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2025 Income Tax Information for Individuals

Dear Clients and Friends:

Here is to a prosperous and favorable new year!

We appreciate the confidence you have placed in Anderson, Davis & Associates, CPA and consider this an honor and a privilege to provide quality tax, accounting, and consulting services.

<u>What's New in 2025 Tax Filing Season (2026)</u>

We sent out a letter on July 21, 2025 highlighting the new changes from the One Big Beautiful Bill Act (OBBBA) signed into law by President Trump (this can also be found on our website here). Please review that letter in going forward with your current tax planning for this year. We will post any new tax updates and items, as it relates to 2025 tax filing, throughout 2026 on our website not included below.

Additional Deduction for Seniors

Individuals that are 65 or older by the end of the tax year can claim an additional deduction of $6,000 ($12,000 for joint filers if both spouses qualify) in addition to the standard deduction or itemized deductions. The deduction starts to phase out once Modified Adjusted Gross Income (MAGI) exceeds $75,000 ($150,000 for joint filers) and is completely eliminated when MAGI reaches $175,000 ($250,000 for joint filers).

No Tax on Tips

Eligible workers can deduct up to $25,000 of qualified tips (voluntary tips only) annually from their federal taxable income. For self-employed individuals, the deduction may not exceed the net income (without regard to this deduction) from the specific trade or business where the tips were earned. Deduction phases out for taxpayers with MAGI over $150,000 ($300,000 for joint filers).

No Tax on Car Loan Interest

Eligible taxpayers can deduct up to $10,000 of qualified car loan interest annually. The deduction can be claimed even if you take the standard deduction (you do not need to itemize). The deduction applies to interest paid on loans originated after December 31, 2024, and is available for tax years 2025 through 2028. The vehicle must be new (used or leased vehicles do not qualify) and the vehicle must be for personal use (not business or commercial use). The vehicle must be a car, minivan, van, SUV, pick-up truck, or motorcycle, with a gross vehicle weight rating of less than 14,000 pounds and that has undergone final assembly in the United States. The deduction phases out for taxpayers with MAGI over $100,000 ($200,000 for joint filers). The VIN must be reported on the tax return.

No Tax on Overtime

Effective for 2025 through 2028, individuals who receive qualified overtime compensation may deduct the pay that exceeds their regular rate of pay – such as the "half" portion of "time-and-a-half" compensation -- that is required by the Fair Labor Standards Act (FLSA) and that is reported on a Form W-2, Form 1099, or other specified statement furnished to the individual. The maximum annual deduction is $12,500 ($25,000 for joint filers). The deduction phases out for taxpayers with MAGI over $150,000 ($300,000 for joint filers). The deduction is available for both itemizing and non-itemizing taxpayers. A statement must be provided from the employer or indicated on the W-2 Box 14.

Trump Accounts/Contributions
A new type of individual retirement account (IRA) has been established by law (officially referred to as a "Trump Account"). These accounts are available for eligible children who have not turned 18 before the end of the calendar year in which the account was established. A one-time $1,000 federal contribution is available for children born between January 1, 2025 and December 31, 2028. Individuals (such as parents, guardians, grandparents and friends) can make after-tax contributions up to an annual limit of $5,000 per child (indexed for inflation after 2027). Employers can contribute up to $2,500 annually per employee's dependent to a qualifying plan, which is excluded from the employee's income.

