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Where to File: Business Returns Filing Addresses—2025 Returns

Note: At the time of publication, the IRS had not released the 2025 filing addresses for business returns. This information will be posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder** when available.

Principal Business Activity Codes—Forms 1065, 1120, and 1120-S

Note: At the time of publication, the IRS had not released the 2025 principal business activity codes for business returns. This information will be posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder** when available.

Business Quick Facts Data Sheet[1]

	2026	2025	2024	2023	2022
FICA/SE Taxes					
Maximum earnings subject to tax:					
Social Security tax	$ 184,500	$ 176,100	$ 168,600	$ 160,200	$ 147,000
Medicare tax	No Limit	No Limit	No Limit	No Limit	No Limit
Maximum tax paid by:					
Employee—Social Security	$ 11,439.00	$ 10,918.20	$ 10,453.20	$ 9,932.40	$ 9,114.00
SE—Social Security	22,878.00	21,836.40	20,906.40	19,864.80	18,228.00
Employee or SE—Medicare	No Limit	No Limit	No Limit	No Limit	No Limit
Business Deductions					
Section 179 deduction—limit	$ 2,560,000	$ 2,500,000	$ 1,220,000	$ 1,160,000	$ 1,080,000
Section 179 deduction—SUV limit (per vehicle)	32,000	31,300	30,500	28,900	27,000
Section 179 deduction—qualifying property phase-out threshold	4,090,000	4,000,000	3,050,000	2,890,000	2,700,000
Depreciation limit—autos, trucks, and vans (1st year with special depreciation)	[2]	20,200	20,400	20,200	19,200
Depreciation limit—autos, trucks, and vans (1st year with no special depreciation)	[2]	12,200	12,400	12,200	11,200
Retirement Plans					
SIMPLE IRA plan elective deferral limits:					
Under age 50 at year end	$ 17,000[3]	$ 16,500[3]	$ 16,000[3]	$ 15,500	$ 14,000
Age 50 or older at year end	21,000[3, 4]	20,000[3, 4]	19,500[3]	19,000	17,000
401(k), 403(b), 457, and SARSEP elective deferral limits:					
Under age 50 at year end	$ 24,500	$ 23,500	$ 23,000	$ 22,500	$ 20,500
Age 50 or older at year end	32,500[5]	31,000[5]	30,500	30,000	27,000
Profit-sharing plan/SEP contribution limits	72,000[3]	70,000[3]	69,000	66,000	61,000
Compensation limit (for employer contributions to profit-sharing plans)	360,000	350,000	345,000	330,000	305,000
Defined benefit plans—annual benefit limit	290,000	280,000	275,000	265,000	245,000
***Key employee* compensation threshold**	235,000	230,000	220,000	215,000	200,000
***Highly compensated* threshold**	160,000	160,000	155,000	150,000	135,000
Estate and Gift Taxes					
Estate tax exclusion	$15,000,000[6]	$ 13,990,000[6]	$13,610,000[6]	$12,920,000[6]	$12,060,000[6]
Gift tax exclusion	15,000,000[6]	13,990,000[6]	$13,610,000[6]	12,920,000[6]	12,060,000[6]
GST tax exemption	15,000,000	13,990,000	13,610,000	12,920,000	12,060,000
Gift tax annual exclusion	19,000	19,000	18,000	17,000	16,000

[1] See Tab 3 in the *1040 Quickfinder® Handbook* for an expanded *Quick Facts Data Sheet*.

[2] Amount not released by IRS at publication time; will be posted to the Handbook Updates section of **tax.thomsonreuters.com/quickfinder** when available.

[3] Beginning in 2024, this limit is increased by 10% if the employer has no more than 25 employees. For employers with 26–100 employees, higher elective deferral limits are allowed if the employer contributes either 3% of compensation or 4% of an employee's elective deferrals.

[4] $5,250 for individuals who are 60, 61, 62, or 63 in 2025 and 2026.

[5] $11,250 for individuals who are 60, 61, 62, or 63 in 2025 and 2026.

[6] Plus the amount of any deceased spousal unused exclusion and/or any restored exclusion related to lifetime gifts to a same-sex spouse—see Tab H.

Schedules K-2 and K-3 (Form 1065) provide a *domestic filing exception,* a *Form 1116 exemption exception, and a small partnership filing exception* for filing and furnishing Schedules K-2 and K-3.

Domestic filing exception. Partnerships that meet this exception do not have to include Schedules K-2 and K-3 in their tax return or furnish copies of Schedule K-3 to their partners unless requested by a partner after the date one month before the date the partnership files its Form 1065. If a partner requests a Schedule K-3 after the one-month date, the partnership must provide the schedule to the partner, but Schedules K-2/K-3 are not filed with the IRS. Domestic partnerships potentially qualify for the domestic filing exception if they have no foreign activity or have limited foreign activity. For this exception, foreign activity is:

1) Payment or accrual of foreign income taxes.
2) Foreign-source income or loss.
3) Ownership interest in a foreign partnership (generally, a partnership that is not a domestic partnership).
4) Ownership interest in a foreign corporation.
5) Ownership of a foreign branch.
6) Ownership interest in a disregarded foreign entity.

Limited foreign activity. If a partnership has foreign activity, such foreign activity is limited to:

1) Passive category foreign income (for example, dividend income);
2) Upon which no more than $300 of foreign income taxes allowable as a foreign tax credit (FTC) are paid or accrued by the partnership; and
3) The foreign income and FTC are shown on a payee statement (for example, Form 1099) furnished to the partnership.

Domestic partnerships that have no (or limited) foreign activity qualify for the domestic filing exception if they meet the following three tests: 1) U.S. Citizen/Resident Alien Partners Test; 2) Notification Test; and 3) No Schedule K-3 Requests by the One-Month Date. See Partnership Instructions for Schedules K-2 and K-3 (Form 1065) for more information.

Form 1116 exemption exception. A domestic partnership is not required to complete Schedules K-2 and K-3 if all partners are eligible for the Form 1116 exemption and the partnership receives notification of the partners' eligibility for such exemption by the one-month date.

Beginning with tax year 2024, partnerships that answered "Yes" to question 4 on Schedule B of Form 1065 (generally, those with total receipts less than $250,000 and assets less than $1 million) are no longer required to file Schedules K-2 and K-3. Partnerships will be subject to the same notification requirements of the domestic filing exception.

Schedules K-1/K-3 deadline. Partnerships are required to furnish a Schedule K-1/K-3 to each partner by the due date, including extensions, of the partnership tax return (Form 1065). For statements required to be furnished in 2026, a $340 penalty, imposed with respect to each Schedule K-1/K-3 for which a failure occurs, applies for failure to furnish Schedule K-1/K-3 when due or failure to include all required information or for including incorrect information. The maximum penalty is $4,098,500 for all such failures during a calendar year for taxpayers with average annual gross receipts for the most recent three tax years of more than $5,000,000. For taxpayers with average annual gross receipts of $5,000,000 or less, the maximum penalty is $1,366,000. If the requirement to report correct information is intentionally disregarded, each $340 penalty is increased to $680 or, if greater, 10% of the aggregate amount of items required to be reported, and the $1,366,000 (or $4,098,500) maximum doesn't apply. The $340 penalty may be reduced to $60 or $130 per failure, and the $1,366,000 (or $4,098,500) maximum penalty to $239,000 or $683,000 (or $683,000 or $2,049,000), respectively, depending on when the failure is corrected (IRC Sec. 6722; Rev. Proc. 2024-40).

Electronic Schedule K-1. Partnerships required to furnish a K-1 to a partner may provide it in an electronic format instead of on paper. The partner's affirmative consent to receive the K-1 in electronic format is one of the requirements of Rev. Proc. 2012-17 that must be met for the partnership to be treated as furnishing the K-1 timely.

Online business tax account. Individual partners of partnerships are eligible for an IRS business tax account (BTA). BTA is an online self-service tool for business taxpayers that allows them to view and make balance-due payments. When fully developed, BTA will allow many types of business taxpayers to check their tax history, make payments, view notices, authorize powers of attorney, and conduct other business with the IRS. Individual partners will be able to access business tax account information once they have filed a business return with the Schedule K-1 and it is processed by the IRS. To access a business tax account, individuals must have a Schedule K-1 for a minimum of one year on file. Only information for the years they have a Schedule K-1 on file will be available. New businesses won't have access until a business return is submitted, processed, and on file with the IRS. The business tax account is available at **www.irs.gov/businesses/business-tax-account**.

