**Federal Income Taxation, Schmalbeck, Zelenak, Lawsky, Oei**
**2025 Summer Update to the 6th Edition**

**With Further Updates for Fall 2026 by Bogdanski**

In July 2025, Congress passed H.R. 1, Pub. L. No. 119-21 ("the 2025 Act" or "the Act").[1] The 2025 Act makes permanent many of the temporary provisions of the 2017 Tax Cuts and Jobs Act ("2017 TCJA") that were scheduled to sunset at the end of 2025. It also makes other important changes to US federal tax law. This 2025 Summer Update highlights key provisions of the 2025 Act and how they impact the 6th edition of the Casebook.

Some key points should be emphasized: First, different provisions in the 2025 Act have different effective dates: some are effective immediately for the 2025 tax year, while others only take effect after 2025. Second, while many of the 2025 Act's provisions are permanent (at least until Congress decides to change the law), the Act does make use of temporary provisions designed to sunset at a later date. Third, some of the Act's provisions are modifications or enhancements of existing provisions (e.g., enhancement of the §21 child care credit and the §24 child tax credit), while other provisions are simply new (e.g., the new rules regarding certain tips and overtime income; creation of "Trump Accounts" for qualifying children). These features create some challenges for deciphering how the 2025 Act relates to current and prior law.

This 2025 Summer Update incorporates updates that were introduced in last year's 2024 Summer Update document. Thus, instructors and students no longer need to refer to the 2024 Summer Update.

Finally, this Update is not meant to be read in its entirety at the beginning of the semester. Rather, it should be consulted in pieces, as each new chapter rolls into view.

[1] While sometimes referred to as the "One Big Beautiful Bill Act" (or "OBBA"), this is not the official name of the legislation, so this Update will refer to it as the 2025 Act.

## CHAPTER 1

*p. 4 fn. 2 — 2025 Inflation Adjustments*

Inflation-adjusted tax rate tables for 2025 are contained in Rev. Proc. 2024-40, 2024-45 IRB 1100 (Oct. 22, 2024).

For 2026, see Rev. Proc. 2025-32, 2025-45 IRB 695 (reprinted starting on page 1724 of our Code book).

The 2025 Act has made the 2017 TCJA's tax rate and brackets permanent. Those TCJA rates and brackets had reduced and modified the pre-TCJA rates and brackets but would have expired at the end of 2025 absent further legislative action.

Effective for post-2025 tax years, the 2025 Act has also modified the way the income tax brackets are indexed for inflation. 2025 Act §70101 (amending §1(j)). For 2025, the tax rates and brackets in Rev. Proc. 2024-40 remain accurate.

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*p. 3-13 — Introductory Problem*

The 2025 Act will change the outcome in the introductory problem involving John and Mary. In the 6th edition, the problem relates to the 2023 tax year. If the tax year is 2025 (a year in which some but not all of the 2025 Act's changes will have taken effect), the following will be the result:

For the 2026 results, see Appendix A, page 26 *infra.*

*Gross Income*. The Smiths' gross income computation will remain the same at $135,000. Their above-the-line §219 IRA deduction also remains the same. Therefore, their adjusted gross income remains $133,000.

*Standard Deduction*. The Act permanently extends the standard deduction amount provided for in the 2017 TCJA and provides an inflation adjustment; the 2025 standard deduction for a married couple filing jointly will be $31,500. The Smiths would obviously still take the standard deduction. Thus, their taxable income for 2025 will be:

$135,000 gross income
- $2,000 above-the-line IRA deduction (§219)
- $31,500 standard deduction
= $101,500.

*Tentative Tax Liability Computation*. The Act makes permanent the tax rate reductions and tax bracket changes introduced by the 2017 TCJA and makes changes to how inflation indexing is done. The Smiths' tentative tax liability computation under §1(a) would be done using the 2025 tax rate schedules, provided in Rev. Proc. 2024-40, as follows:

- First $23,850 of taxable income x 10% tax rate = $2,385
- Next $73,100 of taxable income x 12% tax rate = $8,772
- Last $4,550 of taxable income x 22% tax rate = $1,001
- Total tentative tax liability = $12,185.

*Capital Gains Adjustment*. The Smiths would then adjust their tentative tax liability downwards to account for the lower 15% capital gain rate. After inflation adjustment, only $4,800 of the Smiths' $5,000 capital gain is taxed at 15%. The remaining $200 is taxed at 0%. *See* Rev. Proc. 2024-40, § 1.03.

This time, the $12,185 tentative tax was derived by taxing only $4,550 of the $5,000 capital gain at the 22% ordinary income rate (because of where the ordinary income rate brackets break in 2025; see Rev. Proc. 2024-40, § 1.01 Table 1). The remaining $450 of the $5,000 capital gain was taxed at the 12% ordinary income tax bracket. Therefore, the Smiths would get a credit of $4,550 x (22%-15%) = $318.50. Of the remaining $450, $250 (i.e., $4,800 – $4,550) is taxed at 15%, not 12%, so the Smith owe an extra 3% x $250 = $7.50. The last $200 of capital gains should be taxed at a zero rate, so the Smiths would get a credit of 12%-0%) x 200 = $24. Thus, their tax liability after adjustment of their tentative tax liability for the capital gain rate would be $12,185- $318.50 + $7.50 - $24 = $11,823.

A simpler way of doing this would be calculate tax on $96,500 of non-capital income and then calculate the 15% capital gain tax on the amount over $96,700 (the maximum zero-rate amount) in Rev. Proc. 2024-40, § 1.03, and then calculate the capital gains tax, as follows:

- First $23,850 of taxable ordinary income x 10% = $2,385
- Remaining $72,650 of taxable ordinary income x 12% = $8,718
- Tax on capital gains over the maximum zero rate amount ($101,500 - $96,700) x 15% = $720
- TOTAL = $11,823

*Credits*. The Act increases the §24 child tax credit from $2,000 to $2,200 per child starting in 2025 and indexes it for inflation. Thus, for 2025, the Smiths will get a $4,400 §24 child tax credit.

The 2025 Act has modified and enhanced the §21 child care credit for 2026 and later years (see discussion in this 2025 Summer Update regarding pp. 754-56), but these changes are not in effect for the 2025 year. Therefore, the Smiths' §21 credit will remain $1,200 for 2025.

The Smiths' final tax liability after credits will be $6,223 (i.e., 11,823 - $4,400 - $1,200).

*Miscellaneous Issues*. For years starting in 2026, the Act will allow taxpayers who take the standard deduction to deduct charitable contribution deductions of up to $2,000 for joint filers ($1,000 for individual filers), but this provision will not be effective for 2025, so it will not impact the Smiths' 2025 taxable income computation. 2025 Act § 70424.

Note also that the Act sets the §151 personal exemption amount permanently at zero, though it does create a new, temporary deduction for taxpayers age 65 or older (effective for the 2025 through 2028 tax years). 2025 Act §70103. Finally, the Act has made the disallowance of miscellaneous itemized deductions permanent (other than a deduction for educator expenses). 2025 Act §70110.

