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Dear Client:

It's that time of year again where we should consider meeting to discuss any year end strategies that might reduce your 2025 taxes.

For a short time this past summer, tax news became national news when the President signed the One Big Beautiful Bill Act (OBBBA). The OBBBA is a budget bill that makes the 2017 tax cuts permanent, introduces a bunch of new tax breaks, and repeals all but a few of the clean energy tax credits. Because most of the changes apply to the 2025 tax year, we'll want to factor them into our year-end planning. So, let's start with what's new and then move on to other year-end considerations.

A Word About Acronyms. I try not to use too many acronyms, but you'll see "AGI" a lot. AGI stands for "adjusted gross income," which is your total income minus a handful of key deductions such as IRA contributions, HSA contributions, and self-employed health insurance. The tax rules use AGI everywhere for limitations and phaseout thresholds, so there's no escaping the concept or the acronym.

New Tax Breaks

Most of the new tax breaks enacted by the OBBBA are available regardless of whether you itemize or take the standard deduction. However, most of them phase out for income above specified thresholds. These deductions are potentially quite valuable, so it might be worth your time to see if any apply to you:

- Increased SALT limit. The biggest break for individuals in the OBBBA isn't new, but it's greatly expanded. The limit on the state and local tax deduction has been increased from $10,000 to $40,000. You must itemize your deductions to take advantage of the SALT deduction. If you haven't itemized in recent years, the increased SALT limit may make it attractive to do so. The $30,000 increase in the deduction limit starts phasing out for AGI above $500,000. A less favorable limit and phaseout threshold apply to married individuals filing separate returns.

- Deduction for Car Loan Interest. There's a new deduction of up to $10,000 for interest on car loans taken out after 2024 for the purchase of a new personal use vehicle assembled in the U.S. The deduction is allowed through 2028 and begins to phase out for AGI above $100,000 ($200,000 for joint returns). The deduction is available regardless of whether you itemize or take the standard deduction. *Pro Tip*: To find out if your vehicle was assembled in the U.S., go to vpic.nhtsa.dot.gov/decoder/ and put in the vehicle's VIN and model year. The last item under "Other Information" is the final assembly plant's location.
- Deduction for Tip Income. There's a new deduction of up to $25,000 for tips received by an individual in an occupation which customarily and regularly receives tips (I can send a list of qualifying occupations). The deduction is allowed for both employees and independent contractors. The deduction begins to phase out for AGI above $150,000 ($300,000 for joint returns). The deduction is allowed through 2028, and is available regardless of whether you itemize or take the standard deduction.
- Deduction for Overtime Pay. This is another new tax break available through 2028. This one allows you to deduct up to $12,500 ($25,000 on joint returns) for overtime pay that's required to be paid at time and a half by federal law. The deduction begins to phase out for AGI above $150,000 ($300,000 for joint returns). The deduction is allowed through 2028, and is available regardless of whether you itemize or take the standard deduction.
- Deduction for Seniors. The OBBBA added a new $6,000 per person deduction for all individuals who have reached age 65 before the end of the tax year. This one works like personal exemptions used to before they were repealed: it doesn't matter whether you itemize your deductions and you don't have to do anything to claim it other than have a social security number (and file a joint return, if married). The senior deduction begins to phase out for AGI above $75,000 ($150,000 for joint returns).
- Charitable Contribution Deduction for Non-Itemizers. This one isn't available until 2026, but it's one you'll want to be aware of as you plan any year-end charitable contributions. The maximum deduction is $1,000 ($2,000 for joint returns). Eligible contributions must be made in cash (checks and credit/debit cards are also fine) to a public charity. There is no phase out for this deduction. *Planning Opportunity:* If you don't plan to itemize in 2025, you may get a tax benefit from delaying

year-end charitable contributions until January when the new tax break takes effect.