Income/tax rates. Profits and losses are passed through to partners on Schedule K-1 and taxed on their individual returns.

Limited liability companies (LLCs) are created and regulated under state law. Those with more than one member are treated as partnerships for federal income tax purposes, unless an election is made to be taxed as a corporation. LLCs generally have the same options as partnerships for electing tax treatment under check-the-box regulations. See *Limited Liability Company (LLC)* on Page F-1 for more information.

Partnership representative. A partnership's primary representative in dealings with the IRS is its *partnership representative* (PR). The partnership must designate its PR by completing information on page 4 of Form 1065 for the tax year for which the designation applies. Designation of a PR is made separately for each tax year, and is only effective for the tax year for which it is made [Reg. 301.6223-1(a) and (c)].

The PR is not required to be a partner, and can be any person (including an individual or an entity) with a substantial presence in the U.S. A wholly-owned disregarded entity is eligible to serve as a PR, and the partnership can designate itself as its own PR. A person who is not an individual can be a PR only if an individual who meets the substantial presence test is appointed by the partnership as the sole individual through whom the PR will act. A PR meeting these requirements is an *entity partnership representative* and the individual through whom such an entity partnership representative acts is the *designated individual*. The designated individual must be appointed at the same time as the PR [Reg. 301.6223-1(b)].

The PR has the sole authority to bind the partnership and all partners. If a partnership does not designate a PR, the IRS may select any person as the PR, with certain limitations. Partnerships will need to ensure their agreements establish procedures for choosing, removing, and replacing the PR. In addition, the partnership agreement should carefully outline the duties of the representative.

Consider addressing in the partnership agreement whether the:

- PR must provide partners with copies of IRS notices and inform them of the status of an audit or tax proceeding.
- Consent of a majority of the partners is needed before the PR can agree to extend the statute of limitations or settle with the IRS. (While such a provision will not limit the PR's authority in the eyes of the IRS, it may give partners recourse under state law if the PR fails to comply.)
- Partnership agreement should limit the PR's fiduciary risk through indemnity protection.

Note: Effective October 7, 2025, the IRS has issued updated guidance on procedure changes pertaining to the designation of the partnership representative. See LB&I-04-1025-0010 for more information.

- First at the partnership or S corporation level and again at the partner or shareholder level.
- Generally to taxpayers with average annual gross receipts for the three-tax-year period ending with the prior tax year of over $25 million, adjusted for inflation ($31 million for 2025).

A partnership that has current year gross receipts greater than $5 million is required to report gross receipts to partners for the three immediately preceding tax years as well as gross receipts for the current year. The gross receipts are reported on a partner's Schedule K-1, in box 20 with the code AG. Partnerships whose current year gross receipts are less than or equal to $5 million may also use this code to report gross receipts.

Final regulations (TD 9905 and 9943) address, among other things, the calculation of ATI and the application of the limitation to Controlled Foreign Corporations (CFCs). The regulations also provide guidance regarding the definitions of *real property development, real property redevelopment*, and *syndicate*. The regulations affect taxpayers that have business interest expense, particularly pass-through entities, their partners and shareholders, as well as foreign corporations and their U.S. shareholders.

Excess business interest expense (EBIE) is the amount of disallowed business interest expense of the partnership for a tax year.

Form to use. The limitation is computed on Form 8990 [Limitation on Business Interest Expense Under Section 163(j)].

Business interest. Interest is considered business interest if it is on debt that is properly allocable to a trade or business as defined in IRC Sec. 163(j)(7), *not* to a trade or business (1) in which the taxpayer is an employee, (2) that is an electing (a) real property trade or business or (b) farming business, or (3) that furnishes or sells certain public utility products or services. Business interest does not include investment interest.

Adjusted taxable income (ATI). This is taxable income computed without regard to any [IRC Sec. 163(j)(8)]:

1) Item of income, gain, deduction, or loss not properly allocable to a trade or business.
2) Business interest income or expense.
3) NOL under IRC Sec. 172.
4) QBI deduction under IRC Sec. 199A.
5) Deduction allowable for depreciation, amortization, or depletion.
6) Other adjustments in regulations issued or to be issued.

Law Change Alert: For tax years beginning on or after January 1, 2022, and before January 1, 2025, allowable depreciation, amortization, or depletion reduced ATI and may have significantly limited the allowable deduction for business interest expense. The 2025 Act (formerly referred to as the One Big Beautiful Bill or OBBB) restored the add-back of these deductions in computing ATI [IRC Sec. 163(j)(8)(v)]. The 2025 Act provides that (1) the business interest expense limitation is calculated before applying any interest capitalization rules, with any allowable interest after applying the limitation allocated first to amounts that would be capitalized and the remainder, if any, to amounts that would be deducted; and (2) any business interest carried forward is not subject to the interest capitalization provisions [IRC Sec. 163(j)(10), which applies to tax years beginning after December 31, 2025]. The IRS issued Fact Sheet 2025-9 on December 23, 2025, which contains FAQs regarding the limitation changes implemented by the 2025 Act.

Tax shelters. A tax shelter isn't eligible for the $25 million gross receipts exception ($31 million for 2025). For this purpose, tax shelter means [IRC Secs. 448(d)(3) and 461(i)(3)(B)]:

1) An enterprise (other than a C corporation) whose interests have been offered for sale in a transaction required to be registered with a state or federal agency that regulates the sale of securities,
2) A syndicate, or
3) An entity formed to avoid or evade federal income tax.

Syndicates. While it's uncommon for a partnership to run afoul of item 1 or 3 above, a partnership may unintentionally be a *syndicate*, which is an entity (other than a C corporation) that allocates more than 35% of its losses during the tax year to limited partners or limited entrepreneurs [Reg. 1.1256(e)-2]. Gains or losses from sales of capital assets or Section 1221(a)(2) assets (real or depreciable property used in a business) are not taken into account for the 35% of losses calculation. A *limited entrepreneur* is one who has an interest in an enterprise other than as a limited partner and does not actively participate in the management of the enterprise [IRC Sec. 461(k)(4)].

Limited partners/entrepreneurs who actively participate in the management of the entity (or who actively participated for at least five years or whose spouse, ancestors, or descendants actively participate) are not considered limited partners/entrepreneurs for the syndicate definition. Neither is the estate of an individual who actively participated.

A facts and circumstances test is used to determine if someone actively participates in management. Owners who make operational or management decisions for the business, or have the authority to hire and fire employees, generally escape classification as limited partners/entrepreneurs for the syndicate definition. However, those who are protected against loss to any significant degree are more prone to qualify.

Reg. 1.448-2(b)(2)(iii)(B) permits entities to elect to determine syndicate status by looking at whether they allocated more than 35% of their losses to limited owners in the prior year. This allows the entity to know early in the year whether it is a tax shelter. Since syndicate status depends on whether an entity generates a tax loss (of which more than 35% is allocated to limited owners), an entity's status can change from year to year. The regular test looks at whether the entity generates a loss for the year in question, so an entity may not know whether it's a syndicate until after year-end. Classification as a tax shelter means that an entity does not qualify for the small-taxpayer exemption from the Section 163(j) business interest expense limit. Entities making this election must attach a statement to their timely-filed federal income tax return (including extensions) that this election is made. If such a statement is not attached, the election is not valid and has no effect for any purpose. The final regulations indicate that this is an annual election and applies only to the tax year for which it is made [Reg. 1.448-2(b)(2)(iii)(B)].

Observation: A limited partnership that traditionally allocates 99% of its losses to limited partners (1% to a general partner) will be subject to IRC Sec. 163(j) even if it meets the $25 million gross receipts test ($31 million for 2025). This may have a disproportionate effect on certain industries that rely heavily on the limited partnership structure, including the real estate industry. Fortunately, there is an elective solution which is electing out of the Section 163(j) election.

