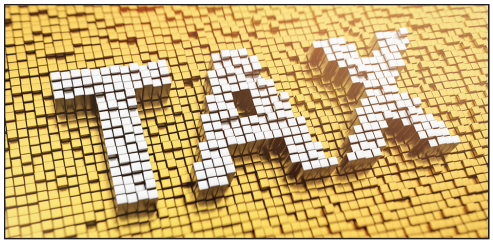

Tax News and Industry Updates

2025
Volume 13, Issue 3

ARROWHEAD TAX SERVICE

100 S. CHURCH ST.
NEW CARLISLE, OHIO
937-543-5770
www.arrowheadtaxservice.com

Inside This Issue

HSA Inflation Adjusted Amounts

Cross References

- IRC §223
- Rev. Proc. 2025-19
- Rev. Proc. 2024-25

The IRS recently announced inflation adjusted amounts for health savings accounts (HSAs) for 2026. These amounts are reflected in the chart below in comparison to 2025.

HSA Limitations

Annual contribution is limited to:	2026	2025
Self-only coverage, under age 55	$4,400	$4,300
Self-only coverage, age 55 or older	$5,400	$5,300
Family coverage, under age 55	$8,750	$8,550
*Family coverage, age 55 or older	$9,750	$9,550
Minimum annual deductibles:		
Self-only coverage	$1,700	$1,650
Family coverage	$3,400	$3,300
Maximum annual deductible and out-of-pocket expense limits:		
Self-only coverage	$8,500	$8,300
Family coverage	$17,000	$16,600

*Assumes only one spouse has an HSA. See IRS Pub 969 if both spouses have separate HSAs.

continued in next column

◆ ◆ ◆

Relief for Disaster Victims

Cross References

- irs.gov

As of June 3, 2025, taxpayers affected by the following disasters still qualify for the following extensions of time to file various tax returns and make tax payments.

Disaster	Date Disaster Began	Location	Extended Filing and Payment Deadline
Hurricane Helene	9/22/2024	North Carolina	9/25/2025
Wildfires	1/7/2025	California	10/15/2025
Severe winter storms and flooding	2/10/2025	Virginia	11/3/2025
Severe storms, straight-line winds, flooding, and landslides	2/14/2025	Kentucky	11/3/2025
Severe storms, straight-line winds, flooding, landslides, and mudslides	2/15/2025	West Virginia	11/3/2025
Severe storms, straight-line winds, tornadoes, and flooding	4/2/2025	Tennessee and Arkansas	11/3/2025

In general, if a due date to file a tax return or pay a tax falls on or after the date a disaster affected the taxpayer, the due date is extended. The date the disaster began for a particular location is the date it affected the taxpayer. For example, flooding in Virginia that occurred starting on February 10, 2025 occurred prior to the April 15, June 16, and September 15, 2025, estimated tax payment due dates. All of those due dates are now extended to November 3, 2025.

◆ ◆ ◆

One-Third of IRS Auditors Terminated or Resigned as of March 2025

Cross References

- TIGTA Report 2025-IE-R017 dated May 2, 2025

As part of the President's actions to reduce the size of the federal government's workforce, the Office of Personnel Management issued guidance for agencies to follow related to probationary employee terminations and the deferred resignation program (DRP). The DRP allowed federal employees to voluntarily resign with pay through September 30, 2025.

The Treasury Inspector General for Tax Administration (TIGTA) initiated a review to provide an update on the IRS's efforts to reduce its workforce. The report provides a snapshot of IRS business units impacted. TIGTA's report also shares demographics of probationary employees who received termination notices and employees who took the DRP offer (collectively referred to as separations), as of March 2025.

As of March 2025, TIGTA found that more than 11,000 IRS employees (out of 103,000 total IRS workforce) were either approved for the DRP or received termination notices during their probationary employment period. These departures represent 11 percent of the IRS's total workforce and impact certain business units more than others.