Individual Income Tax provisions

Filing Threshold and Standard Deduction
Filing thresholds and standard deduction have increased for inflation. (See Tax Addendum p.8)

Long-Term Capital Gains
While the capital gains tax rates did not change under the Tax Cuts and Jobs Act of 2017, the income threshold required to qualify for each bracket has increased for inflation. (see Tax Addendum p.8)

Retirement Plan Contributions
The following thresholds and maximum elective deferrals increased for inflation: deferral to retirement plans [e.g., 401(k), 403(b), 457(b)], elective deferral to SIMPLE IRAs, uniform non-elective contribution to SIMPLE plans, annual additions to defined contribution plans or SEP IRAs, annual compensation taken into account for contributions, definition of highly compensated employee and key employee in top-heavy plans. (see Tax Addendum p.9)

Income thresholds for single, head of household, and married filing jointly for Traditional and Roth IRAs contributions have increased for inflation. (See Tax Addendum p.9)

Standard catch-up contribution limitations (for ages 50+) for employer-sponsored retirement plans and individual retirement plans did not change from prior year. (See Tax Addendum p.9)

Starting in 2025, participants in employer-sponsored retirement plans [401(k), 403(b), 457(b), TSP] who are ages 60, 61, 62, or 63 by the end of the calendar year are eligible for an increased catch-up contribution of $11,250 ($5,250 if SIMPLE IRA), instead of the standard catch-up amount, if their plan sponsor chooses to offer this optional feature. (See Tax Addendum p.9)

HSA Contributions
For 2025, the maximum you can contribute to an HSA is $4,300 for self-coverage and $8,550 for family coverage. Individuals who are 55 and older can contribute an additional $1,000 catch-up contribution.

Education Contributions
Maryland 529 accounts have a lifetime contribution limit of $500,000 per beneficiary (across all 529 accounts), including the Prepaid College Trust. Although there is no federal annual contribution limit, contributions are subject to federal gift tax rules. For 2025, you can contribute up to $19,000 per year ($38,000 for married couples) without gift tax implications. In addition, you can "front-load" five years of gifts at once for a total of $95,000 ($190,000 if married) but you must file a gift tax form (Form 709). Maryland taxpayers can deduct up to $2,500 per beneficiary from state income for contributions made to a Maryland 529 plan ($5,000 if joint filers). Unused deductions can be carried forward for up to 10 years.

For 2025, the total annual contribution limit to all Coverdell Education Savings Accounts per beneficiary remains $2,000, subject to MAGI limitations. Distributions are tax-free to the extent that they are used for qualified elementary, secondary, or higher education expenses of the designated beneficiary. The earnings portion of excess distributions is taxable income to the beneficiary.

Itemized Deductions
For itemized deductions in 2025, the following rules are worth pointing out:

- **State and Local Taxes:** The state and local tax (SALT) deduction has a temporary cap of $40,000 (for single, head of household, qualifying surviving spouse or married filing jointly) and $20,000 (for married filing separately). The cap is reduced by 30 cents for every dollar your income exceeds the MAGI phase-out threshold ($500,000 for single, head of household, qualifying surviving spouse or married filing jointly and $250,000 for married filing separately), but it will not fall below a minimum of $10,000.
- **Mortgage Interest:** The mortgage interest deduction did not change from previous year and is limited to $750,000 of indebtedness and those who had $1,000,000 of home mortgage debt before December 16, 2017, will still be able to deduct the interest on that loan.
- **Medical Expenses:** Qualified medical expenses that exceed 7.5% of adjusted gross income (AGI) can be deducted in 2025 (no change in threshold).
- **Charitable Contributions:** The maximum allowable deduction for charitable contributions depends on the type of property contributed and the type of charity to which the contribution was made. For contributions made to public charities: cash contributions are limited to 60% of AGI, ordinary income property contributions are limited to 50% AGI and long-term capital gain property contributions are limited to 30% of AGI. Excess contributions over these limits can be carried forward and deducted for up to five subsequent tax years.

<u>Note</u>: Miscellaneous itemized deductions subject to a 2% AGI floor were temporarily suspended under the Tax Cuts and Jobs Act (TCJA) of 2017. The OBBBA signed into law in 2025 permanently eliminated these deductions.

Qualified Charitable Distributions
Individuals who are ages 70½ or older can transfer up to $108,000 yearly from IRAs directly to charities. Qualified charitable distributions (QCDs) can be a smart tax strategy that reduces your taxable income without itemizing and it counts towards your RMD once you turn age 73. *Please inform us if you have made a QCD as this information is not on the form.*

Required Minimum Distributions
Beginning in 2023, the SECURE 2.0 Act raised the age that you must begin taking RMDs to age 73. If you reach age 73 in 2025, the required beginning date for your first RMD is April 1, 2026.

