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Otherwise Nondeductible Wages Not Eligible for Qualified Business Income Deduction

A.A. Savage, 165 TC No. 5, Dec. 62,714

The shareholders of S corporations engaged in cannabis sales could not include wages disallowed under Code Sec. 280E when calculating the Code Sec. 199A deduction. The Court reasoned that only wages "properly allocable to qualified business income" qualify, and nondeductible wages cannot be so allocated under the statute.

The individuals owned three S corporations and reported pass-through income for the tax years at issue. Two corporations, engaged in cannabis sales, were subject to Code Sec. 280E, which bars deductions for expenses of businesses trafficking in controlled substances. Both entities paid significant W-2 wages, but portions were nondeductible under Code Sec. 280E. Petitioners claimed the full amount of reported wages in computing the Code Sec. 199A deduction.

The IRS reduced the deductions, asserting that only deductible wages could count as W-2 wages under Code Sec. 199A. The Court agreed, finding that Code Sec. 199A(b)(4)(B) excludes any amount not "properly allocable to qualified business income," and Code Sec. 199A(c)(3)(A)(ii) limits qualified items to those "allowed in determining taxable income." Because nondeductible wages are not allowed in determining taxable income, they cannot be W-2 wages. "Although certain amounts may have been reported by an employer to an employee in a Form W-2," the Court explained, "those amounts do not constitute "W-2 wages" for purposes of 199A if they are not properly allocated to qualified business income."

A dissenting judge argued that Congress intended the wage limitation to encourage job creation and that wages properly allocable to a trade or business should count regardless of deductibility. The majority, however, concluded that statutory text foreclosed this interpretation.

Wolters Kluwer Projects Annual Inflation Amounts for 2026

Annual inflation-adjusted amounts for tax year 2026 are projected by Wolters Kluwer. The projected amounts include 2026 tax brackets, the standard deduction, and alternative minimum tax amounts, among others. The projected amounts are based upon Consumer Price Index figures released by the U.S. Department of Labor on September 11, 2025.

Official amounts for 2026 should be released by the IRS later in 2025.

Individual Tax Brackets

The projected bracket ranges for individuals in 2026 are as follows.

For married taxpayers filing jointly:

- The 10% bracket applies to taxable incomes up to $24,800
- The 12% bracket applies to taxable incomes over $24,800 and up to $100,800
- The 22% bracket applies to taxable incomes over $100,800 and up to $211,400
- The 24% bracket applies to taxable incomes over $211,400 and up to $403,550
- The 32% bracket applies to taxable incomes over $403,550 and up to $512,450
- The 35% bracket applies to taxable incomes over $512,450 and up to $768,700
- The 37% bracket applies to taxable incomes over $768,700

For heads of households:

- The 10% bracket applies to taxable incomes up to $17,700
- The 12% bracket applies to taxable incomes over $17,700 and up to $67,450
- The 22% bracket applies to taxable incomes over $67,450 and up to $105,700
- The 24% bracket applies to taxable incomes over $105,700 and up to $201,750
- The 32% bracket applies to taxable incomes over $201,750 and up to $256,200
- The 35% bracket applies to taxable incomes over $256,200 and up to $640,600
- The 37% bracket applies to taxable incomes over $640,600

For unmarried taxpayers:

- The 10% bracket applies to taxable incomes up to $12,400
- The 12% bracket applies to taxable incomes over $12,400 and up to $50,400
- The 22% bracket applies to taxable incomes over $50,400 and up to $105,700
- The 24% bracket applies to taxable incomes over $105,700 and up to $201,775
- The 32% bracket applies to taxable incomes over $201,775 and up to $256,225
- The 35% bracket applies to taxable incomes over $256,225 and up to $640,600
- The 37% bracket applies to taxable incomes over $640,600

For married taxpayers filing separately:

- The 10% bracket applies to taxable incomes up to $12,400
- The 12% bracket applies to taxable incomes over $12,400 and up to $50,400
- The 22% bracket applies to taxable incomes over $50,400 and up to $105,700
- The 24% bracket applies to taxable incomes over $105,700 and up to $201,775
- The 32% bracket applies to taxable incomes over $201,775 and up to $256,225
- The 35% bracket applies to taxable incomes over $256,225 and up to $384,350
- The 37% bracket applies to taxable incomes over $384,350

For estates and trusts:

- The 10% bracket applies to taxable incomes up to $3,300
- The 24% bracket applies to taxable incomes over $3,300 and up to $11,700
- The 35% bracket applies to taxable incomes over $11,700 and up to $16,000
- The 37% bracket applies to taxable incomes over $16,000

Standard Deduction

For 2026, the following standard deduction amounts are projected to apply:

- For married taxpayers filing jointly, $32,200
- For heads of households, $24,150
- For unmarried taxpayers and well as married taxpayers filing separately, $16,100

AMT Exemptions

For 2026, the AMT exemption amounts are projected to be:

2025 Clean Electricity Production Credit Inflation Adjustments Published

The IRS has republished the inflation adjustment factor and applicable amounts for calendar year 2025 for the clean electricity production credit allowable under Code Sec. 45Y. The factor and amounts are used to determine the Code Sec. 45Y credit and apply to calendar year 2025 sales, consumption, or storage of electricity produced in the U.S. or a U.S. possession at a qualified facility.