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*p.14-15 — Exclusions, Deductions, and Credits*

*Insert the following immediately before the first full paragraph on p. 15:*

"The 2025 Act's new rules regarding tip income and overtime compensation present an interesting case of choosing to design a rule as a deduction rather than an exclusion:

*No Tax on Tips.* The 2025 Act creates a new deduction, effective from 2025 through 2028, for "qualified tips" reported to an individual on an information return, provided various statutory conditions are met. 2025 Act §70201 (enacting new IRC §224 and §63(b)(5)). "Qualified tips" generally refers to cash tips received by an individual working in an occupation that customarily and regularly receives tips (determined as of 2024), as provided by the Secretary of the Treasury. Those tips will need to be included in gross income, but the taxpayer then receives a deduction for the amount of that income.[2] The deduction is available to non-itemizers, but is not allowed in determining AGI under §62. The deduction amount is limited to $25,000 per taxable year, reduced by $100 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns). Thus, the effect is to zero out (or reduce) qualified tip income of workers below specified income levels.

*No Tax on Overtime*. The Act also creates a deduction for qualified overtime compensation, also effective 2025 through 2028, again provided various statutory conditions are met. 2025 Act §70202 (enacting new IRC §225). "Qualified overtime compensation" is defined as "overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act of 1938 that is in excess of the regular rate (as used in such section) at which such individual is employed" up to $12,500 ($25,000 for joint returns) for a taxable year, reduced by $100 for each $1,000 by which taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns). §§225(b), (c). Again, this means that that taxpayers must include their overtime compensation in gross income and may then take the allowable deduction. Qualified overtime compensation does not included amounts that are "qualified tips" under new §224(d). Like the deduction for qualified tips, the overtime deduction is available to non-itemizers, but is not allowed in determining AGI under §62.

Thus, for both qualifying tips and overtime compensation, the 2025 Act allows deductions for such income, but taxpayers remain required to include these amounts in their gross income. The decision to design these rules in the form of a deduction rather than an exclusion somewhat muddies the source/use distinction this Casebook has discussed: these new deductions are not based on taxpayer's use of the funds but are nonetheless styled as deductions rather than exclusions."

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[2] §63(b)(5). The deduction does not remove tips from the payroll tax base. It also does not prevent tips from triggering the phaseout of the earned income tax credit. §32(b).

*p. 21 — Tax Expenditures Discussion*

The 2025 Act will obviously affect estimates of the revenue lost due to "tax expenditures," a concept explained in the existing text, though new tax expenditure estimates have not yet been prepared. However, the overarching description of tax expenditure concept remains accurate.

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*p. 28 — Loper Bright and Relentless; Chevron deference overruled*

*Replace last paragraph on p. 28 and accompanying footnotes with the following:*

"Moving upward in the hierarchy of authority, the Internal Revenue Code is, of course, subject to any constraints imposed by the U.S. Constitution. Some older Supreme Court cases struck down various income tax provisions on constitutional grounds, but in recent decades the courts have been very reluctant to find constitutional infirmities in the federal income tax. Moving downward in the hierarchy, regulations promulgated by the Treasury Department under the Code (either under the general authority granted by §7805(a), or under a more specific grant of authority with respect to a particular provision) have the force of law unless they are inconsistent with the statute. Although courts invalidate regulations more often than they find constitutional violations in the statute, judicial invalidation of regulations has historically not been common. In some cases, Congress has delegated to the Treasury the authority to establish substantive rules, rather than merely to interpret the Code.[3] Regulations promulgated under such broad grants of authority are commonly referred to as "legislative" regulations, in contrast to "interpretive" regulations. Because the grants of authority are so broad, legislative regulations have seldom been invalidated.[4] Under the now-overruled *Chevron* deference doctrine, interpretive regulations were at greater risk of invalidation, but if a court believed that a Code provision could reasonably be interpreted in more than one way, it would uphold any reasonable regulatory interpretation.[5]

In June 2024, the Supreme Court overruled Chevron deference in *Loper Bright Enterprises v. Raimondo* and *Relentless, Inc., v. Department of Commerce*., 603 U.S. 369 (2024). Under *Loper Bright*, where there is a challenge to an interpretive regulation, courts will now have to employ their own independent judgment in interpreting the statute, and must come to the "best reading" of the statute, rather than deferring to the agency's reasonable regulatory interpretation.[6] With respect to legislative regulations (i.e., regulations in which the statute properly delegates

[3] See, e.g., §121(c)(2)(B) (authorizing Treasury to issue regulations defining what, if anything, qualifies as "unforeseen circumstances" for purposes of the exclusion of gain from the sale of a principal residence).
[4] For a rare invalidation of a legislative regulation (in the rather arcane area of consolidated corporate returns), see Rite Aid Corp. v. United States, 255 F.3d 1357 (Fed. Cir. 2001).
[5] Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984) (the leading case on judicial deference to reasonable regulatory interpretations; not a tax case); Mayo Foundation for Medical Education and Research v. United States, 131 S. Ct. 704 (2011). In Mayo Foundation, the Supreme Court made clear that interpretive tax regulations are entitled to deference under the usual Chevron standard.
[6] Loper Bright, slip op. at 23.

regulatory authority to the agency), *Loper Bright* holds that courts must "respect the delegation" but must also ensure that the agency is regulating within the scope of the delegation.[7]

Commentators have noted that in the aftermath of *Loper Bright*, we are likely to see more challenges to tax regulations, which may be more successful.[8] The decision may also affect how Treasury goes about rulemaking and how taxpayers engage in tax planning."

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*p. 32 — Tax Rates, Standard Deduction, Personal Exemption*

The 2025 Act has permanently set the §151 personal exemption amount at zero and has set the standard deduction amount to $31,500 for joint filers and surviving spouses ($15,750 for single filers and married taxpayers filing separately), adjusted for inflation for post-2025 tax years.

For 2026, the standard deduction is $32,200 for joint filers and surviving spouses ($16,100 for single filers and married taxpayers filing separately). Rev. Proc. 2025-32, § 4.14.

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*p. 36 — Phaseouts*

The child tax credit amount has been increased to $2,200 per qualifying child for 2025 and indexed for inflation for tax years after 2025. 2025 Act §70104. The phaseout thresholds remain the same.

Due to rounding, the amount is unchanged for 2026.

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*p. 48-52 — Compliance and Enforcement: The Case of Tips*

Because the 2025 Act's new rules regarding taxation of tip income are designed as a deduction, employees and employers would still need to comply with §6053. However, the incentives for employees to report tips to their employers and the policy implications (discussed in notes 2 and 3 on pp. 50-51) would obviously change.

Furthermore, the 2025 Act's changes affect the discussion in notes 4 and 5 on pp. 51-52, which floated policy options for aligning the law on the books with the law in practice (by either capping the inclusion of tips in gross income at 8% or by excluding tips from gross income altogether). The 2025 Act has pursued an alternative design: providing a deduction for qualifying tip income up to $25,000, subject to a phaseout at higher income levels.

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[7] Loper Bright, slip op. at 35.

[8] The Supreme Court's July 1, 2024 ruling *in Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (2024) may further pave the way for such challenges by extending the time frame in which they can be brought. *Corner Post* held that the six-year statute of limitations for bringing APA claims for review of agency rulemaking begins when the plaintiff is first injured by the rule, rather than at the time of the rule's issuance, which is likely earlier.

## CHAPTER 2

*p. 113 — Treatment of Tips and Overtime*

As discussed in this 2025 Summer Update (pp. 14-15), among the provisions of the 2025 Act that have received significant press coverage are the provisions concerning tips and overtime compensation. As this Update has discussed, the new provisions are designed as deductions for qualified tip income and overtime compensation, which means that the taxpayer has to include the tip and overtime amounts in gross income and then take the allowed deduction. However, it is worth highlighting these new provisions here because their effect is to not tax the covered tip and overtime compensation of many taxpayers. Moreover, they have been styled and advertised as exclusion provisions in mainstream news media and in political discourse.