<u>Note</u>: If you turned 73 in 2024 or earlier, you would need to continue taking RMDs as scheduled. If you are turning 73 in 2025, consider when to take your first RMD: Either by December 31, 2025, or delay until no later than April 1, 2026. Remember, if you delay your first RMD to April 1, 2026, you will need to take two RMDs in 2026. Your first RMD by April 1, 2026, which satisfies your required withdrawal for 2025, and your second RMD by December 31, 2026, which satisfies your required withdrawal for 2026.

Annual Gift Tax Exclusion
For 2025 and 2026, an annual exclusion for up to $19,000 per donee is allowed for gifts of present interests. A present interest is an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property. Conversely, future interests are limited to commence in use, possession, or enjoyment at some future date or time and are not eligible for the annual exclusion. If a married couple elects to "split gifts", the annual exclusion is doubled to $38,000 ($19,000 x 2) per donee.

Gift and Estate Tax Lifetime Exemption
Gifts exceeding the $19,000 annual exclusion amount count against your lifetime gift and estate tax exemption. For 2025 and 2026, the lifetime exemption is $15 million per individual (or $30 million for a married couple). Generally, you only owe gift and estate tax if you exceed both the annual exclusion and your total lifetime exemption.

Standard Mileage Rates
The standard mileage rates for 2025, were set by the IRS as follows:

- 70 cents per mile for business miles driven. This rate covers both fixed and variable costs, with 33 cents allocated to depreciation.
- 21 cents per mile driven for medical purposes or moving purposes for qualified active-duty members of the Armed Forces.
- 14 cents per mile driven in service of charitable organizations. This rate is set by statute and remains unchanged.

Kidde Tax
The net unearned income of a dependent child under 18 years of age (or a child age 18 to under 24 who does not provide over half of his/her own support and is a full-time student) is taxed at the parent's rate. The amount of unearned income up to $1,350 is taxed at 0%, and the next $1,350 is taxed at the child's rate. Unearned income greater than $2,700 is taxed at the parent's rate.

Unemployment Compensation
For 2025, a taxpayer must include in gross income the full amount received for unemployment compensation.

<u>Refundable/Non-Refundable Tax Credits</u>

Child Tax Credit and Additional Child Tax Credit
For 2025, the Child Tax Credit is $2,200 per qualifying child under age 17 at the end of the tax year. The credit is partially refundable, with a maximum refundable amount (known as the Additional Child Tax Credit or ACTC) of $1,700 per child. To qualify for the ACTC, you must have at least $2,500 in earned income. The credit is also subject to a phase-out starting at $400,000 for joint filers and $200,000 for single filers and individuals married filing separately.

An additional non-child dependent tax credit of $500 may be claimed for each dependent who is not a qualifying child under age 17. The non-child dependent credit is subject to the same AGI phase-out amounts and is not refundable.

New Clean Vehicle Tax Credit
The new clean vehicle credit is available only for qualifying vehicles acquired on or before September 30, 2025. A credit of up to $7,500 for new electric vehicles ($4,000 for previously owned electric vehicles) subject to modified AGI limitations ($300,000 for joint filers, $225,000 for head of household, and $150,000 for all other filers).

Residential Energy Credits
The residential clean energy credit is a nonrefundable federal tax credit allowing homeowners to claim 30% of the installation costs (including labor) for qualifying solar, wind, and geothermal energy-generating systems installed in their primary or second home. This credit is available for systems installed through December 31, 2025.

The energy efficient home improvement credit is a nonrefundable federal tax credit allowing eligible taxpayers to claim 30% of the costs of qualified energy efficiency improvements up to a maximum of $3,200 annually, with separate limits on doors, windows, and home energy audits. The credit is available for improvements made to an existing primary home located in the U.S. through December 31, 2025.