Itemized Deduction for Educator Expenses. One more tax break that will be available in 2026 is a new itemized deduction for educator expenses. This deduction for K-12 teachers is a complement the longstanding $300 ($350 in 2026) above-the-line deduction for classroom expenses. There are two key differences between the above-the-line deduction and the new itemized deduction: (1) there is no limit on the amount of the itemized deduction; and (2) educator expenses of interscholastic sports administrators and coaches are allowed, and "nonathletic supplies for courses of instruction in health or physical education" are allowed as eligible expenses. There is no phase out for this deduction, but you do have to itemize your deductions to take advantage.

Deductions and Exclusions from Income

Taking the Standard Deduction versus Itemizing. The Tax Cuts and Jobs Act (TCJA) substantially increased the standard deduction amounts, thus making itemized deductions less attractive for many individuals. The OBBBA makes this change permanent. For 2025, the standard deduction amounts are: $15,750 (single), $23,625 (head of household), and $31,500 (married filing jointly).

If the total of your itemized deductions in 2025 will be close to your standard deduction amount, we should evaluate whether alternating between bunching itemized deductions into 2025 and taking the standard deduction in 2026 (or vice versa) could provide a net-tax benefit over the two-year period. For example, you might consider doubling up this year on your charitable contributions rather than spreading the contributions over a two-year period. Adjusting the timing of your payments of state income taxes, property taxes, and medical bills can also help.

Bear in mind that even if you haven't itemized in recent years, the big increase in the limit on the SALT deduction I mentioned earlier may change the math in favor of itemizing. If you're not sure where you stand, let's run the numbers and find out. In years when it applies, itemizing can shave thousands of dollars (sometimes much more) off your tax bill. So it's worth spending a little time to find out if we should change our approach in response to the favorable changes in the rules.

SALT Refresher. Because of the $10,000 cap on this deduction in recent years (2018-2024), it may have been a while since you've had to think about how to max out your deduction. Here's a quick refresher on what you can deduct:

- state and local income taxes;
- property taxes on real estate;
- personal property taxes (typically on motor vehicles); and
- sales taxes, but only as an alternative to deducting state and local income taxes.

If you choose to deduct your sales taxes you can either keep records of the actual sales taxes you pay during the year or let me determine the deductible amount using tables provided by the IRS.

Motor vehicle taxes or fees must be based on the value of your vehicle to be deductible. Taxes and fees based on weight, model year, and/or horsepower are not deductible. But taxes or fees that are partly based on value and partly based on other criteria may qualify in part.

As mentioned before, the SALT deduction limit is $40,000 for 2025, and it starts phasing down to the old $10,000 limit when your AGI reaches $500,000. If you're married and file separately, the limit is $20,000 and the phase down starts at AGI of $250,000.

Medical Expenses. For 2025, your medical expenses are deductible as an itemized deduction to the extent they exceed 7.5 percent of your AGI. To be deductible, medical care expenses must be primarily to alleviate or prevent a physical or mental disability or illness. They don't include expenses that are merely beneficial to general health, such as vitamins or a vacation. Deductible expenses include the premiums you pay for insurance that covers the expenses of medical care, and the amounts you pay for transportation to get medical care. Medical expenses also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract.

Depending on what your taxable income is expected to be in 2025 and 2026, and whether itemizing deductions would be advantageous for you in either year, you may want to accelerate any optional medical expenses into 2025 or defer them until 2026. The right approach depends on your income for each year, expected medical expenses, as well as your other itemized deductions.

Charitable Contributions. If you are itemizing deductions, you can maximize the tax benefit of making a charitable contribution by donating appreciated assets, such as stock, instead of cash. Doing so generally allows you to deduct the fair market value of the asset while also avoiding the capital gains tax that would otherwise be due if you sold the asset. The more highly appreciated the asset, the better this strategy works.

Charitable contributions are highly useful for year-end tax planning because you have great control over both the amount and the timing. That's not to say that you should let the tail wag the dog: if you enjoy making contributions during the holiday season or some other time of year that's meaningful to you, changing the timing of your contributions for tax reasons may not be worth it. But it can't hurt to be aware that there can be a big difference from a tax standpoint between making a contribution in late December versus early January.