Additionally, the separations disproportionately impacted employees in certain positions (e.g., job series). For example, approximately 31 percent of revenue agents separated, while 5 percent of information technology management separated. Revenue agents conduct examinations (audits) by reviewing financial records of individual and businesses to verify what is reported. They can work in several IRS business units examining different types of taxpayers.

To view the details from the TIGTA report, visit: https://www.tigta.gov/sites/default/files/reports/2025-05/2025ier017fr.pdf

◆ ◆ ◆

Limited Partners Subject to SE Tax

Cross References

- *Soroban,* T.C. Memo. 2025-52

In addition to being subject to income tax, self-employed individuals are subject to self-employment (SE) tax. IRC section 1402(a) defines net earnings from self-employment as the gross income derived by an individual from any trade or business carried on by such individual, less the deductions attributable to the business, as well as the individual's distributive share of income or loss from a partnership. An exception to this rule excludes from SE tax the distributive share of income or loss received by a limited partner in a partnership. [IRC §1402(a)(13)]

A limited partner is not subject to SE tax on the distributive share of partnership income, other than guaranteed payments. The tax court has previously applied a functional analysis to determine whether a partner is limited in name only. This functional analysis determines whether a partner is limited by looking at the roles and responsibilities of the partner. Thus, a partner that has limited liability protection, but otherwise performs significant services for the partnership, could still be subject to SE tax on his or her distributive share of partnership income.

Soroban Capital Partners LP (Soroban) is a limited partnership with one general partner and three limited partners. When calculating net earnings from self-employment, Soroban included guaranteed payments it had made to its limited partners but otherwise excluded their shares of partnership income. The IRS claimed all of the income earned by the limited partners was subject to SE tax. The tax court performed the following functional analysis to determine whether the limited partners were subject to SE tax on their distributive share of partnership income.

Role in generating income. The partnership generated income from fees it charged its clients for managing their investments. The limited partners' time, skills, and judgment were essential to these services. They were responsible for managing risk. They managed trade offers. All three limited partners oversaw and participated in the investment process which contributed to the generation of Soroban's income. The fees were substantial, generating approximately $247 million in revenue for Soroban during the two years at issue in this case.

Role in management. All three limited partners participated in management and served on the Brokerage, Trade Allocation, Management, and Valuation Committees. They made decisions related to hiring, firing, promoting, and evaluating partnership employees. They exercised authority delegated to them by the general partner to negotiate and execute business agreements and documents.

Soroban argued that this work was not done by the limited partners alone and that it would be inappropriate to attribute the generation of income solely to the limited partners. The record makes clear that Soroban employed people other than the limited partners to carry out the operations of the business. But the limited partners maintained control over the operations of the business, exercising authority over the core functions of Soroban's business.

Time devoted to the business. While no formal time records were maintained, Soroban estimated that the three limited partners each worked 2,300 to 2,500 hours annually during the two years at issue. They devoted their full-time efforts to actively pursuing the business of Soroban.

Marketing. Soroban advertised the unique skill and experience of the limited partners. The skill and experience of one of the limited partners was so crucial that if he became incapacitated, it would be a key-man event triggering rights notice to investors and the right to withdraw funds on short notice. In addition, if no limited partner was available to manage the funds, the funds would liquidate. The limited partners were publicly held out as essential to the operation of Soroban.

Capital contributions. The capital contributions of the limited partners were insignificant, indicating that their distributive shares of income were not returns on an investment of capital. Their distribute shares of income bear no relationship to their capital contributed or their partnership capital accounts.

Authority designated by general partner. Soroban argued that the limited partners were defined as limited partners under state law. They acted solely with authority delegated to them by the general partner.

The tax court stated that a partner labeled a limited partner under state law does not dictate how the partner is treated for federal tax purposes. A partner labeled a limited partner who works for the business full time, whose work is essential to generating the business's income, who is held out to the public as essential to the business, and who contributes little or no capital, is not functioning as a limited partner regardless of the label placed on that partner. Their roles in the business are not those of passive investors.

