be in a lower tax bracket in 2026, accelerating expenses into 2025 and deferring income until 2026 should help. Some examples:
    - Increase charitable contributions (see "bunching" discussion above)
    - Look for investments that have experienced a loss and sell them in 2025 to offset gains. This is called "tax loss harvesting"

Tax Loss Harvesting: For all tax brackets, tax loss harvesting is typically an important year-end strategy. You save taxes by simply selling investments that have decreased in value. You can replace those securities with investments that are somewhat similar, but to avoid the "wash sale" rule, you can't buy back the same or substantially same security within a 30-day period.

Flexible Spending Account (FSA)

If available through your employer, FSAs deserve a look. You can contribute up to $3,400 through payroll deductions during 2026. Amounts contributed are not subject to federal income tax, Social Security tax or Medicare tax. Some employers also may provide a matching contribution to your FSA. For plans that permit carryover of unused amounts, the maximum 2025 carryover amount to 2026 is $660.

FSA funds can be used for qualified medical expenses not covered by health plans, including, co-pays, deductibles and a variety of medical products. Also covered are dental, vision care and hearing aids. Many over-the-counter items are also FSA eligible.

Social Security and Medicare

FICA payroll taxes total 7.65%. This is a combination of the 6.2% Social Security tax and the 1.45% Medicare tax. The Social Security tax is assessed on wages up to $176,100 for 2025 and $184,500 for 2026. For Medicare, the tax is assessed on all wages. These numbers double (15.30%) for those who are self-employed.

There is an additional Medicare tax of .9% for married taxpayers with combined wages over $250,000 and for single taxpayers with wages over $200,000. There are no changes to these figures for 2026.

Social Security benefits are increased annually. Effective January 1, benefits will increase by a factor of 2.8%.

The age at which full benefits are available (full retirement age) has been increased from age 65 to 67, on a phased-in schedule. If your birth year is 1960 or after, normal retirement age is 67. For those born between 1953 and 1959, the full retirement age is between 66 and 67. Although early retirement at age 62 is still possible, benefits are substantially reduced.

Retirees who have reached full retirement age may work without any reduction in Social Security benefits. However, the earnings limit still applies to workers who have not reached full retirement age. Benefits are reduced $1 for every $2 earned over $23,400 in 2025 and $24,480 in 2026, for those age 62 to full retirement age. In the year full retirement age is reached, benefits are reduced $1 for every $3 earned over $62,160 in 2025 and $65,160 in 2026, but only earnings before the month you reach full retirement age are subject to this reduction.

Social Security benefits continue to be taxable. For those with "provisional" income above $44,000 ($34,000 if single), you will be taxed on 85% of those benefits. For income between $32,000 and $44,000 ($25,000 and $34,000 if single), 50% of benefits are taxable. Below these thresholds, Social Security benefits are tax-free. Most states *do not* tax Social Security Benefits, only 9 states do (CO, CT, MN, MT, NM, RI, UT, VT, WV).

Children

There was a time when shifting investment income to your children was an excellent tax saving strategy, but over the years, Congress effectively closed this loophole.

For children under 18 and full-time students under 24, the "kiddie tax" computation is fairly complex, but in general starts with the child's total unearned income and then applies a standard deduction of $2,700 for 2025 and 2026. What is left is taxed at the parents' rate.

Shifting assets to children works best when using a 529 education savings plan (see below) or when their education is complete. However, hiring your children in your business can still yield good results.

Retirement Issues

Retirement contributions (whether 401(k), 403(b), profit sharing, pension, SEP, or SIMPLE) still provide a major opportunity to reduce your tax bill. If you have an employer sponsored salary deferral plan, in most situations it makes sense to maximize your contributions.

Contribution deferral maximums to 401(k) and 403(b) plans are $23,500 for 2025 and $24,500 for 2026. For those age 50 or older, the additional annual allowable catch-up contribution is $7,500 for 2025 and $8,000 for 2026. Are you 60, 61, 62 or 63 in 2026? If so, you are entitled to an extra catch-up contribution to your 401(k). If your plan has been updated, instead of $8,000, up to $11,250 may be deferred.

Starting in 2026, individuals with more than $150,000 of Social Security W-2 wage earnings in the prior year will need to make their catch-up contributions to a Roth account. If the employer plan does not allow for Roth contributions, then no catch-up contribution is allowed – pre-tax or Roth.

SIMPLE plan contribution limits are $16,500 for 2025 and $17,000 for 2026, and the 50 or older catch-up contribution is $3,500 for 2025 and $4,000 for 2026.

For business owners, the maximum you can contribute to a qualified retirement plan for 2025 is the lesser of $70,000 ($62,500 with $7,500 catch-up if applicable), or 25% of compensation. For 2026, the limit increases to $72,000 ($64,000 with $8,000 catch-up if applicable). The maximum compensation level for computing your contribution is $350,000 for 2025 and $360,000 for 2026.