2026 Change Alert. If you make substantial contributions in some years and not others, there's a good reason why you might want to choose 2025 over 2026. Beginning in 2026, if you itemize, your charitable contribution deduction will be reduced by 0.5% of your AGI. For example, if your income is $200,000, your deduction will be reduced by $1,000. No such rule applies in 2025.

Charitable Contributions Directly from Your IRA. If you have an individual retirement account and are 70 1/2 years old and older, you are eligible to make charitable contributions directly from your IRA. You don't get a deduction for such contributions, but you don't have to include the amount in your income. This can be advantageous compared with taking a distribution and making a donation to the charity that may or may not be deductible as an itemized deduction. It can also be advantageous from a standpoint of lowering your AGI, which can help reduce taxes on your social security income, reduce any net investment income tax, and preserve your ability to claim various deductions that are phased out or reduced based you income.

Mortgage Interest Deduction. If the mortgage on your principal residence has a balance of $750,000 or less, your mortgage interest will generally be fully deductible. If your loan balance is higher than $750,000, deductibility depends on when you incurred the debt:

For Acquisition Debt Incurred -	*Interest is Deductible on Up To This Much Loan Balance -*
After 12/15/2017	$ 750,000
Before 12/16/2017	$1,000,000

The same limit that applies to your original mortgage applies to any refinancings. If your loan balance increases when you refinance (i.e., a "cash out" refinancing), the interest on the additional loan balance is only deductible to the extent you used the funds to substantially improve your home. If you operate a business from your home, any loan balance/interest we allocate to the business is not subject to the above limits.

Interest on Home Equity Loans. You can potentially deduct interest paid on home equity indebtedness, but only if you used the debt to substantially improve your home. Thus, for example, interest on a home equity loan used to build an addition to your existing home is typically deductible, while interest on the same loan used to pay personal expenses, such as credit card debt, is not. The balance of any home equity loans is added to the balance of your mortgage for purposes of applying the $750,000/$1,000,000 limits discussed above.

Mortgage Insurance Premiums. Beginning in 2026, you can deduct mortgage insurance premiums as mortgage interest. The deduction is phased out for AGI above $100,000 ($50,000 for married filing separately).

Student Loan Interest. You can deduct up to up to $2,500 of interest paid on a qualified education loan in computing AGI. This is an above-the-line deduction, so you do not have to itemize to claim it. In 2025, the deduction is phased out for AGI above $170,000 for married filing jointly and $85,000 for all others.

Sale of a Home. If you sold your home this year and it was your principal residence for at least two of the five years before the sale, you can exclude from income up to $250,000 of your gain on the sale ($500,000 if you're married filing jointly and meet a few conditions). Your taxable gain is also reduced by any amounts that you spent on improvements and additions that add to the value of a residence, prolong its useful life, or adapt it to new uses. If you think your gain might exceed the $250,000/$500,000 exclusion, you'll want to put together records of any improvements you made to the home, which we can use to reduce your gain. I'd be happy to send you examples of what qualifies as an improvement for tax purposes and what doesn't.

Note that if you rented out your home or used part of it for business purposes, your exclusion may be reduced. The reduction generally does not apply if you rent your home out for less than three years between the date you moved out and the date you sold it, as long as it was your principal residence prior to that. A loss on the sale of a principal residence is generally not deductible. But if you rented out your home or used it for business, the loss attributable to that portion of the home is deductible.

Tax Credits

Tax credits are more favorable than deductions because a tax credit reduces the amount of income tax you may have to pay. Unlike a deduction, which reduces the amount of income subject to tax, a credit directly reduces the tax itself.