Electing out of the Section 163(j) limitation—real property trade or business. A *real property trade or business* (that is, a real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business, including operation or management of a lodging facility) can elect to treat interest expense as not from a trade or business and thus, not subject to the Section 163(j) limit. To be an *electing real property trade or business*, an election must be made in a manner prescribed by the IRS and the alternative depreciation system (ADS) must be used to depreciate nonresidential real, residential rental, and qualified improvement property [IRC Secs. 163(j)(7)(B) and (j)(10)(A) and 168(g)(1)(F) and (g)(8)]. Thus, a limited partnership, LLC, or S corporation conducting a real property trade or business that is not eligible for the small business $25 million gross receipts ($31 million for 2025) exception to the Section 163(j) limit can avoid the limitation by electing to be treated as an electing real property trade or business. The effect of this election is that the entity's real property is depreciated under ADS and is not eligible for bonus depreciation. Once made, the ADS election is irrevocable.

Businesses that can use Section 179 expensing to compensate for the loss of bonus depreciation may find that being an electing real property trade or business has little tax cost relative to using the ADS in exchange for the exemption from the Section 163(j) limit.

Continued on the page B-8

that's more than 50% owned, directly or indirectly, by the covered corporation [IRC Sec. 4501(c)(2)]. In some instances, the excise tax applies to the acquisition of stock of certain foreign corporations [IRC Sec. 4501(d)].

Note: While the corporations subject to the excise tax must be publicly traded, the repurchased stock itself need not be publicly traded. So, corporations will need a means of establishing the FMV of repurchased stock that's not traded on an established market.

IRC Sec. 4501(e) provides a "de minimis" exception for stock repurchases subject to the excise tax. The excise tax does not apply where the total value of the stock repurchased during the tax year does not exceed $1 million.

Proposed regulations (REG-115710-22) clarify that the determination of whether the de minimis $1 million exception applies in a given tax year is made before applying a reduction for a statutory exception and a reduction under the netting rule. This means a corporation may still owe tax on stock repurchases of less than $1 million if the aggregate amount of the repurchases exceeds $1 million before exceptions and netting.

The proposed regulations also provide statutory exceptions to the excise tax, namely exceptions for reorganizations under IRC Sec. 4501(e)(1). The proposed regulations also include exclusive lists of transactions both subject to and exempt from the excise tax.

Note: While TD 10002 finalized rules related to the reporting and payment requirements for the excise tax, interim guidance from proposed regulation REG-115710-22 related to the statutory netting rule and the $1 million "de minimis" exception for stock purchases has not yet been finalized.

Law Change Alert: The IRS has issued final regulations (T.D. 10037) on the 1% excise tax for corporate stock repurchases, effective for transactions occurring after November 24, 2025. The final regulations narrow the tax's applicability, withdraws some proposed rules, provides transition relief for certain preferred stock issued before August 16, 2022, and simplifies tax administration around the excise tax.

Corporation Defined

For federal tax purposes, corporations include the following:

1) Businesses organized under a federal or state law that identifies the entity as a corporation.
2) Joint stock companies.
3) Insurance companies.
4) Certain banks.
5) Business entities wholly owned by a state or any political subdivision thereof.
6) Certain foreign business entities.

Other entities, such as publicly traded partnerships, may be treated as corporations by other Code sections.

***Check-the-box* rules.** Noncorporate entities, such as sole propri-etorships and partnerships, may elect to be taxed as corporations by filing Form 8832 (Entity Classification Election).

Note: Corporations cannot elect out of corporate tax treatment. If an entity is classified as a corporation under IRS regulations, the entity must file as a corporation.

Caution: Some states have rules that classify entities for tax purposes. Not all states recognize reclassification of an entity under the check-the-box rules.

See *Check-the-Box Rules—Entity Classification Election (Form 8832)* on Page F-2 for more information.

Limited Liability

A corporation formed under state law shields owners from liability for the corporation's actions. A shareholder's risk of loss is limited to the amount invested in stock. This is in contrast to sole proprietors or general partners in partnerships, who are personally liable for debts of the business.

State laws determine an entity's liability status. A proprietor or partnership cannot receive limited liability status simply by electing to be taxed as a corporation under the check-the-box rules.

Courts have disregarded the limited liability status of corporate shareholders in the following circumstances:

- Fraud.
- Bad faith.
- Failure to observe corporate formalities.
- Need to accomplish substantial justice.

A shareholder owning 100% of the stock of a corporation is particularly susceptible to having the corporate veil pierced. Incorporating a business is not a substitute for liability insurance.

Other shareholder liability. A corporation will not protect a shareholder from liability directly linked to the individual. For example, a shareholder who personally guarantees a corporate loan is liable for repayment. Similarly, if a shareholder performs services using his own vehicle and is involved in an accident, he may be liable for damages because he owns the vehicle.

Tax Treatment of C Corporations

For federal income tax purposes, a C corporation is a separate taxpaying entity. A corporation conducts business, realizes net income or loss, pays taxes, and distributes profits to shareholders. Income is taxed to the corporation when earned, and taxed again when distributed to the shareholders as dividends. The corporation does not receive a tax deduction for the dividends paid.

Example: Lookback Corporation is taxed at a flat 21% and its sole shareholder is in the highest individual bracket. The corporate tax on $1,000 of profits equals $210. The remaining $790 dividend will incur tax of $188 to the shareholder since he is in the highest bracket (20% individual tax rate on dividends plus 3.8% net investment income tax). This leaves $602 in after-tax profits for the shareholder and results in an effective combined tax rate of 39.8%.

Unlike S corporations and partnerships, various types of income do not retain their character as they pass from a C corporation by dividends to shareholders.

Example: The BCA Corporation received tax-exempt interest and distributed it to shareholders as taxable dividends. The fact that the money was originally tax-exempt interest is of no consequence to a shareholder. However, if the company was an S corporation or a partnership, the tax-exempt interest would retain its character as it passed through to shareholders or partners.

Schedule M-3 (Form 1120)—Reconciliation of Books With Tax Return

Domestic corporations with total assets of $10 million or more on the last day of the tax year must complete Schedule M-3 [Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More]. The schedule requires detailed explanations of the transactions that create book-tax differences, and is filed in place of Schedule M-1. Schedule M-3 is filed as an attachment to Form 1120. In addition, Form 8916-A (Supplemental Attachment to Schedule M-3) is filed to reconcile cost of goods sold and interest income and expense reported on Schedule M-3. Mixed consolidated return groups (those including certain insurance companies) must also file Form 8916 (Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups) to reconcile Schedule M-3 with their returns (Forms 1120, 1120-L, and 1120-PC).

A corporation filing Form 1120 that is not required to file Schedule M-3 may voluntarily file Schedule M-3 in place of Schedule M-1. For these corporations, and for those that are required to file Schedule M-3 but have less than $50 million in total assets at the end of the tax year, there is an option concerning how Schedule M-3 is completed. In lieu of completing all parts of Schedule M-3, these corporations may complete the schedule only through Part I, and then complete Schedule M-1 of Form 1120 (or Form 1120-C, if applicable) instead of completing Parts II and III of Schedule M-3. In addition, these filers are not required to file Schedule B (Form 1120) or Form 8916-A. If this option is selected, make sure line 1 of Schedule M-1 equals line 11 of Part I of Schedule M-3.

A corporation filing Schedule M-3 must check the box on Form 1120, page 1, item A(4), indicating that Schedule M-3 is attached (whether required or voluntary). For IRS website information on Schedule M-3, search for "Schedule M-3" at **www.irs.gov**.

Schedule UTP—Uncertain Tax Position Statement

A corporation must file Schedule UTP with Form 1120 if it (1) has assets equal to or exceeding $10 million, (2) issued or is included

Caution: While the Joint Committee on Taxation estimated that approximately 150 corporations were subject to a prior proposed version of the CAMT, the CAMT exacts an annual compliance burden on a larger group of taxpayers. Specifically, in every year, a corporation will need to determine: 1) whether it is subject to the CAMT as an AC and 2) if it is an AC, the amount of its CAMT liability.