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*p. 115 fn. 33 — Moving Expenses*

The 2025 Act makes the inclusion in employee gross income of moving expense reimbursements paid by employers permanent for most taxpayers. 2025 Act §70113(c). It does this by making §132(g)(2)—the provision suspending the §132(a)(6) exclusion of "qualified moving expense reimbursements" from gross income—permanent. Active-duty U.S. Armed Forces members continue to be eligible to exclude moving expense reimbursements from their gross income, and the 2025 Act also extends this exclusion to certain members of the intelligence community required to relocate due to a change in assignment. 2025 Act §70113(d).

The 2025 Act also permanently disallows moving expense deductions to taxpayers (employees or self-employed taxpayers) starting work at a new principal place of work by making §217(k)—which was introduced by the 2017 TCJA and which suspended the deduction for 2018 through 2025—permanent. 2025 Act § 70113(a). This deduction disallowance does not apply to active-duty Armed Forces members and certain members of the intelligence community.

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*p. 143 note 3 —Employer Payments of Student Loans*

The 2025 Act has made permanent the inclusion of employer payments of principal and interest on an employee's student loans in the §127 exclusion amount (discussed in the second paragraph of note 3 in the Casebook). 2025 Act §70412(a). In other words, employees can continue to exclude such employer student loan payments (as well as tuition paid by the employer) from gross income, up to the §127 limitation of $5,250. For post-2026 years, the 2025 Act also adjusts the $5,250 amount for inflation. 2025 Act §70412(b).

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**CHAPTER 3**

*p. 262 — The Realization Requirement and Moore v. United States*

*Replace first full paragraph on p. 262 with the following:*

"In June 2023, the Supreme Court granted certiorari in *Moore v. United States*.[9] The narrow issue in the case — involving a constitutional challenge to a provision of the Tax Cuts and Jobs Act of 2017 taxing shareholders of a controlled foreign corporation (CFC) on the CFC's undistributed earnings — is far outside the scope of this book. However, in ruling against the taxpayers' challenge, the Ninth Circuit had opined that realization of income is not a constitutional requirement for taxation.[10] In June 2024, the Supreme Court decided *Moore* 7-2, upholding the tax on CFC undistributed earnings and denying taxpayers' refund request.[11] Justice Kavanaugh's majority opinion was narrow and did not rule on whether realization is a constitutional requirement. However, four of the justices favored a realization requirement (Justices Alito and Barrett in a concurrence, and Justices Gorsuch and Thomas in the dissent), while only one (Justice Jackson) said realization was not constitutionally required. The remaining four justices did not address whether the Constitution requires realization. Thus, while *Moore* did not change the constitutional status of *Macomber* (whatever that might be) and did not answer the question of whether, for example, a tax on unrealized gains of billionaires would be constitutional, future litigation seems likely."

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*pp. 301-303; 368-69 — Federal Estate and Gift Tax Exemption Amount*

As the Casebook discusses on pp. 302 and 369 fn. 57, the 2017 TCJA doubled the federal estate tax exemption amount from $5,000,000 to $10,000,000 through 2025, adjusted for inflation.[12] But absent further action, the exemption would have been reduced starting in 2026.

The 2025 Act increases the exemption amount to $15,000,000 for 2026, adjusted for inflation, effective for decedents dying and gifts made after December 31, 2025. 2025 Act §70106. This increase is permanent.

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[9] Moore v. United States, Docket No. 22-800.
[10] Moore v. United States, 36 F4th 930 (9th Cir. 2022).
[11] Moore v. United States, 144 S. Ct. 1680 (2024)
[12] Thus, in 2023, the exemption amount was $12,920,000 and for 2025 it is $13,990,000.

## CHAPTER 4

*p. 376, 380 — Charitable Contribution Deduction for Non-Itemizers*

For tax years beginning after December 31, 2025, the 2025 Act allows non-itemizing taxpayers to claim a charitable deduction of up to $1,000 ($2,000 for joint filers) for qualifying contributions made in cash to a public charity. 2025 Act §70424. Under pre-2025 Act law (which continues to apply to the 2025 tax year), individuals who did not itemize deductions were not allowed to deduct their charitable contributions.[13]

Note that, as is the case with the §199A deduction, this new charitable deduction for non-itemizers is not an above-the-line deduction, because it is not allowed in determining §62 AGI. §63(b)(4).

and the tips, overtime pay, and vehicle loan interest deductions,

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*p. 390 — Limitations on Deductions and Carryovers*

For tax years beginning after 2025, the 2025 Act imposes a floor on individual charitable deductions equal to 0.5% of a taxpayer's "contribution base" (generally, the taxpayer's adjusted gross income for that year). This means that a taxpayer must reduce her charitable contribution by 0.5% of her contribution base. 2025 Act §70425. The Act provides ordering rules specifying the order in which the new 0.5% floor will apply to various types of contributions, as well as rules regarding when and how disallowed contributions can be carried forward.

For tax years beginning after 2025, the 2025 Act also makes permanent the 60%-of-contribution-base limit introduced by the 2017 TCJA (discussed on p. 390 of the Casebook in fn. 17 and accompanying text), which was set to expire at the end of 2025. 2025 Act §70425(b) (amending §170(b)(1)(G)). The Act makes the ordering sequence explicit by providing that the 60% limit is calculated after applying the 50%-of-contribution-base limit in §170(b)(1)(A).

*The following changes will affect the Examples in the Casebook for 2026 and future tax years. For those years, replace Examples 4.1 and 4.2 with the following:*

***"Example 4.1***. A taxpayer with a contribution base of $100,000 makes cash gifts to public charities of $40,000, and cash gifts to private foundations of $30,000. Assume that the private foundation is not one described in IRC§170(b)(1)(F) and so §170(b)(1)(B) applies. In this case, the 60 percent cash limitation will permit up to $60,000 to be deducted, so all of the $40,000 given to the public charities is deductible. With respect to the $30,000 of cash gifts to private foundations, the deduction is limited to the lesser of $30,000 (i.e., 30 percent of the $100,000 contribution base) or $10,000 (i.e., 50 percent of the $100,000 contribution base minus $40,000, the allowable deduction for the cash gifts to public charities).[19] In this case, even though the $30,000 of private foundation gifts does not exceed the 30 percent of contribution base limitation,

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[13] As noted on p. 376 fn. 3 and p. 380 fn. 10 in the Casebook, there was a small charitable deduction available to nonitemizers in 2020 and 2021, but that provision had expired.

[19]. IRC §170(b)(1)(B), (G). Treas. Reg. §1.170A-8(f), ex. 1.

it is limited by the "lesser than" rule in §170(b)(1)(B)(ii). Thus, before applying the 0.5% of contribution base floor, the taxpayer's total §170 deduction was $50,000, consisting of $40,000 of contributions to the public charity and $10,000 of contribution to the private foundation. Applying the 0.5% of AGI floor to the $100,000 contribution base, the taxpayer's allowable deduction must be reduced by $500, to $49,500.