If you are claiming one of the residential energy credits described above, please be sure to provide us with a copy of related invoices.

Education Credits
The American Opportunity Tax Credit (AOTC) is available for qualified tuition, fees, and course materials (including books) paid for a student's first four years of higher education at an eligible educational institution. The maximum AOTC is $2,500: 100% of the first $2,000 of qualified expenses plus 25% of the next $2,000 of expenses paid during the year. Subject to certain restrictions, 40% of the AOTC is refundable. This means that up to $1,000 may be refunded. The qualified expenses are on a "per student" basis and must be incurred on behalf of the taxpayer, taxpayer's spouse, or taxpayer's dependent. The credit phase-out begins with MAGI exceeding $80,000 ($160,000 for joint filers), with full phase-out at $90,000 ($180,000 for joint filers).

The Lifetime Learning Credit (LLC) is available for an unlimited number of years for qualified tuition and related course fees at eligible educational institutions. The LLC is equal to 20% of qualified expenses up to $10,000. Qualified expenses are on a "per taxpayer" basis, rather than a "per student" basis, so the maximum credit is $2,000 regardless of the number of qualifying students. The credit phase-out begins with MAGI exceeding $80,000 ($160,000 for joint filers), with full phase-out at $90,000 ($180,000 for joint filers).

<u>Note:</u> A parent may claim a lifetime learning credit for the expenses of one child and an American opportunity credit for the expenses of another child in the same taxable year. However, more than one credit cannot be claimed for the same student in the same year.

Business Income Tax Incentives

Section 199A Qualified Business Income Deduction
For 2025, the Section 199A Qualified Business Income (QBI) deduction allows eligible pass-through business owners to deduct up to 20% of their QBI. The OBBBA has made this deduction permanent starting in the 2026 tax year. For 2025, the ability to claim the full deduction is based on your taxable income (before the QBI deduction) and filing status. Threshold amounts and phase-in range amounts for married individuals filing joint is between $394,600 and $494,600. Threshold amounts and phase-in range amounts for all other filers is between $197,300 and $247,300.

Section 179 Expense Deduction and Bonus Depreciation
In lieu of depreciation, a taxpayer can elect to immediately expense a fixed amount of the cost of qualified business-use property purchased and placed in service during the year. The 2025 allowance is $2,500,000, with a phase-out threshold starting at $4,000,000 of total equipment purchases. The deduction is limited to taxable income (before the deduction).

Under bonus depreciation rules, a taxpayer can expense an additional percentage of qualified property that is placed into service in the current year. For 2025, the bonus depreciation rate is 100% for qualifying property that is both acquired and placed in service after January 19, 2025. Previously, under the Tax Cuts and Jobs Act (TCJA), the rate for property placed in service in 2025 would have been 40%. This older rate still applies to property acquired under a written binding contract before January 20, 2025. Bonus depreciation is claimed after the Section 179 expense deduction, if elected, but before the regular MACRS deprecation expense deduction.

Net Operating Losses
A net operating loss (NOL) generated in tax years ending after December 31, 2020 can be carried forward indefinitely and NOL deductions are limited to 80% of taxable income (before the NOL deduction).

1099-K/NEC Thresholds
For 2025, the IRS Form 1099-NEC reporting threshold remains $600. For 2025, the IRS Form 1099-K reporting threshold has reverted to the previous requirement of over $20,000 in gross payments and more than 200 transactions in a calendar year from a third-party settlement organization.

Tax Planning

If you are considering retirement, starting or selling a business or investments, we strongly suggest you reach out to Anderson, Davis, & Associates, CPA, PA to discuss these items. If you have any family or friends looking for assistance, we happily welcome the referral.

Please review our separate attachment to this email regarding our preferred methods of receiving your tax documents for this upcoming tax season.

Best wishes,

Anderson, Davis & Associates, CPA

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