The following are the main tax credits available for individuals in 2025:

- Residential Clean Energy Credit. The residential clean energy credit is one of the casualties of the 2025 Tax Act's broad repeal of clean energy credits. Its expiration date has been moved from December 31, 2032 to December 31, 2025. The amount of the credit equals 30 percent of the cost (with no cap) of qualified residential energy property, such as solar energy systems, solar water heaters, and battery storage. While you can still take advantage of the credit, be aware that the IRS requires that qualified property must be paid for *and* installed by December 31. So make sure that your contractor can commit to completing the project by that deadline and that you can get out of the deal if they don't follow through.
- Energy Efficient Home Improvement Credit. Another credit expiring on December 31, 2025, is the energy efficient home improvement credit. This credit equals 30 percent of the cost of installing energy efficient doors, windows, central air conditioners, electric panels ,water heaters and several other qualifying improvements. The credit has a dollar limit for each type of improvement and an overall annual limit of $1,200. Heat pumps, heat pump water heaters, biomass stoves, and boilers have a separate $2,000 annual limit, bringing the total potential value of the credit to $3,200.
- Child Tax Credit. For 2025, you can claim a tax credit of $2,200 (up to $1,700 is refundable) for each dependent child under age 17, and a $500 credit for qualifying dependents other than qualifying children. The credit is phased out for AGI over $200,000 ($400,000 for married filing jointly). For 2025, new requirements for providing social security numbers apply.
- Earned Income Credit. The earned income tax credit (EITC) is a generous credit based on a percentage of earned income that phases out at relatively low levels of income. For 2025, the credit completely phases out at AGI of $68,675 for individuals with three qualifying children and at lower levels for individuals with fewer children (or none). The credit is unavailable to individuals with more than $11,950 in investment income.

- Dependent Care Credit: If you incurred eligible expenses to care for a dependent under age 13 so that you can work or look for work, you can claim the child and dependent care credit. The credit is based on a percentage of eligible expenses. For 2025, the percentage ranges from 20 to 35% based on AGI. Up to $3,000 in childcare expenses can be taken into account for one qualifying dependent (up to $6,000 for two or more qualifying dependents). Although the credit percentage phases down to 20% at relatively low levels of income, it does not go any lower, even for very high incomes.
- Premium Tax Credit. A health insurance subsidy is available in the form of a premium assistance tax credit for eligible individuals and families who purchase health insurance through the Affordable Care Act's Health Insurance Marketplace (aka, the "Exchange"). This credit is refundable and payable in advance directly to the insurer on the Exchange. Beginning in 2026, individuals with incomes exceeding 400 percent of the poverty level will not be eligible for the credit (there was no such limit from 2021-2025).
- American Opportunity Tax Credit. If you have one or more postsecondary students in the family, you may qualify for an American opportunity tax credit of up to $2,500 per year for each eligible student. The credit, which is available for the first four years of a student's postsecondary education, is based on 100 percent of the first $2,000 of qualified education expenses and 25 percent of the next $2,000 of such expenses paid. The credit is phased out for AGI above $80,000 ($160,000 for joint filers).
- Lifetime Learning Credit. The lifetime learning credit applies to tuition and fees paid for the enrollment or attendance of yourself, your spouse, or your dependents for courses of instruction at an eligible educational institution. The credit, which is limited to $2,000 per tax return, per year, is based on 20 percent of the first $10,000 in qualifying expenses. The credit is phased out for AGI above $80,000 ($160,000 for joint filers). The lifetime learning credit and the American opportunity tax credit cannot be claimed for the same student in the same year.
- Savers Credit. For 2025, a retirement savings credit of up to $1,000 ($2,000 for joint filers) is available for qualified contributions made to a traditional IRA, a Roth IRA, and several other types of retirement plans. The credit is calculated by multiplying up to $2,000 of an individual's qualified contributions by a percentage of either 50, 20, or 10 percent determined using the individual's AGI and filing status. For 2025, the highest income that qualifies for the 10 percent credit is $79,000.

Section 529 Plans Enhancements

The OBBBA brought plenty of good news for 529 plan owners. You can now withdraw funds for a wide range of K-12 expenses (as opposed tuition only under the old rules). Eligible expenses include amounts paid for curricular materials, books or other instructional materials, online educational materials, tutoring or educational classes outside the home, testing fees, fees for dual enrollment in an institution of higher education, and educational therapies for students with disabilities. Beginning in 2026, the limit of withdrawals for K-12 expenses doubles, from $10,000 to $20,000.