***Example 4.2.*** A taxpayer with a contribution base of $100,000 gives $10,000 cash to public charities and $60,000 cash to private foundations. In this case, the $10,000 given to public charities would be deductible because it is below the 60 percent of contribution base limitation for cash gifts to public charities. With respect to the $60,000 of cash gifts to private foundations, the deduction is limited to $30,000. This is the lesser of $30,000 (i.e., 30 percent of the $100,000 contribution base) or $40,000 (i.e., 50 percent of the $100,000 contribution base minus $10,000, the allowable deduction for the cash gifts to public charities). After application of both limitations, the taxpayer would be allowed a deduction of $40,000, consisting of the $10,000 of contributions to public charities, and $30,000 of the $60,000 contributed to private foundations. Applying the 0.5% of AGI floor to the $100,000 contribution base, the taxpayer's allowable deduction must be reduced by $500, to $39,500."

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*<u>p. 395 — New Temporary Deduction for Certain Personal Car Loan Interest</u>*

From 2025 through 2028, the 2025 Act allows taxpayers to deduct interest paid on loans used to purchase some personal use vehicles (cars, minivans, vans, SUVs, pickup trucks, motorcycles), provided certain requirements are met. 2025 Act §70203 (enacting new IRC §163(h)(~~3~~)). For example, the debt must be incurred after December 31, 2024, and must be secured by a first lien on the vehicle; the vehicle must be bought new; the vehicle's original use must start with the taxpayer; the gross vehicle weight rating must be less than 14,000 pounds; and final assembly of the vehicle must occur within the US.

This car loan interest deduction is available to both itemizers and non-itemizers but is capped at $10,000 per year. The deduction is also subject to a limitation based on modified adjusted gross income, phasing out by $200 for each $1,000 (or portion thereof) by which the taxpayer's MAGI exceeds $100,000 ($200,000 for joint filers).

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*<u>pp. 395-96 — Qualified Residence Interest</u>*

The 2025 Act has permanently limited the deduction for qualified residence interest to $750,000 ($375,000 for married taxpayers filing separately). 2025 Act §70108(a) (amending §163(h)(3)(F)). It also makes permanent the treatment of qualified mortgage insurance premiums paid or accrued with respect to acquisition indebtedness as qualified residence interest.

The Act also makes permanent the exclusion of "home equity indebtedness" from the definition of "qualified residence interest."

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*p. 402 note 1 — Adoption Credit*

The 2025 Act enhances the adoption credit by providing that up to $5,000 of the credit will be refundable for 2025 and later years. 2025 Act §70402. This $5,000 refundable amount will be adjusted for inflation for post-2025 years.

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*p. 404 fn. 28 — Business Interest*

For 2025 and later taxable years, the sentence after footnote 28 on p. 404 of the Casebook should be read without the parenthetical "(for taxable years before 2022)." This is because the 2025 Act amends the computation of adjusted taxable income (ATI) in §163(j) by allowing depreciation and amortization to be added back to taxable income for purposes of calculating ATI and the 30%-of-ATI-limitation, thus going back to the pre-2022 approach, which allows computation of ATI based on EBITDA. 2025 Act §70303(a) (amending §163(j)(8)).

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*pp. 412-417 — State and Local Tax (SALT) Deduction*

The 2025 Act temporarily increases the §164 state and local tax deduction by increasing the $10,000 limitation—which was imposed by the 2017 TCJA for 2018 through 2025—to $40,000, retroactive to 2025. 2025 Act §70120 (amending §164(b)(6) and adding §164(b)(7)). This amount is adjusted for inflation to $40,400 in 2026 and then increased each year by 1% of the prior year's deduction amount from 2027 through 2029, before reverting to $10,000 in 2030, absent further congressional action. The allowable deduction is phased down for taxpayers with MAGI over $500,000 in 2025 (inflation adjusted for subsequent years), but does not go below $10,000.

$505,000 in 2026

The increase in the SALT deduction limitation seems likely to reduce the incentive for taxpayers to use alternative strategies to deduct amounts paid to states (discussed on pp. 413-417 of the Casebook).

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*pp. 421-423 — Casualty Losses*

*Limitation on Personal Casualty Loss Deduction to Federally Declared Disasters Made Permanent; Expansion to Include State-Declared Disasters*. As noted on p. 421 fn. 45 and p. 423 of the Casebook, the 2017 TCJA limited the casualty loss deduction to losses from a federally declared disaster (rather than to any disaster) for tax years 2018 through 2025. The 2025 Act makes this limitation permanent, and also expands the allowable losses to include "state-declared disasters," effective for post-2025 tax years. 2025 Act §70109. In short, for tax years after 2025, the deduction is permitted only for losses attributable to federal- and state-declared disasters.

*Waiver of 10% of AGI Requirements and Application of $500 Floor; Availability of Deduction to Non-Itemizers*. Another example of the waiver of the 10% of AGI requirement and the application of a $500 floor—discussed in the last full paragraph of p. 423 of the Casebook—came in the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Pub. L. No. 116-260) and the Federal Disaster Tax Relief Act of 2023 (Pub. L. No. 118-148). The combined effect of these legislations was to waive the 10% of AGI threshold and make personal casualty losses deductible only if exceeding $500 (rather than $100) for federally declared disasters declared within a certain time frame (January 1, 2020 through February 10, 2025) and occurring within a certain time frame (beginning on or after December 28, 2019 and on or before Dec. 12, 2024 and ending on or before January 11, 2025). The deduction was also made available to taxpayers who do not itemize deductions as well as to itemizers.

The 2025 Act extended these waivers and relaxed rules to federally declared disasters occurring on or before July 4, 2025 and declared within 60 days after July 4, 2025 (the date of enactment of the 2025 Act). 2025 Act §70438.

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*pp. 448-49 – Miscellaneous Itemized Deductions*

As discussed in the Casebook, the 2017 TCJA suspended (disallowed) miscellaneous itemized deductions for 2018 through 2025. This suspension was set to expire for tax years after 2025. However, the 2025 Act has now made the disallowance of miscellaneous itemized deductions permanent. 2025 Act §70110(a) (amending existing §67(g) and redesignating it §67(h)).

The 2025 Act also added a deduction for unreimbursed employee expenses of eligible educators to the list of itemized deductions allowable under §67(b). 2025 Act §70110(b) (creating new §67(b)(13) and new IRC §67(g)). Eligible educators are, generally, elementary and secondary school teachers, instructors, counselors, sports administrators, and coaches in a school for at least 900 hours, and eligible expenses are generally expenses for books, supplies, equipment and supplementary materials used as part of instructional activity.

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*p. 449 — Reduction of Itemized Deductions for High Income Taxpayers*

For 2026 and later tax years, the 2025 Act repeals prior §68, which had in years past provided that deductions must be reduced for taxpayers whose income exceeded certain amounts (the so-called "Pease limitation"). As noted in the Casebook, this Pease limitation had been suspended for 2018 through 2025 and, absent new legislation, would have applied again starting in 2026. The Act repeals the Pease limitation and enacts instead a new overall limitation on itemized deductions, which reduces otherwise allowable itemized deductions by 2/37 of the lesser of (1) the amount of itemized deductions or (2) so much of the taxpayer's taxable income that exceeds the beginning of the 37% bracket. The effect of the new limitation is to limit the benefit of an itemized deduction to 35% for taxpayers in the top (37%) bracket.

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<u>*p. 458 — Environmental Policy Through Personal Tax Credits*</u>

The 2025 Act makes a policy shift away from using personal tax credits (and also business tax credits) to address climate change, which, as discussed in the Casebook, had been a key design feature of the 2022 Inflation Reduction Act:

*§30D Clean Vehicle Credit*. The 2025 Act accelerates the termination date for the §30D Clean Vehicle Credit, providing that it will now terminate for vehicles acquired after September 30, 2025 (rather than vehicles placed in service after December 31, 2032). 2025 Act §70502(a) (amending IRC §30D(h)).