IRS guidance. Notice 2023-7 provided corporations with a safe harbor method for determining whether they are an AC for the first tax year beginning after December 31, 2022. All corporations, other than RICs, REITs, S corporations, and a corporation that is not an applicable corporation under the simplified method and chooses to apply that method (as explained in the Form 4626 instructions) must file Form 4626 whether or not they owe CAMT. The IRS has published proposed regulations that address the application of CAMT (REG-112129-23). The proposed regulations would affect taxpayers that are ACs, certain taxpayers that own interests in ACs, and certain entities in which ACs hold interests. Prop. Reg. 1.59-2(g)(2) provides a simplified method for a corporation to determine whether it is an AC.

The IRS has issued several other pieces of interim guidance, including Notice 2025-27, which provides (1) a new interim simplified method for determining applicable corporation status under IRC Sec. 59(k) and (2) updated tax years that will receive relief from estimated tax penalties (see *Estimated Tax* on Page C-3 for discussion). Under the new interim simplified method, large corporations with average AFSI of less than $800 million will not be considered an AC subject to the CAMT. Before final regulations are issued, the IRS intends to issue proposed regulations similar to the interim guidance. The IRS has issued Notices 2025-46 and 2025-49, which provide additional interim CAMT guidance. The notices contain several rules that appear to reduce AFSI and provide taxpayers with significant flexibility in relying upon CAMT guidance issued since September of 2024.

Base Erosion Minimum Tax

The base erosion minimum tax prevents companies from stripping earnings out of the U.S. through payments to foreign affiliates that are deductible for U.S. tax purposes. The tax [often called the base erosion and anti-abuse tax (BEAT)] is structured as an alternative minimum tax that applies when a multinational company reduces its regular U.S. tax liability to less than a specified percentage of its taxable income, after adding back deductible base eroding payments, and a percentage of tax losses claimed that were carried from another year (IRC Sec. 59A). The BEAT applies to corporations (other than RICs, REITs, and S corporations) that have average annual gross receipts of $500 million or more for a three-tax year period.

Losses and Miscellaneous Items

Passive Activity Losses

Passive loss rules of IRC Sec. 469 apply to noncorporate taxpayers, closely held C corporations, and PSCs [IRC Sec. 469(a)(2)]. Closely held C corporations and PSCs are subject to passive loss limitations to prevent taxpayers from incorporating simply to avoid the passive activity rules.

Closely held corporations. For purposes of the passive activity rules, a corporation is closely held if more than 50% of the value of outstanding stock is owned by five or fewer individuals at any time during the last half of the tax year [IRC Sec. 469(j)(1)]. A closely held corporation can offset passive losses against active income (unlike individuals), but not against portfolio income [IRC Sec. 469(e)(2)].

Note: Taxpayers subject to the passive activity rules are limited in their ability to use transferred eligible credits against their federal income tax liability. Generally, this means that purchased credits can only be used to offset their passive income tax liability. Most taxpayers do not have passive income tax liability as it generally does not include tax liability arising from most investment activities.

Casualty and Theft Losses

100% of the loss is allowed as a deduction against business income.

Corporate Terms

Brother-sister corporations. More than one corporation is owned by the same shareholders. See IRC Sec. 1563(a)(2) for definition and requirements.

Closely held corporation. A corporation that does not offer shares to the public on a securities exchange; the transferability of the shares may be restricted. Many of the shareholders participate in the management of the business. Although for most purposes, there is no maximum number of shareholders that a corporation can have to be considered a closely held corporation, these corporations generally have relatively few shareholders.

Consent dividends. A corporation can avoid or reduce the accumulated earnings tax by declaring a consent dividend. In a consent dividend, no cash or property is distributed to the shareholders. The corporation reduces accumulated E&P by the amount of the consent dividend, and the shareholder pays tax on the dividend as if it was received. The consent dividend will also increase the shareholder's basis in stock held. See the Form 972 (Consent of Shareholder To Include Specific Amount in Gross Income) instructions for details.

Consolidated returns. Corporations that are members of a parent-subsidiary affiliated group, as defined in IRC Sec. 1504(a), may file a consolidated income tax return. The regulations under IRC Sec. 1502 outline the filing requirements for consolidated returns.

Controlled group. A controlled group of corporations as defined under IRC Sec. 1563(a) is limited for purposes of computing the accumulated earnings credit. See IRC Sec. 1561(a). A controlled group can be a parent-subsidiary, brother-sister, or combined group. IRC Sec. 482 allows the IRS to reallocate income and deductions among the member corporations whenever it is determined that the members shifted the income and deductions to avoid tax.

Parent-subsidiary group. One or more corporations are connected through stock ownership with a common parent corporation. See IRC Sec. 1563(a)(1) for definition and requirements.

Control Structure of Parent-Subsidiary Group of Corporations

A Corporation. Common parent of a parent-subsidiary controlled group consisting of A, B, and C Corporations.

A Corporation → 80% Control → B Corporation

B Corporation
↓
80% Control
↓
C Corporation

Note: A parent-subsidiary controlled group would also exist if A, rather than B, owned the C stock [Reg. 1.1563-1(a)(2)(ii), Example (2)].

J Corporation. Common parent of a parent-subsidiary controlled group consisting of J, K, L, and M Corporations. [Reg. 1.1563-1(a)(2)(ii), Example (3)].

J Corporation → 80% Control → K Corporation

J Corporation
↓
80% Control
↓
L Corporation

K Corporation
↓
40% Control
↓
M Corporation

L Corporation → 40% Control → M Corporation

Personal service corporations. The principal activity of the corporation is the performance of personal services. See the chart *Personal Service Corporation (PSC)* on Page F-12 for the various definitions that apply.

Publicly held corporation. A corporation with shares traded on securities exchanges or for which price quotations are published.

This means the employee will not pay federal income taxes on some of their qualified overtime compensation. However, FICA taxes are still paid on this income. The Act requires enhanced reporting of overtime income on Form W-2. For calendar year 2025, the IRS stated that employers should continue to withhold federal income taxes when overtime income is paid to the employee (IR-2025-82). The IRS will issue guidance for calendar years 2026-2028 on how FITW can be adjusted for overtime compensation that will not be subject to income taxes. For more information, see *No Tax on Tips and Overtime* on Page Q-1.

Qualified overtime compensation for IRC Sec. 225(a) purposes is defined as overtime compensation paid to an individual (whether an employee or independent contractor) under Section 7 of the Fair Labor Standards Act (FLSA) that is in excess of the individual's regular pay rate. Only the "time-and-a-half" premium required by the FLSA qualifies, not additional state law or collectively bargained overtime (Notice 2025-69).

Note: Although the individual will not be liable for federal income taxes on the qualified overtime compensation, the employer will continue to have an income tax deduction for federal income tax purposes for overtime compensation paid to employees or independent contractors.

Reporting Tip Income on Form W-2

Law Change Alert: For tax years 2025–2028, the 2025 Act allows individuals who receive qualified tip income to deduct a certain amount of the income from AGI on their personal income tax return (IRC Sec. 224). A maximum of $25,000 of qualified tip income can be deducted by each eligible taxpayer who receives tips in an occupation where tipping was customary before January 1, 2025. The deduction is allowed for both employees and independent contractors. The deduction phases out by $100 for every $1,000 of MAGI above $150,000 ($300,000 for married, filing jointly). Married individuals claiming the tip income deduction must file a joint return.

Employers and businesses paying independent contractors must properly report the qualified tip income and the recipient's occupation on Forms W-2, 1099-NEC, or 1099-K. For tips received in 2025, reporting entities are not required to separately report qualified tips or overtime. Employees and independent contractors will need to use reasonable methods to determine and substantiate their qualified tip and overtime amounts for the deduction (Notice 2025-69). The IRS must adjust withholding procedures to reflect the new deduction starting in 2026 and provide guidance regarding FITW on tip income (IRC Sec. 3402). For more information, see *No Tax on Tips and Overtime* on Page Q-1.

The IRS released a list of occupations that qualify as occupations that customarily and regularly receive tips for purposes of the qualified tip income deduction in proposed regulations issued in September 2025. These nearly 70 occupations will be eligible for the deduction. The eligible occupations are listed in the proposed regulation using a TTOC, a three-digit code along with descriptions for the occupation [Prop. Reg. 1.224-1(f)]. See *Regular and Customary Tipped Occupations* on Page Q-13 for a complete list.