Section 529 plan funds can also now be used for post-secondary credentialing expenses, a broad new category that includes vocational training and licensing programs, continuing education (where required to maintain a credential), fees for licensing and certification exams, and many other postsecondary educational expenses that fall outside the realm of traditional higher education. There is no annual limit on withdrawals used to pay for such expenses.

Retirement Plans, HSAs, and FSAs, and Trump Accounts

Retirement Plans. If you can afford to do so, investing the maximum amount allowable in a qualified retirement plan will yield a large tax benefit. If your employer has a 401(k) plan and you are under age 50, you can defer up to $23,500 of income into that plan for 2025. Catch-up contributions of $7,500 are allowed if you are 50 or over, and "super" catch-up contributions of $11,250 are allowed if you are 60, 61, 62, or 63.

If you have a SIMPLE 401(k), the maximum pre-tax contribution for 2025 is $16,500. That amount increases to $20,000 if you are 50 or older and $21,750 if you are 60, 61, 62, or 63.

The maximum IRA deductible contribution for 2025 is $7,000 and that amount increases to $8,000 if you are 50 or over. Also, don't overlook the possibility of a spousal IRA, which allows a spouse who does not have enough taxable compensation to make a maximum IRA contribution to use a portion of the other spouse's taxable compensation in calculating his or her own allowable contribution for the year.

Health Savings Accounts. You may also want to consider health saving accounts (HSAs) if you don't already have one. These are tax-advantaged accounts for individuals who have high-deductible health plans (HDHPs). If you are eligible to set up such an account, you can deduct the amount you contribute to the account in computing AGI. These contributions are deductible whether you itemize deductions or not. Withdrawals from an HSA are tax free if they are used to pay for qualified medical expenses (i.e., medical, dental, and vision expenses). Unused amounts accumulate in the HSA and grow tax free. For 2025, the annual contribution limits are $4,300 for an individual with self-only coverage and $8,550 for an individual with family coverage.

Flexible Spending Accounts. If your employer offers a Flexible Spending Account (FSA), consider setting aside some of your earnings tax free in such an account so you can pay medical and dental bills with pre-tax money. Since you don't pay taxes on this money, you'll save an amount equal to the taxes you would have paid on the money you set aside. FSA funds can be used to pay deductibles and copayments, but not for insurance premiums. You can also spend FSA funds on prescription medications, as well as over-the-counter medicines, generally with a doctor's prescription. The only catch is that FSAs have a use-it-or lose-it rule: unused funds do not carryover from one year to the next.

Trump Accounts. Trump accounts are essentially non-deductible IRAs for children that will transform into traditional IRAs when the beneficiary reaches age 18. Accounts will be allowed to start accepting contributions on July 4, 2026. We should see guidance on how parents can set up accounts for their children ahead of that date. Accounts can accept an aggregate of $5,000 in contributions annually from parents and other individuals. There are several provisions that allow employers, nonprofits, and government entities to make contributions that are not counted toward the annual limit. Funds in a Trump account grow tax-free and must be invested in S&P index funds or similar equity index funds.

Life Events

Life events can have a significant impact on your tax liability. For example, if you have head of household filing status in 2025, but you no longer provide a home for a qualifying dependent in 2026, your filing tax status will change to single in 2026. As a result, your tax rates will go up and your standard deduction will go down (the opposite of what happens if you go from single to head of household).

If you were married or divorced during the year and changed your name, you need to notify the Social Security Administration (SSA). A mismatch between the name shown on the tax return and the SSA records can cause problems in the processing your tax return and may even delay tax refunds.

Let me know if you have been impacted by a life event, such as a birth or death in your family, a change in marital status, the loss of a job or a change in jobs, or a retirement during the year. All of these can affect your tax situation.

Sincerely,

Reilly, Creppage & Co. Inc.

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