*§25E Credit for Previously Owned Clean Vehicles*. The 2025 Act accelerates the termination date for the §25E credit, providing that it will now terminate for vehicles acquired after September 30, 2025 (rather than vehicles acquired after December 31, 2032). 2025 Act §70501 (amending IRC §25E(g)).

*§25C Energy Efficient Home Improvement Credit*. The 2025 Act accelerates the termination date of the §25C credit, providing that it will not apply for any property placed in service after December 31, 2025. 2025 Act §70505(a) (amending IRC §25C(h)). The previous termination date was December 31, 2032.

*§25D Residential Clean Energy Credit*. The 2025 Act terminates the §25D credit for expenditures made after December 31, 2025. 2025 Act §70506.

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<u>*p. 460 — New IRC §25F*</u>

*Insert the following after the discussion of "Environmental Policy Through Personal Tax Credits":*

"3. Credit for Contributions to Scholarship Granting Organizations

The 2025 Act enacts a new credit, effective for 2027 and later tax years and available to US citizens and residents, for qualified cash contributions to "scholarship granting organizations," up to an annual ceiling of $1,700. 2025 Act §70411 (enacting new §25F). A "scholarship granting organization" is one that meets certain statutory requirements, including being described in §501(c)(3), using contributed amounts to fund elementary and/or secondary education scholarships for qualifying students who meet the statute's household income requirements, and being included on a state's list of eligible scholarship granting organizations within the state. The $1,700 annual ceiling on the federal credit is reduced "by the amount allowed as a credit on any State tax return of the taxpayer for qualified contributions made by the taxpayer during the taxable year." §25(b)(2). So, for example, if the taxpayer contributes $3,700 to a "scholarship granting organization" and is allowed a $2,000 state credit, this will reduce the $1,700 federal credit amount to zero. Thus, the effect of the statute as drafted is that the existence of allowable state credits will reduce the federal credit amount, even though the taxpayer contributed $1,700 for which no state credit was available. It is unclear whether this is what Congress really intended.

The amount claimed as a credit under §25F does not qualify as a deductible charitable contribution under §170. The credit is not refundable, but any credit disallowed due to nonrefundability can be carried forward five years. The 2025 Act also enacts new IRC §139K, which provides that any scholarship awarded by a scholarship granting organization is not included in the gross income of either the student or the student's parents. 2025 Act §70411(b) (enacting new §139K).

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*p. 498 — Moving Expenses*

As noted above, the 2025 Act makes the inclusion in gross income of employee moving expense reimbursements paid by employers permanent for most taxpayers. 2025 Act §70113(c). See discussion regarding p. 115, n. 33 above.

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## CHAPTER 5

*p. 541 — Gambling Losses*

The 2025 Act modifies the §165(d) wagering losses limitation in a way that could significantly impact the gambling industry. For post-2025 tax years, the 2025 Act provides that the §165(d) deduction is limited to 90% of the amount of losses from wagering transactions, and that it should be allowed only to the extent of gains from wagering transactions during that taxable year. 2025 Act § 70114(a) (replacing §165(d) with new language). New §165(d)(2) also maintains the 2017 TCJA's reversal of the *Mayo* rule (discussed on p. 541 Note 1) by providing that wagering losses "includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction." In other words, otherwise deductible business losses (not just wagering bets placed) are subject to the 90% limitation in §165(d).

This new 90% limitation means that some gamblers might find themselves owing tax despite not having a net gambling gain. For example, if a gambler places two bets, winning $100,000 on one and losing $100,000 on the other, she can only deduct $90,000 of the $100,000 loss, and will owe tax on $10,000. If a gambler instead wins $100,000 and loses $110,000, her §165(d) deduction would be limited to $99,000 (i.e., 90% of $110,000), and she would owe tax on $1,000. The impacts of the new rule on gambling behavior and the gambling industry remain to be seen.

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*p. 570 note 4 — Hobby Losses*

The 2025 Act has made the disallowance of miscellaneous itemized deductions permanent. 2025 Act §70110. Thus, hobby expenses are no longer deductible.

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*p. 587 — Qualified Business Income Deduction*

As discussed in the Casebook, §199A was enacted by the 2017 TCJA, effective for 2018 through 2025. The 2025 Act makes the §199A deduction permanent, and also makes other modifications:

*Minimum Deduction for Active QBI.* The 2025 Act creates a new minimum §199A deduction amount of $400 (subject to an inflation adjustment) for qualifying taxpayers. Thus, taxpayers whose aggregate QBI from all active qualified trades or businesses for the taxable year is at least $1,000 will get a minimum §199A deduction of $400. 2025 Act §70105(b) (amending §199A(i)).

*Broadening of Phase-in Ranges*. The 2025 Act increases the phase-in ranges of the §199A(b)(2)(B) limitation (i.e., the W-2 wage and qualified property basis limitations) and the

§199A(d)(3) SSTB limitation from $50,000 ($100,000 for joint filers) to $75,000 ($150,000 for joint filers). 2025 Act §70105(a).

*§199A(b)(2)(B) Phase-in Range*. As the Casebook describes (and as illustrated in Example 5.3), the §199A deduction is generally the lesser of:

(1) 20% of QBI, or
(2) the greater of (a) 50% of W-2 wages paid by the taxpayer, or (b) the sum of 25% of W-2 wages plus 2.5% of unadjusted basis of all qualified property.

However, prior to the 2025 Act, the latter W-2 wages and/or unadjusted basis limitation (i.e., limitation (2) above) did not apply if the taxpayer had taxable income over the threshold amount ($182,100/$364,200 in 2023; $197,300/$394,600 in 2025). If the taxpayer had taxable income over the threshold amount but not more than $50,000/$100,000 over the threshold amount, there was a partial reduction in the §199A deduction, as illustrated in Example 5.4.

The 2025 Act increases the phase-in range from $50,000/$100,000 to $75,000/$150,000 for 2026 and later tax years. Thus, in Example 5.4, for years after 2025, the denominator of the fraction in the second to last sentence would be $75,000 instead of $50,000. The $182,100 threshold amount would also need to be adjusted for inflation. For 2026, the threshold amount is $201,750. (twice that amont on a joint return).

*§199A(d)(3) SSTB Limitation Phase-in Range*. The 2025 Act likewise increases the SSTB phase in range from $50,000/$100,000 to $75,000/$150,000 for 2026 and later tax years.

As described in the Casebook on p. 558, the SSTB limitation does not apply to taxpayers whose taxable income is below the threshold amount ($182,100/$364,200 in 2023; $197,300/$394,600 in 2025). If the taxpayer has taxable income over the threshold amount but not more than $50,000/$100,000 over the threshold amount (for years before the 2026 tax year), the taxpayer is eligible for a reduced §199A deduction with respect to income from an SSTB.

The 2025 Act increases the $50,000/$100,000 phase in range to $75,000/$150,000. Thus, for years after 2025, in Problem 5.5, the denominator of the ratio used to determine the reduction percentage would be $75,000 rather than $50,000 (with the $182,100 threshold amount also adjusted for inflation).