Conclusion. The court concluded that Soroban's limited partners were limited partners in name only, and thus, are not limited partners within the meaning of IRC section 1402(a)(13). Their earnings constitute net earnings from self-employment.

◆ ◆ ◆

The Public Policy Doctrine

Cross References

• *Hampton,* T.C. Memo. 2025-32

IRC section 165(a) allows a deduction for any loss sustained during the tax year and not compensated for by insurance or otherwise. For individual taxpayers, the deduction is limited to losses incurred:
1) In a trade or business,
2) In a transaction entered into for profit, or
3) In certain instances of casualty or theft.

Before 1969, courts applied the "Public Policy Doctrine" to deny taxpayers a deduction for which they otherwise qualified for under IRC sections 165 or 162 in cases where allowing the deduction would "frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof." The Supreme Court clarified that the doctrine virtually always forbids deduction of governmentally imposed fines and penalties, stating that the "deduction of fines and penalties uniformly has been held to frustrate state policy in severe and direct fashion by reducing the 'sting' of the penalty prescribed by the state legislature."

The Tax Reform Act of 1969 codified this doctrine by disallowing a deduction for "any fine or similar penalty paid to a government for the violation of any law." [IRC §162(f)]

In 2013, the taxpayer in this case pleaded guilty to charges of bribery, fraud, and money laundering. The U.S. District Court for the Southern District of Ohio ordered the taxpayer to forfeit approximately $2.2 million of the resultant accretions to income and wealth. In 2016, the U.S. Marshals Service seized money from the taxpayer's wholly owned S corporation in part to settle this judgment. The S corporation then claimed a loss for the asset seizures, and the taxpayer deducted the corresponding passthrough loss on his 2016 individual income tax return. The IRS disallowed the loss.

In court, the taxpayer argued that the public policy doctrine has no application to this case, primarily because the S corporation was never indicted or charged with wrongdoing. He argued that because the doctrine did not prohibit the S corporation from claiming a 2016 loss on account of the asset seizures, then he was entitled

to claim that same loss in his capacity as the S corporation's sole shareholder.

The court stated that even if it is assumed that the S corporation was entitled to claim a deduction for the asset seizures, the taxpayer is barred by the public policy doctrine from reporting his 100% passthrough share of the loss. To hold otherwise would be to frustrate the sharply defined policy against conspiring to commit offenses against the United States. The taxpayer was the wrongdoer, and the S corporation assets were seized as part of the penalty for his wrongdoing. The seized and forfeited assets were clearly "property constituting, or derived from, proceeds obtained, directly or indirectly, as a result of the violations" that caused the taxpayer to plead guilty to charges of bribery, fraud, and money laundering. Allowing him a deduction on account of the S corporation loss would unquestionably reduce the "sting" of the penalty for him. Allowing the taxpayer to deduct a loss by simply interposing his S corporation between him and some of the seized assets would violate the public policy doctrine as formulated by the Supreme Court.

The public policy doctrine is not so rigid or formulaic that it may apply only when the convicted person himself hands over a fine or penalty. The taxpayer claims that because the public policy doctrine is an equitable doctrine, the court should take into consideration the fact that the United States' seizure of his S corporation's assets violated due process, and (given that the S corporation was not the wrongdoer) was otherwise overzealous. However, the court stated it sees no legal impropriety in the seizure of the S corporation's assets to satisfy the taxpayer's forfeiture liability. A corporation is not a person other than the defendant when it is wholly owned and controlled by the defendant. The law allows a court to order forfeiture of any other property of the defendant if the property involved in or obtained from the defendant's criminal offense is unavailable.

Over the years the S corporation's sole source of business income was the commissions generated by the taxpayer that were assigned to the S corporation. It was those assigned commissions that led to the criminal indictment, plea, and forfeiture at issue in this case. It is impossible to see how the S corporation was independent of the taxpayer such that the forfeiture loss deduction should be allowed.

The court ruled that the taxpayer was not allowed to deduct the passthrough losses from his S corporation.

◆ ◆ ◆