The maximum Individual Retirement Account (IRA) deduction is $7,000 in 2025 and $7,500 in 2026. For those age 50 or older by year-end, the catch-up contribution is $1,000 for 2025 and $1,100 for 2026. IRA contributions are allowed at any age, as long as there is earned income sufficient to cover the contribution.

For married filing joint taxpayers, traditional IRA contributions are not deductible if you and your spouse are covered by a company retirement plan and your combined income exceeds $146,000 in 2025 and $149,000 in 2026. However, a deductible IRA is allowed when one spouse is covered by an employer-sponsored plan, but the other is not, if AGI is less than $246,000 in 2025 and $252,000 in 2026.

For single taxpayers, traditional IRA contributions are deductible, but not if you are covered by a company retirement plan and your combined income exceeds $89,000 in 2025 and $91,000 in 2026.

If you are prohibited from deducting traditional IRA contributions, you may still fund nondeductible contributions. Earnings on these contributions accumulate tax-free until they are withdrawn. If you fund nondeductible IRA contributions, keep a record of contributions using IRS Form 8606 to be certain that you are not taxed on this money when it is withdrawn.

Don't forget that non-working spouses are allowed to contribute the full amount to an IRA account, whether deductible or not, as long as the other spouse has sufficient earned income. This is an excellent opportunity to shelter additional income, allowing earnings to accumulate tax-deferred.

If AGI in 2025 is below $236,000 if married ($150,000 for single taxpayers), a Roth IRA is generally better than a traditional nondeductible IRA, because Roth earnings grow tax-free and can escape taxation when withdrawn.

Education Accounts

Section 529 plans (like Edvest in Wisconsin) remain a popular way to save for college. Contribution limits are generous, there are no income limitations, and withdrawals used to pay qualifying costs are tax-free if funds are used for education. Contributions can be funded on behalf of any individual, not just dependents or other family members. Section 529 plan funds can also be used to pay for up to $10,000 annually ($20,000 starting in 2026) in education costs at private elementary and high schools.

Funds in a 529 plan can be used to pay down up to $20,000 of student debt. This is a lifetime limit for each beneficiary, not for each loan. Caution: You can't take a deduction for a 529 contribution and then use that money to pay down debt. That's considered a "double-dip."

Rules for 529 plans are not the same in every state. Here are the rules for Wisconsin:

- Contributions funded by April 15, 2026 can be counted for 2025.
- Contributions up to $5,130 per beneficiary are deductible on the state return for 2025. The 2026 amount has not yet been announced.
- Contributions exceeding the annual deduction may be carried forward and deducted in a future year.
- Rollovers from other state plans are acceptable and the principal portion is eligible for a tax deduction.
- To qualify for a deduction, contributions must be kept in the account at least 365 days before withdrawal.
- The maximum account balance per beneficiary is $589,650 for 2025.
- Computers and related technology costs are qualified expenses for distribution purposes.
- For distributions after July 4, 2025, additional qualified expenses include specific tutoring fees, college prep materials, and certain job training and continuing education programs.
- Withdrawals for K-12 expenses are allowed up to $10,000 ($20,000 starting in 2026).

- Funds not needed for education that have been in a 529 account for at least 15 years, can be rolled to a Roth IRA for the beneficiary, subject to various limitations.

Investment Matters

Qualifying dividends and long-term capital gains continue to be taxed at a lower, more favorable rate of 15% (or 0% if your tax rate is 12% or less). However, for 2025, if taxable income is greater than $600,500 for joint filers or $533,400 for single filers, the top tax rate is 20%. For 2026, these limits are $613,700 and $545,500, respectively.

Dividends, capital gains and certain other investment income remain subject to a 3.8% Net Investment Income surtax for married filers with modified adjusted gross income (MAGI) exceeding $250,000, and single taxpayers with MAGI exceeding $200,000.

Typically, the best strategy for investing:

- In retirement (sheltered) accounts, you want to own investments that *are not* eligible for lower tax rates, such as taxable bonds, Real Estate Investment Trusts (REITs), high turnover stock funds and short-term stock holdings.
- In your taxable (unsheltered) accounts, if your tax bracket is 32% or higher, you want to hold state and municipal bonds (or municipal bond funds) to take advantage of federally tax-free (and sometimes also state tax-free) income generated from these investments, as well as appreciating securities held more than 12 months, because gains from long-term holdings still enjoy a lower tax rate.

As always, consult your investment advisor before acting on suggested strategies for your portfolio.

Generally, it is not a good idea to make after-tax investments in mutual funds near year-end because mutual fund companies distribute capital gains to shareholders near the end of the year. This means that you could end up paying tax on an entire year of capital gains, even if you did not receive any cash, and even if you owned the fund for only a few days.

With how well financial markets performed in 2025, you may be surprised to see that some mutual funds are reporting significant capital gains on year-end tax statements. To find out when capital gains and losses will be posted, call your broker, or look at the website for your mutual fund company. As always, look for losses in your portfolio that can be sold to help offset recognized capital gains.