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## CHAPTER 6

*p. 623 — §168(k) Bonus Depreciation; § 179*

*§168(k) Bonus Depreciation*. The 2025 Act has permanently set §168(k) bonus depreciation at 100% in the first year for qualified property placed in service after January 19, 2025. It provides a transitional election allowing taxpayers to take less than 100% depreciation in the case of qualified property acquired after January 19, 2025 and placed in service during the first taxable year after that date. 2025 Act §70301.

*§179 Expensing*. Effective for property placed in service in tax years beginning in 2025 and after, the 2025 Act has also increased the §179 maximum annual amount from $1,000,000 to $2,500,000, and has increased the statutory threshold for the total cost of property placed in service from $2,500,000 to $4,000,000. These numbers are subject to inflation adjustments. 2025 Act §70306.

*New §168(n)*. The 2025 Act added a new provision, IRC §168(n), which lets taxpayers elect a 100% depreciation deduction for "qualified production property," which is broadly speaking nonresidential real property used as an integral part of a qualified production activity (generally, manufacturing production or refining of tangible personal property, subject to certain conditions and exceptions) in the US or in a US possession. 2025 Act §70307. Construction of the qualified production property must begin after January 19, 2025 and before January 1, 2029, and the property must be placed in service before January 1, 2031; moreover, the original use of the property must commence with the taxpayer.

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For 2026, the § 179 maximum annual amount is $2,560,000, and the statutory threshold for total cost is $4,090,000. Rev. Proc. 2025-32, § 4.24.

## CHAPTER 8

*p. 721 — Excess Business Loss Limitation*

The 2025 Act has made §461(l) permanent, effective as of 2027. 2025 Act §70601.

The Act also changes the inflation calculation for the additional amount ($250,000/$500,000) that can be added to the gross income of the taxpayer in calculating excess business loss disallowed, effective for 2026 and later years. 2025 Act §70601.

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*p. 750 Note 1 — Alternative Minimum Tax*

*Replace Note 1 with the following:*

"The Klaassens would not run into the same issue under current law, not because the AMT now permits deductions for personal exemptions, but because the regular law disallows such deductions. There has been a similar change with respect to the AMT and miscellaneous itemized deductions. The AMT disallows miscellaneous itemized deductions, including unreimbursed employee business expenses and §212 expenses for the production or collection of income. For moderate-income taxpayers with significant miscellaneous itemized deductions, this disallowance used to be the main culprit in subjecting them to the AMT. But as of 2018, the regular tax has also disallowed the deduction of miscellaneous itemized deductions.[40] State and local tax deductions are also disallowed by the AMT; and these were also capped at $10,000 by the regular tax from 2018 through 2024. (The cap has been raised to $40,000 from 2025 through 2029—adjusted for inflation starting in 2026—which may cut in the opposite direction.) Deductions for interest on home equity loans are disallowed by both the AMT and, now, the regular tax. Thus, the AMT will have much less bite than it used to (though the effect of the 2025 changes remains to be seen). The effect of the 2017 legislation on the scope of the AMT could hardly have been more dramatic. Having applied to 3 percent of households in 2017, the AMT applied to a mere 0.1 percent of households in 2019.[41] With the AMT now applying to such a tiny sliver of taxpayers, should Congress simply repeal it, and be done with the remaining complexity?"

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For 2026, the amount is $40,400.
See Code section 164(d)(7)(A)(ii).

[40] For the regular tax treatment of unreimbursed employee business expenses, see Chapter 4.F.
[41] Tax Policy Center Briefing Book, *Who Pays the AMT?*, taxpolicycenter.org/briefing-book/who-pays-amt (last visited June 26, 2023).

## CHAPTER 9

*pp. 754-56 — Child Care Credit*

Effective for 2026 and later tax years, the 2025 Act has permanently "enhanced" the child care credit by increasing the maximum credit rate and modifying the AGI ranges at which the credit rate is reduced.

The Act provides that the maximum credit rate will be 50%, reduced (but not below 35%) by 1 percentage point for each $2,000 or fraction thereof by which taxpayer's AGI exceeds $15,000, and further reduced (but not below 20%) by 1 percentage point for each $2,000 or fraction thereof by which taxpayer's AGI exceeds $75,000 ($150,000 for joint filers). 2025 Act §70405. The new credit phasedown ranges mean that when taxpayer AGI reaches $43,001, the credit rate is 35% and remains 35% until AGI exceeds $75,000.

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*p. 756 — §129 Dependent Care Assistance Exclusion*

For 2026 and later tax years, the 2025 Act has increased the §129 exclusion to a ceiling of $7,500 ($3,750 for married filers filing separately). 2025 Act §70404.

*Replace Problem 9.9 with the following:*

"***Problem 9.9.*** Alice spends $12,000 on day care for her only child, and she would like a tax benefit for as much of the $12,000 as possible. If her employer has a DCAP, can she exclude $7,500 under §129 and claim a credit based on another $3,000 of credit eligible expenses under §21? Notice that this is *not* an attempt to obtain both an exclusion and a credit for the same dollars, which would be prohibited by §129(e)(7)."

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*p. 758 — Child Credit*

*Replace the discussion on pp. 758-761 (Child Tax Benefits Not Based on Expenditures) with the following:*

***"2. Child Tax Benefits Not Based on Expenditures***

a. Exemptions

Until 2018, §151 allowed a taxpayer to claim one personal exemption for himself (two exemptions for a married couple filing a joint return) and an additional exemption for each dependent. The amount of the exemption was indexed for inflation; the exemption amount for 2017, for example, was $4,050. As used in this context, "exemption" is just another word for deduction. A taxpayer was generally entitled to a §151 deduction equal to the inflation-adjusted exemption amount multiplied by the number of people in his household.

The personal and dependency exemptions served two functions. First, they worked together with the standard deduction to prevent the imposition of income tax liability on persons living at or below the poverty level. And second, exemptions adjusted tax liabilities for differences in family size across a wide range of income levels. Exemptions were phased out for upper-income taxpayers.

From 2018 to 2025, however, personal exemptions were suspended by the 2017 TCJA. Instead, the child tax credit was increased, and a credit for dependents who are not qualifying children was added. The 2025 Act has now permanently eliminated the §151 personal exemption for most taxpayers and has also extended and enhanced the child tax credit and credit for dependents. 2025 Act §70103 (amending §151(d)(5)); 2025 Act §70104 (child and dependent tax credit enhancements). The 2025 Act also creates a new temporary "senior deduction" for taxpayers aged 65 and older. §151(d)(5)(C). Such taxpayers are entitled to a $6,000 deduction per qualified individual for 2025 through 2028, reduced (but not below zero) by 6% of the amount by which the taxpayer's modified adjusted gross income exceeds $75,000 ($150,000 for joint filers).

b. The Child Credit

Rather than declare a victor in the great debate between proponents of dependency exemptions and proponents of credits, in 1997 Congress decided to make everyone a winner by enacting the §24 child credit — in addition to, rather than as a replacement for, the §151 dependency exemption. Before 2018, the basic amount of the credit was $1,000 per child. The 2017 TCJA doubled that basic amount to $2,000 per child for tax years 2018 through 2025. These amounts were not indexed for inflation, either before or after the 2017 Act.

The 2025 Act made the 2017 TCJA changes permanent for 2025 and later tax years and also made some modifications and enhancements: The 2025 Act increased the basic child tax credit amount to $2,200 per qualifying child starting in 2025 and indexed the credit amount for inflation for post-2025 tax years. 2025 Act §70104(c). The 2025 Act also modified the eligibility requirements for the credit, by requiring that both the claiming taxpayer and the child provide a qualifying social security number on the tax return. 2025 Act §70104(b).