Note: Although the employee will not be liable for federal income taxes on the qualified income, the employer will continue to have an income tax deduction for federal income tax purposes for all overtime compensation paid to workers.

Forms W-2 and W-3

Form W-2 (Wage and Tax Statement) reports information about employee wages and withholding to the employee, the IRS, and the Social Security Administration (SSA). The employee copy of the completed Form W-2 should be *furnished* to each employee by January 31. *Furnished* includes mailing by January 31. Forms W-2 may be provided to employees electronically as long as the employee consents and does not withdraw the consent prior to receiving the statement [Reg. 31.6051-1(j)].

Employers may voluntarily truncate employees' social security numbers (SSNs) to appear in the form of truncated taxpayer identification numbers (TTINs) on all copies of Form W-2 except for Copy A filed with the SSA [Reg. 301.6109-4(b)(2)(iii)].

Form W-3 (Transmittal of Wage and Tax Statements) is a summary of an employer's Forms W-2 for the calendar year.

Due date for filing. Both paper and electronically filed Forms W-2 and W-3 must be filed with the SSA by January 31 of the following calendar year. A 30-day extension to file Form W-2 may be requested by submitting a complete application on Form 8809 (Application for Extension of Time to File Information Returns) indicating that at least one of the criteria on the form for granting an extension applies and signed under penalties of perjury. The IRS will only grant the extension in extraordinary circumstances or catastrophe.

Note: If granted, an extension only extends the due date for filing with the IRS. It does not extend the due date for furnishing statements to recipients.

Errors. If an error is discovered after issuing a Form W-2 or W-3, corrections are made using Forms W-2c and W-3c. The corrected forms must be issued to the employee and sent to the SSA. A safe harbor exception to the penalty for failure to file correct information returns may apply to returns that are otherwise correct and timely filed, but that include *de minimis* errors in the amount required to be reported [IRC Sec. 6721(c)(3)]. An error is considered *de minimis* if no single amount reported differs from the correct amount by more than $100, or if no amount reported for tax withheld differs from the correct amount by more than $25 [Reg. 301.6722-1(d)(2)]. The safe harbor exception is not available if the failure is due to intentional disregard of the rules [IRC Sec. 6721(e)(1)].

Electronic filing. Employers filing 10 or more information returns for a calendar year must file all information returns electronically [Reg. 301.6011-2(c)(1)]. In determining whether the electronic filing threshold is met, most information returns (including all Forms W-2 and Forms 1099) must be aggregated [Reg. 301.6011-2(c)(4)(i)]. For example, a taxpayer filing five Forms W-2 and five Forms 1099-MISC (Miscellaneous Information) for a calendar year is required to file both the Forms W-2 and the Forms 1099-MISC electronically. This means that most employers must file Forms W-2 electronically. Corrected Forms W-2 must be filed electronically if the original Form W-2 was filed electronically.

Note: Employers can obtain a waiver of the electronic filing requirement for a calendar year, based on undue hardship or if using the technology required to file electronically conflicts with the filers religious beliefs, by filing Form 8508 (Request for Waiver from Filing Information Returns Electronically). The request must be filed at least 45 days before the deadline for filing the forms.

Final Forms W-2—business closing. Employers that go out of business or stop paying wages to employees are required to issue Forms W-2 to their employees by the date the final Form 941 (or 944) is due (the final Form 941 is due the end of the month after the quarter, or year for Form 944, in which operations end). Final Forms W-2 and W-3 to be filed with the SSA are due by the last day of the month that follows the due date of the final Form 941 [Regs. 31.6051-1 and 31.6071(a)-1].

Nonemployee Compensation (Form 1099-NEC)

Box 1. Form 1099-NEC should be used by businesses (including sole proprietorships) and nonprofit organizations that paid $600 or more during calendar year 2025 in the course of a trade or business for the following items (not an exhaustive list):

1) Services of an independent contractor (including parts and materials).
2) Directors' fees.

offset by the research credit are deductible as a business expense for income tax purposes under IRC Sec. 162 [IRC Sec. 3111(f)(4)].

How to claim the research credit against payroll taxes. Each quarter a completed Form 8974 (Qualified Small Business Payroll Tax Credit for Increasing Research Activities) must be filed with the employer's Form 941 to claim some (or all) of the research credit against payroll taxes. Annual filers attach Form 8974 to their annual return (Form 944 or Form 943).

Form 941 filers. For employers that file Form 941, the credit is claimed on the Form 941 filed for the first calendar quarter that begins after the QSB's federal income tax return is filed for the tax year in which the election is made on Form 6765. If the credit can't be used completely in that quarter, it can be carried over to succeeding quarters and allowed as a payroll tax credit.

The first $250,000 of the credit is applied against the employer's share of social security tax (the 6.2% portion of FICA tax). An additional $250,000 of the credit can be applied against the employer's portion of Medicare tax (the 1.45% of FICA tax). Any credit amount not used in a quarter can be carried forward to the next quarter. Once an employer has determined how the credit will affect its payroll tax liability, the amount of future payroll tax deposits made by the employer can be adjusted to take the credit into account.

Forms 944 and 943 filers. Employers filing Form 944 or 943 claim the credit on the annual Form 944 or 943 that includes the first quarter beginning after the date on which the business files its income tax return reflecting the election (Notice 2017-23). If the credit can't be fully used on the first annual Form 944 or Form 943 after the income tax return is filed, the unused amount can be carried forward to the following year. The amount of the employer's social security and Medicare tax that can be used when determining the credit amount allowed on Form 944 or Form 943 is limited to the tax for the quarters after the quarter in which the employer's federal income tax return making the election was filed. Any unused credit is carried forward to the next period until the remaining credit for that income tax year reaches zero.

Other Payroll Tax Issues

Earned Income Credit Notification

Employers must notify employees who worked for them at any time during the year and from whom no income tax was withheld that they may be eligible for the Section 32 earned income credit (EIC) [Reg. 31.6051-1(h)]. Employers are also encouraged to notify any other employees who may be eligible.

This can be accomplished in several ways (IRS Pub. 15):

- Copy B of the Form W-2 with the required EIC information on the back;
- Substitute Form W-2 with EIC information on the back;
- IRS Notice 797 [Possible Federal Tax Refund Due to the Earned Income Credit (EIC)]; or
- Company-written notice that contains the required information.

The IRS has created online tools to determine eligibility, calculate the EIC, and meet preparer due diligence requirements—see **www.eitc.irs.gov** (and click on "Tax Preparer Toolkit").

Payroll Taxes on Tips

Generally, all tip income received by an employee is subject to federal income tax. However, if tips total less than $20 in a month from any one employer, those tips are not subject to FICA and are not required to be reported to the employer [IRC Sec. 3121(a)(12)(B)].

Tips reported to the employer are subject to both employer's and employee's share of FICA including the 0.9% additional Medicare tax. Certain tips that are not reported to the employer are also subject to FICA tax, including:

- Tips of $20 or more in a month that employee reports on Form 4137 (Social Security and Medicare Tax on Unreported Tip Income).
- Form W-2 allocated tips that employee reports on Form 4137.
- Tips reported later as a result of IRS audit.

Law Change Alert: For tax years 2025–2028, the 2025 Act allows individuals who receive qualified tip income to deduct a certain amount of the income from AGI on their personal income tax return (IRC Sec. 224). A maximum of $25,000 of qualified tip income can be deducted by each eligible taxpayer who receives cash tips in an occupation where tipping was customary before January 1, 2025. All tip income must continue to be reported for payroll tax purposes for tax year 2025.

Note: For tax year 2025, employers and payors are not required to separately report qualified tips on Forms W-2, 1099-NEC, 1099-MISC, or 1099-K. Employees and independent contractors will need to use reasonable methods to determine and substantiate their qualified tip amounts for the deduction (Notice 2025-69).

The IRS will issue guidance regarding changes in tip income reporting for tax years 2026-2028. See *No Tax on Tips and Overtime* on Page Q-1 and *Regular and Customary Tipped Occupations* on Page Q-13.

IRS guidance. Rev. Rul. 2012-18 provides employers guidance on how and when to pay employment taxes on unreported tips and clarifies that service charges cannot be treated as tip income.