Keep in mind that short-term and long-term gains and losses are netted together, and net losses are deductible to a maximum of $3,000 per year, with an indefinite carry-forward. Net capital losses exceeding $3,000 cannot be used to reduce other types of investment income for purposes of the 3.8% Net Investment Income surtax computation. Also remember that brokerage costs decrease your taxable gain, and bonds purchased between interest dates require an interest adjustment for tax purposes.

More on Charitable Contributions

If payment for a charitable contribution is mailed or charged to a credit card before December 31, the deduction can be taken in the current year.

Every cash donation must be supported by a cancelled check, credit card receipt or written communication from the charity. Moreover, to be deductible, non-cash clothing and household donations must be in at least “good condition.” Remember, if you have total non-cash contributions of $500 or more during the year, some additional information is required, such as how you determined the worth of the donated property, what it originally cost, and how it was acquired. If your gift is over $5,000, a qualified appraisal is required. Finally, specific rules about the value of your deduction apply to donations of vehicles and watercraft.

Keep in mind, you must obtain a written receipt from charities for all gifts over $250, as a cancelled check is not considered sufficient support. Also, for non-cash gifts, the receipt must describe the gift in detail, but it need not confirm its value. You are required to have your receipt in hand *before* your return is filed.

Frequent mistakes:

- Raffle winnings are taxable, and the cost of a raffle ticket is <u>not</u> deductible.
- Donation of a week's stay at your second home or time share to a charity auction is not deductible.
- If you bid on an auction item, you can only deduct what you paid above fair market value. If the charity marks it "priceless," it isn't. Everything has a cost or market value.

Finally, if you receive something in exchange for your donation, say a meal or a complimentary ticket, the charity must tell you in writing what portion of your donation is deductible. If no goods or services are received in exchange for your donation, the receipt <u>must</u> state so. If this wording is missing, it is up to you to notify the charity and obtain a corrected document.

Other Issues

Rental Properties

Most rental real property is considered a "passive" investment. For AGI under $100,000, up to $25,000 of losses are deductible, but only if you actively participate in managing the property.

For AGI over $100,000, the rental loss is phased out, with no current deduction available for taxpayers having income over $150,000. However, in certain circumstances, if you spend over half your total working time (at least 750 hours a year) on realty development or management, you can deduct all rental real estate losses from regular income and the $25,000 loss limit does not apply.

Although rental losses may be phased out, they are not lost. Such losses are postponed and are used to offset future gains or are deducted in full when the property is disposed of.

Rental income is subject to the 3.8% Net Investment Income surtax if modified AGI exceeds $250,000 for joint filers and $200,000 for single filers, unless the income is from a rental trade or business (i.e., you qualify as a real estate professional with respect to this income).

Estate Planning

For 2025 and 2026, individuals are eligible to give $19,000 per calendar year to as many persons as they wish and avoid gift tax filings. Married couples can contribute twice the limit to one individual. In addition to these limits, tuition and medical expenses paid on someone's behalf also avoid gift and estate tax, regardless of the dollar amount, if payments are made directly to the educational or medical institution.

Most people do not realize that life insurance proceeds paid to a beneficiary may be taxed as part of your estate when you die. In addition, proceeds from IRAs and retirement plans can be taxed twice when you die - once as part of your estate, and once on the beneficiary's tax return. Consult your estate planning attorney for details and techniques to avoid double-taxation.

For 2025, the federal estate tax is imposed on assets of $13.99 million or more at a maximum tax rate of 40%. For 2026, the exclusion amount increases to $15 million. Lifetime gift tax and generation skipping tax limits follow these same exclusion figures.

Small Business Planning

The tax rate for regular C corporations remains at a flat 21%.

For many business entities, other than C corporations, a 20% tax deduction is possible for Qualified Business Income. The computation is complex with restrictions on certain professionals, high earning individuals, and limits based on income, W-2 wages, and assets. Additional tax forms are required to be filed showing calculations for the deduction.

The immediate write-off of up to $2.5 million in business assets is available for 2025. Even heavy SUVs and trucks are eligible. More property is eligible for faster write-offs, including vehicles, assets contained in rental property and farming equipment.

The standard mileage rate for business use of a vehicle is 70 cents per mile for 2025. The 2026 rate has not yet been announced.

A reminder of some existing provisions:

- The deduction limit for business meals is 50%.
- While the write-off of business entertainment (golf course fees, sporting events, show tickets, etc.) has been eliminated, travel rules have not changed.
- Business travel deductions are limited to expenses for yourself and your employees. You are not allowed to claim expenses for a non-employee spouse, dependent or other traveling companion.
- Receipts are not required (but are highly recommended) for business expenses under $75. However, upon audit you still need some evidence to support the expense.

Happy holidays and best wishes for the start to a healthy new year!

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