In contrast to the exemption, the value of the credit is independent of the taxpayer's marginal tax rate. For most taxpayers, the calculation of the credit could not be simpler: By the terms of §24(a) and (h), just multiply $2,200 (2025 amount, not adjusted for inflation) by the number of the taxpayer's "qualifying children." Like the dependency exemption, however, the credit is phased out for higher income taxpayers.

The child credit phaseout begins at $400,000 for married couples filing joint returns and at $200,000 for any other filing status for 2018 and later years.[4] These phaseout thresholds are *not* adjusted for inflation, either before or after the 2025 Act.[14] The credit phaseout serves as a way of

[4] The American Rescue Plan Act of 2021 temporarily modified the §24 credit for 2021, but those modifications were effective for only one year. §24(i).

[14] The phaseout thresholds were increased to this level by the 2017 TCJA for 2018 through 2025. They were scheduled to revert to (lower) pre-TCJA levels for post-2025 years but were made permanent by the 2025 Act.



Due to a rounding-down rule, this amount remains the same for 2026.

means-testing the subsidy embodied in the credit. It is easy enough to understand why Congress might subject such a subsidy to means-testing, but it is not easy to understand why the means-testing should be so minimal. It is true that the phaseout prevents a couple with $600,000 AGI from receiving the subsidy, but why should a couple with $330,000 AGI receive just as large a per-child subsidy as a couple with $30,000 AGI?

If the phaseout makes credit calculations somewhat complex for high-income parents, there is even more complexity in the rules applicable to low-income parents. Most tax credits, with the very important exception of the earned income credit, are nonrefundable. That means they are of value to a particular taxpayer only to the extent that the taxpayer has a before-credit income tax liability. For example, if a taxpayer has a pre-credit income tax liability of $300 and is theoretically entitled to a nonrefundable credit of $1,000, $700 of the credit will be unusable. On the other hand, if the credit were refundable, the taxpayer could use $300 of the credit to reduce income tax liability to zero and would be entitled to receive the other $700 as a check from the government.

To oversimplify the political debate a bit, liberals and conservatives have differing views as to whether the child credit should be refundable. The liberal view is that the credit is intended as a subsidy for parents and their children, and that there is no good reason why eligibility for a subsidy should depend on having income tax liability to offset — in fact, poor parents with little or no pre-credit income tax liability are in greatest need of the subsidy. Under this view, the credit should be fully refundable. To conservatives, however, there is a great moral gulf between the last dollar of tax reduction (good) and the first dollar of transfer payments (bad). Under this view, it is one thing to allow the credit to reduce or eliminate the income tax burden on low-income parents, but it is a very different thing to use the credit to give low-income parents a handout (on top of the already refundable earned income credit). Each of these positions is philosophically coherent, and either would be simple to implement. Unfortunately, the legislative compromise between the two makes little policy sense and imposes considerable complexity on taxpayers who cannot afford expensive professional assistance in dealing with it. The messy compromise, embodied in §24(d) and §24(h), is a version of partial refundability. According to the statute (as amended by the 2025 Act), the credit is refundable to the extent of 15 percent of the amount by which earned income exceeds $2,500. The statutory maximum amount refundable[5] is $1,400 per qualifying child. The dollar amount is adjusted for inflation, and is $1,700 per qualifying child for 2025.[6] The following examples illustrate the application of §24(d), after taking into account the special rules in §24(h)(5), §24(h)(6) and §24(i) (as amended by the 2025 Act). For purposes of these examples, assume the tax year is 2025.

For 2026, the dollar amount remains $1,700 due to rounding.

The results are the same in 2026.

***Example 9.1***. Assume that the $2,500 threshold applies, and a particular taxpayer's earned income is $7,000. Assume that the taxpayer has one qualifying child. In this case, $675 of the taxpayer's §24 credit would be refundable (i.e., ($7,000 – $2,500) × 15%).[7] The refundable credit amount is the lesser of $675 or $1,700, the statutory maximum refundable.

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[5] But see the §24(i) special rule for 2021, discussed in the previous footnote.

[6] Rev. Proc. 2024-40, §3.05.

[7] ($7,000 − $2,500) × .15 = $675. For taxpayers with three or more children, the partial refundability calculations are even more complicated. Basically, they can calculate the amount of refundable credit using either the method described in the text, or a method that makes the credit refundable to the extent the taxpayer's social security taxes exceed the taxpayer's earned income credit. If this sounds like a complicated mess, it is. At least it is a pro-taxpayer mess, as the taxpayer is entitled to use whichever method produces the larger refundable amount.

***Example 9.2.*** Assume the same facts as in Example 9.1 but now assume the taxpayer has two qualifying children. In this case, the taxpayer's refundable credit remains $675, because that calculation is applied on a per-taxpayer basis. The refundable credit amount is now the lesser of $675 or $3,400 (i.e., $1,700 × 2 children).

***Example 9.3.*** Now assume that the taxpayer has two qualifying children and $17,500 of earned income. The taxpayer's refundable credit is now $2,250, which is the lesser of $2,250 (i.e., ($17,500 – $2,500) × 15%) or $3,400 (i.e., $1,700 × 2 children).

***Example 9.4.*** Now assume that the taxpayer has one qualifying child and $17,500 of earned income. The taxpayer's refundable credit is now $1,700, which is the lesser of $2,250 (i.e., ($17,500 – $2,500) × 15%) or $1,700.

The partial refundability rule acts as a *negative* 15 percent marginal tax rate, beginning at $2,500 earned income. This negative tax rate operates over much of the same income range as the hidden *positive* marginal tax rate imposed by the phaseout of the earned income credit of §32,8 and serves to counteract the high marginal tax rates otherwise caused by the combination of the §1 rate schedule and the earned income tax credit phaseout. For example, if a taxpayer is simultaneously subject to a 10 percent rate under §1, a 21.06 percent earned income credit phaseout rate (the rate applicable to taxpayers with two or more qualifying children), and a 15 percent negative rate under §24, the taxpayer's overall marginal tax rate (ignoring social security tax and state income tax) is 16.06 percent. The negative marginal tax rate under the child credit does not fully offset the earned income credit phaseout, both because the §24 negative rate is lower than the phaseout rate for the earned income credit and because the income range for phaseout of the earned income credit extends well beyond the end of the negative tax rate under §24. Of course, there is value in having §24 even partially offset the high marginal tax rates imposed by §32. It might be better yet, however, to redesign the system to eliminate both the negative tax of §24 and the positive tax imposed by §32. Why would anyone design a tax system under which a low-income parent with one child is simultaneously subject to a 15.98 percent positive tax under §32 and a 15 percent negative tax under §24?9 Depending on your taste in literary references, the system must have been designed either by the Duke of York[10] or Alice's White Knight.[11] Rather than having the positive tax and the negative tax virtually cancel out each other, wouldn't it be simpler to get rid of both?

Most of the time, if a child would have qualified as a taxpayer's dependent for exemption purposes, the child will also be a "qualifying child" for purposes of the child credit. There is, however, one important difference: The credit is allowed only with respect to a child who is 16 or younger at the end of the taxable year.[12] Thus, parents will often be unable to claim the credit with respect to

8. For the earned income tax credit, see section E of this chapter.
9. The phaseout rate for taxpayers with only one qualifying child is 15.98 percent. *See* §32(b)(1).
10. "He had ten thousand men/He marched them up to the top of the hill/and marched them down again."
11. "But I was thinking of a plan/To dye one's whiskers green/And always use so large a fan/That they could not be seen."
12. *See* §24(c)(1).

children attending high school. The legislative history provides no explanation for this rather strange cut-off age.