A *tip* is generally an amount a customer pays freely with the unrestricted right to determine the amount. A *service charge* generally is an amount that the business states will be added to a bill due to certain factors. For example, if a restaurant adds a 20% gratuity when serving eight or more people, that is considered a service charge, not a tip. The service charge must be treated as regular wages for the server, not as tip income.

Proposed service industry tip compliance agreement program. Currently, employers with employees who receive tip income can participate in one of three tip-reporting programs: Tip Reporting Alternative Commitment (TRAC), Tip Rate Determination Agreement (TRDA), or the Employer-Designed Tip Reporting (EmTRAC). In early 2023, the IRS issued a proposed revenue procedure (Notice 2023-13), that if finalized, will establish the Service Industry Tip Compliance Agreement (SITCA), a voluntary tip reporting program that will replace the three current programs. The IRS requested comments on the proposal and expects to issue final guidance as a revenue procedure. Final guidance had not been issued when this Handbook was published.

The SITCA program would be a voluntary tip reporting program between the IRS and employers in the service industry (excluding the gaming industry) that is designed to enhance tax compliance using agreements instead of traditional audit techniques. The new program will take advantage of advancements in point-of-sale systems, time and attendance systems, and electronic settlement methods. It should decrease taxpayer's administrative burdens and provide more transparency and certainty to taxpayers.

In-home Care Payments Subject to Employment Taxes

Certain in-home care payments to service providers, whether related or not, are considered payments for services and taxable for both income and FICA/FUTA tax purposes. However, in Notice 2014-7, the IRS noted that certain in-home care payments to service providers, including parents who receive payments from the Medicaid waiver program for the care of their child, are treated as difficulty-of-care payments under IRC Sec. 131 and therefore not taxable for federal income tax purposes. However, the Notice did not address the FICA or FUTA tax treatment of these in-home care payments. The IRS concluded in a CCA that these payments are still generally subject to FICA and FUTA tax unless an exception applies (CCA 202243009).

IRS Scrutiny of the Employee Retention Tax Credit (ERTC)

The Employee Retention Tax Credit (ERTC) was a payroll tax credit available during 2020 and 2021 to aid businesses during the COVID pandemic. The ERTC turned into somewhat of an administrative nightmare for the IRS because of the "tsunami" of ERTC claims submitted.

2025 Employer and Self-Employed Retirement Plan Chart

<table>
<tr><th>Defined-Benefit</th><th>Defined-Contribution (Profit-Sharing)</th><th>401(k)</th><th>403(b)</th></tr>
<tr><td colspan="3">Any employer.</td><td>Tax-exempt religious, charitable, or educational organizations.</td></tr>
<tr><td colspan="3">Employees at least age 21 with one year of service (1,000 hours).</td><td>Employees[7] who work 20 or more hours per week, do not participate in another 401(k), 457 or 403(b) plan, and will contribute more than $200 per year.</td></tr>
<tr><td>Actuarially determined contribution. Maximum benefit payout limited to 100% of average compensation for the three consecutive years of highest compensation (limited to $350,000), but not to exceed $280,000.[8]</td><td>Contributions per participant up to lesser of 100% of compensation or $70,000. Employer deduction limited to 25% of aggregate compensation (limited to $350,000 per employee) for all participants (20% of net SE income after SE tax deduction for self-employed).[8]</td><td>Employee elective deferrals limited to $23,500 (additional $7,500 if age 50 or older at end of the year). Employer deduction limited to 25% of combined wages of all employees (elective deferrals do not reduce wages for the 25% limit). Combined employer contributions and employee elective deferrals per employee limited to lesser of 100% of wages or $70,000 (additional $7,500 for employees age 50 or older by year-end).[8]
Note: For employees age 60–63 at year end, a catch-up of $11,250 is allowed. Catch-up contributions for high-wage taxpayers must be made to a Roth 401(k) for the 2026 plan year.</td><td>Employee elective deferrals limited to $23,500 (additional $7,500 if age 50 or older at end of the year). Special formula applies to additional employer contributions based on years of service. Combined employer contributions and employee elective deferrals per employee limited to lesser of 100% of wages or $70,000 (additional $7,500 for employees age 50 or older by year-end).[8]
Note: For employees age 60–63 at year end, a catch-up of $11,250 is allowed. Catch-up contributions for high-wage taxpayers must be made to a Roth 401(k) for the 2026 plan year.</td></tr>
<tr><td colspan="4">10% of distribution. (See Exceptions to 10% Additional Tax on Withdrawals Before Age 59½ on Page K-6.)</td></tr>
<tr><td colspan="4">For self-employed and >5% owners, by April 1 of the year following the year the account owner reaches the RBD. For all other employees, April 1 of the year following the year the account owner retires or reaches the RBD, whichever is later.[9]</td></tr>
<tr><td colspan="2">Return due date, including extensions for profit-sharing plan contributions. 8½ months after year-end for defined benefit plan contributions.
Note: Qualified retirement plans adopted after the close of a tax year but before the due date (including extensions) of the tax return may be electively treated as having been adopted on the last day of the tax year.</td><td colspan="2">For employer contributions, return due date including extensions.[10]
Note: Qualified retirement plans adopted after the close of a tax year but before the due date (including extensions) of the tax return may be electively treated as having been adopted on the last day of the tax year.</td></tr>
<tr><td>Yes</td><td>No</td><td colspan="2">Generally no.</td></tr>
<tr><td colspan="4">Yes, if plan permits. Must pay back in five years (unless used to buy a principal residence). Qualified plans are prohibited from making plan loans through credit cards or similar arrangements.</td></tr>
<tr><td>Yes</td><td>Yes</td><td>Yes</td><td>Yes</td></tr>
<tr><td colspan="2">Employers are subject to a 10% excise tax on nondeductible (excess) contributions, unless an exception applies.</td><td colspan="2">Employee's elective deferral: No excise or income tax if 2025 excess is withdrawn by April 15, 2026 (but allocable earnings are taxable in year withdrawn). If not withdrawn by April 15, 2026, excess is taxed twice—once in the year of excess contribution and again when distributed because no cost basis is allowed for excess contribution.
Employer's contribution: 10% excise tax on excess contributions (resulting from plan failing average deferral percentage test) unless distributed (with earnings) to highly compensated employee(s) within 2½ months after the close of the plan year (taxable to employee in year of deferral). Failure to distribute excess within 12 months after close of plan year results in plan failing to qualify for that plan year and all subsequent plan years for which the excess contributions remain uncorrected.</td></tr>
</table>

[7] Includes self-employed ministers.

[8] Nondiscrimination rules may affect contributions/deferrals for certain employees. For plan years beginning after 2019, the maximum default rate for automatic safe harbor enrollment increased from 10% to 15%. However, the rate remains at 10% for the initial year that the deemed election applies to a participant.

[9] Age 70½ for individuals born before July 1, 1949; age 72 for those born July 1, 1949 through December 31, 1950; age 73 for those born January 1, 1951 through December 31, 1959; age 74 for those born January 1, 1951 through December 31, 1959; age 75 for those born on or after January 1, 1960.

[10] The Tax Code does not specify when the employer is required to deposit employee elective deferrals into the employee's account. However, under ERISA regulations, employee elective deferrals must be contributed to the employee's 401(k) plan account as soon as reasonably can be segregated from the employer's general assets, but not later than the 15th business day of the month immediately after the month in which the contributions either were withheld or received by the employer.

on the level of control the employer is able to exert on the worker. The employer can request an IRS determination of status by filing Form SS-8. The IRS estimates that a significant number of workers are misclassified as independent contractors and continues its focus on worker classification issues through a variety of initiatives. More worker classification information is available in Tab I.

The Department of Labor (DOL) has established rules surrounding worker classification. These rules are consistent with judicial precedent and the FLSA's text and purpose. The DOL streamlined *economic reality* test has a total of six factors, none of which has a pre-determined weight. This evolving issue is governed by labor laws as well as both federal and state taxing authorities. It is important to know how workers are classified for each of these purposes. For more information, see the DOL economic reality test factors at **www.dol.gov/agencies/whd/fact-sheets/13-flsa-employment-relationship** and the IRS common law rules at **www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee**.

Part-time employees usually do not require the same amount of employee benefits as full time employees. Overtime pay is avoided.

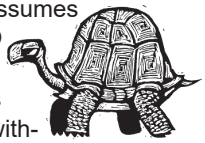
Family members. Employing family members who are in a lower tax bracket than the business owner (usually children or grandchildren) can shift taxable income to them, thus reducing the family's tax burden. Such compensation must be reasonable, however, or the IRS could recast it as income to the owner. See *Hiring Family Members* on Page P-2 for more information.

Ownership interest. An employee who perceives that a start-up business has a good chance for success may accept a small salary with a potential equity position. This can be in the form of a partnership interest, shares of stock in a corporation, a stock option plan, a profit-sharing plan, or other employee benefit plan.

Note: See Tab K for discussion of employee benefit plans.

Outsourcing can be a cost-effective way of reducing administrative and regulatory burdens (bookkeeping, payroll processing, etc.). A business might consider outsourcing these tasks to companies that specialize in business administration services. For example, a payroll service company may be relatively inexpensive compared to the cost of hiring additional staff. See *Outsourcing Payroll* on Page I-2.

Employee leasing is implemented by using a leasing company/lessor that is also known as a professional employer organization (PEO) that furnishes workers to a business/lessee under an arrangement that results in the workers being treated as employees of the lessor. The leasing company retains payroll tax responsibilities for the leased employees. Employee leasing can also involve a transfer of employees to a third party, which assumes the employer's duties. **Note:** A *certified PEO* is treated as the sole employer of the employees, which relieves the contracting business from responsibility for taxes due that are not withheld or remitted by the PEO. Regs. 31.3511-1 and 301.7705-1 cover employment tax consequences for CPEOs and their customers. See *PEOs* on Page I-3.



Employee leasing often can be cost-effective. Employee leasing organizations pool the employees of a large number of clients, thereby having the advantage of group purchasing power for employee benefits. Because risk is spread over a larger group, small employers can usually reduce their employment costs.

Labor Laws

U.S. Department of Labor: **www.dol.gov**

Fair Labor Standards Act

The federal Fair Labor Standards Act (FLSA), commonly referred to as the *Wage and Hour Law*, regulates the minimum wage, overtime pay, recordkeeping requirements, and child labor standards for certain employees. Civil penalties for noncompliance can result in fines for each offense and for each youth employment provision violation. Criminal penalties, including imprisonment, can be imposed for willful violations. See *Selected Federal Employment Legislation* on Page M-9.

Most states have their own labor standards in addition to federal regulations. Generally, the law that provides the employee with the highest minimum wage or the greatest protection is the law that applies. The employer should check with the individual state labor department for information regarding state labor standards.

Current FLSA Requirements

Covered, nonexempt workers are entitled to a minimum wage of not less than $7.25 per hour effective July 24, 2009.

A minimum wage of not less than $4.25 may be paid to employees under the age of 20 for their first 90 consecutive calendar days of employment with any employer as long as their work does not displace other workers. After 90 consecutive days of employment, or when the worker reaches age 20 (whichever comes first), the worker must be paid at the general minimum wage level.

Overtime pay. Nonexempt workers must be paid overtime pay at a rate of at least one and one-half times the regular rate of pay for hours worked in excess of 40 per week. Certain executive, administrative, professional, computer, and outside sales employees are exempt from the minimum wage and overtime pay requirements. To qualify for exemption, employees generally must earn a set minimum weekly salary. Employers are allowed to count a portion of certain bonuses/commissions towards meeting the salary level. See **www.dol.gov/agencies/whd/overtime/salary-levels** for details.

Law Change Alert: For tax years 2025–2028, the 2025 Act allows individuals who receive qualified overtime compensation to deduct a certain amount of the overtime compensation from adjusted gross income (AGI) on their personal federal income tax return [IRC Sec. 225(a)]. The Act requires enhanced reporting of overtime income on Form W-2. For 2025, employers and payors are not required to separately report overtime as the reporting forms will not be updated until 2026. Employees and independent contractors will need to use reasonable methods to determine and substantiate their qualified overtime amounts for this deduction (Notice 2025-69). See *Reporting Overtime Wages on Form W-2* on Page I-7 for more information.

Recordkeeping requirements. Employers must keep the following information regarding each covered employee:

- Full name and social security number.
- Sex and occupation.
- Address including zip code.
- Basis on which wages are paid.
- Date of birth (if under age 19).
- Time (hour and day) of start of workweek.
- Total hours worked each day/week.
- Total straight-time earnings for the workweek.
- Total overtime earnings for the workweek.
- Regular hourly pay rate.
- Additions to or deductions from the employee's wages.

What's New

Tab Q Topics

Inflation-Adjusted Amounts ..... Page Q-1
Tax Legislation History ..... Page Q-1
Recent Legislation ..... Page Q-1
No Tax on Tips and Overtime ..... Page Q-1
Circular 230 ..... Page Q-3
Changes to Tax Provisions Affecting 2025 ..... Page Q-5
Changes to Tax Provisions Affecting 2026 and Beyond ..... Page Q-8
Regular and Customary Tipped Occupations ..... Page Q-13

Inflation-Adjusted Amounts

For a summary of inflation-adjusted amounts for 2025 (plus 2026 and 2024 and prior years), see the *Business Quick Facts Data Sheet* on Page A-1.

Tax Legislation History

The following table identifies selected tax legislation enacted beginning in 2021 that may impact 2025 and later tax returns.

Name of Act	Public Law Number	Date of Enactment
Consolidated Appropriations Act, 2021	PL 116-260	12/27/20
American Rescue Plan Act of 2021	PL 117-2	3/11/21
Inflation Reduction Act of 2022	PL 117-169	8/16/22
Consolidated Appropriations Act, 2023	PL 117-328	12/29/22
The 2025 Act, formerly known as the One Big Beautiful Bill (OBBB)	PL 119-21	07/4/25

Recent Legislation

The 2025 Act

On July 4, 2025, President Trump signed into law P.L. 119-21—The 2025 Act, formerly referred to as the One Big Beautiful Bill (OBBB). The Act made most of the 2017 Tax Cuts and Jobs Act tax cuts permanent. The 2025 Act introduced new tax breaks for workers, as well as ending some energy-related credits. The legislation permanently lowered individual tax rates, expanded the standard deduction, increased the child tax credit, and raised the estate tax exclusion. It also solidified business tax breaks, like 100% bonus depreciation, the 20% qualified business income deduction and permanent expensing of R&D costs. The state and local tax deduction cap was increased to $40,000 through 2029 (subject to certain AGI levels) and then reverts to $10,000 in 2030. The law provided new relief for tip income, overtime pay, a deduction for Seniors, and car loan interest. Additional measures included a new $1,000 "Trump account" for children born between 2025 and 2028, higher international tax rates, and benefits for the oil, gas, and real estate industries.

There are several provisions in the 2025 Act that affect topics which are presented in this Handbook for 2025. See *The 2025 Act [formerly referred to as the One Big Beautiful Bill (OBBB)] Changes to Tax Provisions Affecting 2025* on Page Q-5. Many of the changes made by this legislation are effective over a span of years. For prospective changes, see *The 2025 Act [formerly referred to as the One Big Beautiful Bill (OBBB)] Changes to Tax Provisions Affecting 2026 and Beyond* on Page Q-8 which summarizes the provisions affecting future tax years. For planning ideas around some of the provisions in the 2025 Act, see *Research and Development Costs* on Page O-24, *Research And Experimental Expenditures Under The 2025 Act* on Page P-21, and *Choosing Between Section 179 and Bonus Depreciation* on Page P-6. Additional information on provisions affecting cost recovery methods can be found in Tab 13 of the Depreciation Quickfinder® Handbook.

No Tax on Tips and Overtime

As part of the sweeping changes enacted by the 2025 Act, two new deductions—No Tax on Tips and No Tax on Overtime—were created to potentially reduce taxpayers' federal income tax burden. These provisions limit the taxability of certain earned tips and overtime payments.