A taxpayer is also permitted to claim a $500 nonrefundable credit for each dependent who is not a qualifying child for purposes of the child tax credit, under §24(h)(4)(A). This dependent credit was introduced by the 2017 TCJA on a temporary basis and was made permanent by the 2025 Act. Such dependents could include children ages 17 or 18; children from ages 19 through 23, if they are full-time students; and an unmarried partner if the taxpayer provides more than half the partner's support and the relationship between such individual and the taxpayer is not in violation of local law. The dependent credit is not adjusted for inflation.[13]

***Problem 9.12.*** Gina and George, whose AGI is $408,000, have two "qualifying children" for purposes of the child credit. But for the §24(b)(2) phaseout provision (as modified by §24(h)(3)), they would be entitled to a $4,400 child credit ($2,200 for each child). How large a credit are they entitled to, taking the phaseout into account?

***Problem 9.13.*** Helen, a single parent, has two "qualifying children" for purposes of the child credit. Her earned income for the year is $23,000. If the child credit did not exist, she would have an income tax liability of $200. A $4,400 credit is generally available to a taxpayer with two children, but what will be the amount of Helen's §24 credit? (Assume a 2025 tax year. Assume the $2,500 threshold in §§24(d)(1)(B)(i) and 24(h)(6).)"

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<u>*p. 763 — Tax-Deferred Investment Accounts for Children*</u>

*Insert the following on p. 763 before "B. The Income Tax Treatment of Marriage":*

"d. Tax-Deferred Accounts for Children

Effective 2026, the 2025 Act has created "Trump Accounts," which are a new tax-deferred investment account for children. 2025 Act §70204. These are accounts that are established for qualified children (US citizens who are under 18 years old and who have a social security number). Contributions into these accounts can be made by parents and other taxable entities up to $5,000 a year of post-tax dollars (indexed for inflation for post-2027 tax years), until the beneficiary turns 18. Qualified tax-exempt entities can also make contributions, and these contributions are not limited to the $5,000 limit. Contributions may be made beginning 12 months after July 4, 2025, the 2025 Act's enactment date. Investment earnings grow tax deferred in the account and are not taxed to the beneficiary until the beneficiary makes withdrawals, which are not permitted until age 18. The 2025 Act also establishes a pilot program, effective 2026, which contributes $1,000 into the Trump Accounts of U.S. citizens born in years 2025 through 2028."

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[13] For further discussion, see Section 9.D, below.

*p. 782 – Family Income Splitting by Statute*

As discussed elsewhere in this 2025 Summer Update, the 2025 Act has permanently suspended the personal exemption and dependency exemptions. The 2025 Act has also made the 2017 TCJA's tax rate and brackets permanent.

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## <u>CHAPTER 12</u>

*<u>p. 857-859 — §1202 Qualified Small Business Stock Expansion</u>*

Replace the discussion of §1202 gains on p. 857 with the following:

"*Section 1202 gains*," for which a 28 percent rate also applies in some circumstances. This is a special category of gain on small business corporate stock, for which an exclusion of all or part of the gain from sale or exchange of the stock is allowed, with a 28 percent tax rate applying to rest. For qualified small business stock acquired after July 4, 2025 (the date of the 2025 Act's enactment) and held for five years or more, 100% of the gain is excluded. If the stock is held four years or more, 75% of the gain is excluded; and if the stock is held three years or more, 50% of the gain is excluded. (A 50% exclusion is the same, of course, as including all the gain in income and taxing it at 14%; a 75% exclusion is the same as including all the gain in income and taxing it at 7%; and a 100% exclusion moots the question of the applicable tax rate.)"

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## *APPENDIX A*
## *2026 Version of Problem on Pages 3–4*

*Gross Income.* The Smiths' gross income computation remains the same at $135,000. Their above-the-line § 219 IRA deduction also remains the same. Therefore, their adjusted gross income remains $133,000.

*Standard Deduction.* The Act permanently extended the standard deduction amount provided for in the 2017 TCJA and provides an inflation adjustment; the 2026 standard deduction for a married couple filing jointly is $32,200, as provided in Rev. Proc. 2025-32. The Smiths would obviously take the standard deduction.

For years starting in 2026, the Act allows taxpayers who take the standard deduction to deduct, in addition, certain charitable contribution deductions of cash, up to $2,000 a year for joint filers ($1,000 for individual filers). See Code section 170(p).

Thus, the Smiths' taxable income for 2026 is:

  $135,000 gross income
− $2,000 above-the-line IRA deduction (§ 219)
− $32,200 standard deduction
− $2,000 portion of donation to church
= $98,800.

*Tentative Tax Liability Computation.* The Act makes permanent the tax rate reductions and tax bracket changes introduced by the 2017 TCJA and makes changes to how inflation indexing is done. The Smiths' tentative tax liability computation under §1(a) is performed using the 2026 tax rate schedules provided in Rev. Proc. 2025-32, as follows:

- First $24,800 of taxable income × 10% tax rate = $2,480
- Next $74,000 of taxable income × 12% tax rate = $8.880
- Total tentative tax liability = $11,360.

*Capital Gains Adjustment.* The Smiths then adjust their tentative tax liability downward to account for the lower capital gain rate under section 1(h). After inflation adjustment, see Rev. Proc. 2025-32, § 4.03, their $5,000 capital gain is taxed at 0%.

Section 1(h) is a computational headache, but on these facts, a simple way of doing its work would be to calculate the normal tax on $93,800 of non-capital income, and then add a capital gain tax (starting at 15%) on the amount (if any) of the Smiths' taxable income over $98,900 (the "maximum zero-rate amount," as adjusted for inflation in Rev. Proc. 2025-32, § 4.03). Here are the steps:

- First $24,800 of taxable ordinary income × 10% = $2,480
- Remaining $69,000 of taxable ordinary income × 12% = $8,280
- Tax on capital gains, if any, over the maximum zero rate amount (but $98,800 < $98,900, so…) = 0
- Total = $10,760.

Notice that the couple saves $600 of tax due to the favorable treatment of their capital gain under section 1(h). That's 12% of the $5,000 gain—the entire tax on the gain, computed at their highest marginal rate.

*Credits*. The Act increases the § 24 child tax credit from $2,000 to $2,200 per child starting in 2025, and indexes it for inflation (subject, however, to a rounding-down rule). Thus, for 2026, the Smiths will get a $4,400 § 24 child tax credit. See Rev. Proc. 2025-32, § 4.05(1).

The 2025 Act has modified and enhanced the § 21 child care credit for 2026 and later years (see discussion in this 2025 Summer Update regarding pp. 754–756). Therefore, the Smiths' § 21 credit is $2,100 for 2026 (35% of $6,000).

The Smiths' final tax liability after credits is $4,260 (i.e., $10,760 − $4,400 − $2,100).

*Miscellaneous Issues.* Note that the Act sets the § 151 personal exemption amount permanently at zero, though it does create a new, temporary deduction for taxpayers age 65 or older (effective for the 2025 through 2028 tax years). 2025 Act § 70103. Further, the Act has made the disallowance of miscellaneous itemized deductions permanent (other than a deduction for educator expenses). 2025 Act § 70110.