Employers and other payors reporting qualified tips and/or overtime pay are required to file information returns with the IRS or SSA and furnish statements to taxpayers showing the amount of qualified tips and qualified overtime compensation paid during the year. The IRS will provide transition relief for tax year 2025 for taxpayers claiming these deductions and for employers and other payors subject to the new reporting requirements. See Notice 2025-69.

This discussion will explore the definitions, eligibility, deduction limits, and reporting challenges for 2025 and 2026.

No Tax on Tips

Effective for tax years 2025 through 2028, employees and self-employed individuals may deduct *qualified tips* received in occupations listed by the IRS as customarily and regularly receiving tips as of December 31, 2024. These amounts must be reported on Forms W-2, 1099, or any other specified statement furnished to the individual, or reported directly by the individual on Form 4137. Unreported tips are not eligible for the deduction.

Note: For tax year 2025, employers and payors are not required to separately report qualified tips on Forms W-2, 1099-NEC, 1099-MISC, or 1099-K. Employees and independent contractors will need to use reasonable methods to determine and substantiate their qualified tip amounts for the deduction (Notice 2025-69).

The annual deduction is capped at $25,000 per tax return and limited to the amount of tip income received. Married taxpayers must file jointly to claim the deduction.

Self-employed individuals may deduct more than their net income (before applying this deduction) from the trade or business in which the tips were earned. The deduction phases out for taxpayers with MAGI over $150,000 ($300,000 for joint filers). It is available for both itemizing and non-itemizing taxpayers. A Social Security number must be reported on the return to claim the deduction.

Qualified tips. *Qualified tips* must be received from customers or, in the case of employees, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool. The amount must be paid voluntarily by the customer, not subject to negotiation, and without consequence for nonpayment. To be considered a *qualified tip*, it must be received in a job that traditionally and customarily receives tips as of December 31, 2024.

Proposed regulations (REG-110032-25) define qualified and non-qualified tips. *Qualified tips* must be paid in cash or an equivalent medium, such as check, credit card, debit card, gift card, tangible or intangible tokens readily exchangeable for a fixed cash amount, or other electronic/mobile payment methods denominated in cash. This excludes tips paid in the form of event tickets, meals, services, or digital assets.

Qualified tips don't include certain service charges. For example, if a restaurant imposes an automatic 18% service charge for large parties and distributes that amount to restaurant staff, the distributed amounts are not *qualified tips* if the customer can't modify or decline the charge. Employers should consider allowing customers to adjust automatic gratuities to accommodate this rule.

Amounts received for illegal activity, prostitution services, or pornographic activity are not *qualified tips*. For example, an unlicensed bartender is not eligible for the deduction since serving alcohol without a license is illegal.

Eligible occupations

Proposed regulations also provide a list of occupations that customarily and regularly received tips as of December 31, 2024, for purposes of the No Tax on Tips deduction [Prop. Reg. 1.224-1(f)(1), Table 1].

The list includes the Treasury Tipped Occupation Code (TTOC), which is a three-digit code along with descriptions for the occupations listed within the proposed regulations. The proposed regulations group the occupations into eight categories:

- 100s—Beverage and Food Service
- 200s—Entertainment and Events
- 300s—Hospitality and Guest Services
- 400s—Home Services
- 500s—Personal Services
- 600s—Personal Appearance and Wellness
- 700s—Recreation and Instruction
- 800s—Transportation and Delivery

Self-employed individuals in a Specified Service Trade or Business (SSTB) under IRC Sec. 199A are not eligible for the deduction. Employees whose employer is a SSTB are also excluded. These include professional service businesses, such as lawyers, accountants, doctors, brokers, investment advisers, consultants, athletes and performing artists. Additionally, highly compensated employees that receive income in excess of $350,000 for 2025 are not eligible for the deduction.

For the list, see *Regular and Customary Tipped Occupations* on Page Q-13.

No Tax on Overtime

Effective for 2025 through 2028, individuals who receive qualified overtime compensation may deduct the portion of the pay that exceeds their regular rate (such as the "half" portion of "time-and-a-half" compensation) required by the Fair Labor Standards Act (FLSA). It does not include additional state law or collectively bargained overtime (Notice 2025-69). This compensation must be reported on Forms W-2, 1099, or any other specified statement furnished to the individual.

The maximum annual deduction is $12,500 ($25,000 for joint filers), which phases out for taxpayers with MAGI over $150,000 ($300,000 for joint filers). As with the No Tax on Tips deduction, it is available for both itemizing and non-itemizing taxpayers, a Social Security number is required, and married taxpayers must file jointly to claim the deduction.

Reporting Requirements

Employers must continue to report all wages, tips, and overtime pay (including the premium portion of overtime) on employees' Forms W-2. Federal income tax withholding, Social Security, and Medicare employment taxes must still be withheld on tips and overtime wages as required.

However, due to the new deductions, employers' Forms W-2s and 1099s will need to distinguish the amount of qualified tips, the occupation of the tip recipient, and separately identify the amount of qualified overtime premium pay.

For additional information, see *Reporting Overtime Wages on Form W-2* on Page I-7 and *Reporting Tip Income on Form W-2* on Page I-8.

2025 transition relief. The IRS has announced no changes to individual information returns or withholding tables for 2025. Forms W-2, 1099, 941, and other payroll forms will remain unchanged for the 2025 tax year. Employers and payroll providers should continue using current procedures for reporting and withholding.

Note: For tax year 2025, employers and payors are not required to separately report qualified overtime on Forms W-2, 1099-NEC, 1099-MISC, or 1099-K. Employees and independent contractors will need to use reasonable methods to determine and substantiate their qualified tip amounts for the deduction (Notice 2025-69).

Employees who wish to adjust their income tax withholding to reflect these deductions must submit a revised 2025 Form W-4. For 2025, this adjustment must be calculated manually using the Deductions Worksheet and entering the result in Step 4(b) of the 2025 Form W-4. As of the date of this publication, the IRS tax withholding estimator (TWE) has not been updated to reflect certain provisions of the 2025 Act. Employee who update their withholding for the remainder of 2025 should be encouraged to revisit and update their withholding at the beginning of 2026.

Schedule 1-A. The IRS has released a draft of new Form 1040, Schedule 1-A (Additional Deductions) for 2025. This form includes Parts I-VI, with Parts II-V covering deductions under the 2025, including No Tax on Tips and No Tax on Overtime. Part I calculates the taxpayer's MAGI to determine their eligibility for the additional deductions. The total additional deductions from Schedule 1-A are entered on Form 1040 or 1040-SR, line 13b, or on Form 1040-NR, line 13c. The four additional deductions reported on Schedule 1-A are set to expire after 2028. Presumably, this form will ease the IRS's burden by using one form for all of the additional deductions. As with all draft IRS forms, Schedule 1-A is subject to change.

2026 W-2 changes. The IRS has released draft Forms W-2 and W-4 for 2026. The draft forms and instructions include provisions for reporting tip and overtime payments that qualify for the deductions. The new statutory requirement to report cash tips and the individual's occupation on certain Forms 1099 and on Form W-2 will apply to 2026 Forms W-2 due on February 1, 2027, for calendar year 2026.

The draft 2026 Form W-2 contains several changes to accommodate employer reporting under the new requirements.

Box 12 has three new codes:

TA—Employer contributions to Trump account

TP—Total amount of qualified tips

TT—Total amount of qualified overtime compensation

Box 14 has been split into 14a and 14b:

14a—Other (same as previous Box 14)

14b—Treasury tipped occupation code

The draft instructions to Form W-4 include a new section in Step 4(b) of the Deductions Worksheet for the tip and overtime deduction. The IRS has indicated that it will modify the 2026 withholding formula to reflect these new deductions.

Although there are no changes to the 2025 Form W-2, tax professionals should familiarize themselves with the draft 2026 changes. Doing so will help clients prepare and identify necessary steps to comply with the 2026 reporting requirements.

Action Items

Compliance with the 2025 Act provisions will affect your client's payroll operations, employee benefits, and tax reporting obligations. To help clients navigate these changes smoothly, consider advising them to take the following actions:

- **Update payroll systems**. Assist clients in adjusting withholding tables and tax calculations for 2026 and beyond. Help implement new W-2 reporting fields for tips and overtime