Inflation Adjustment Factor

The inflation adjustment factor for calendar year 2025 is 1.9971. The applicable amount under Code Sec. 45Y(a)(2)(A) for electricity sales, consumption, or storage occurring in calendar year 2025 is 0.6 cents. The applicable amount under Code Sec. 45Y(a)(2)(B) for electricity sales, consumption, or storage is 3 cents.

Notice 2025-38

REFERENCE KEY

USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***

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- For married taxpayers filing jointly, $140,200
- For unmarried individuals and heads of households, $90,100
- For married taxpayers filing separately, $70,100

Estate and Gift Tax

The following amounts related to transfer taxes (estate, generation-skipping, and gift taxes) are projected for 2026:

- The gift tax annual exemption is projected to be $19,000.
- The estate and gift tax applicable exclusion is $15,000,000 for decedents dying in 2026 (NOTE: this is determine by statute due to amendments by the One Big Beautiful Bill Act).
- The exclusion for gifts made in 2026 to a spouse who is not a U.S. citizen is projected to be $194,000.

Other Amounts

The following other amounts are also projected for 2026:

- The adoption credit for 2026 is projected to be $17,670
- For 2026, the allowed Roth IRA contribution amount is projected to phase out for married taxpayers filing jointly with income between $242,000 and $252,000. For heads of household and unmarried filers, the projected phaseout range is between $153,000 to $168,000.
- The maximum amount of deductible contributions that can be made to an IRA is projected to be $7,500 for 2026. Beginning in 2024 pursuant to the SECURE 2.0 Act (P.L. 117-328), the increased contribution amount for taxpayers age 50 and over is adjusted annually for inflation. This amount is projected to increase to $1,100 for 2026.
- The above-the-line deduction for traditional IRA contributions is projected to begin to phase out for married joint filers whose income is greater than $129,000 if both spouses are covered by a retirement plan at work. If only one spouse is covered by a retirement plan at work, the phaseout is projected to begin when modified adjusted gross income reaches $242,000. For heads of household and unmarried filers who are covered by a retirement plan at work, the 2026 income phaseout range for deductible IRA contributions is projected to begin at $81,000.
- For 2026, the $2,500 student loan interest deduction is projected to begin to phase out for married joint filers with modified adjusted gross income (MAGI) above $175,000. For single taxpayers, the 2026 deduction is projected to begin to phase out at a MAGI level of over $85,000.
- The amount of the 2026 foreign earned income exclusion under Code Sec. 911 is projected to be $132,900.

Fraudulent Social Media Tax Schemes on the Rise

IR-2025-90

The IRS has cautioned individuals about a rise in fraudulent tax schemes on social media that misuse credits such as the Fuel Tax Credit and the Sick and Family Leave Credit. The scams typically appear as posts promising guaranteed refunds, urging amended returns without justification, or advising individuals to ignore IRS notices and respond with false details. These schemes attempt to exploit trust by suggesting fast refunds with little documentation. Consequences of participating include delayed or denied refunds, a $5,000 penalty under Code Sec. 6702, and possible IRS examinations or enforcement actions.

The IRS urges individuals to act quickly if misled. Steps include filing Form 1040-X, Amended U.S. Individual Income Tax Return, responding promptly to IRS correspondence, and consulting a trusted tax professional. Suspected scams should be reported to phishing@irs.gov or the Treasury Inspector General for Tax Administration.

IRS Warns of Disaster Donation Scams

Tax Tip 2025-61

The IRS has reminded taxpayers that while donating to disaster relief is a compassionate and effective way to help, it is equally important to remain cautious. In the aftermath of disasters, scam activity increases, with fraudsters creating fake charities or posing as representatives of legitimate organizations. To safeguard contributions, donors should verify organizations through the IRS Tax Exempt Organization Search tool before donating. Additionally, legitimate charities will never request donations in the form of gift cards, cash, or wire transfers. Keeping receipts and reviewing financial statements closely ensures contributions are both secure and potentially tax-deductible.

Further, scammers may impersonate government officials, manipulate caller IDs, or use vague emotional appeals without providing specifics. Thus, donors are urged to avoid giving personal information and ensure their donation is truly reaching a qualified charity. Suspected fraud can be reported to the Federal Trade Commission or the National Center for Disaster Fraud.

Work Opportunity Tax Credit Still Available Through 2025

Tax Tip 2025-60

The IRS is reminding taxpayers that the Work Opportunity Tax Credit will continue to be available to employers through the end of 2025. This federal incentive is designed to encourage businesses to hire individuals who face significant barriers to employment, such as veterans, long-term unemployment recipients, those receiving public assistance, and individuals re-entering the workforce after incarceration.

Before claiming the credit, employers must obtain certification that their new hire is a member of one of the eligible groups. Once approved, businesses may apply the Work Opportunity Credit against their tax liability, generally based on wages paid during the employee's first year. A special provision allows tax-exempt organizations to claim the credit when hiring qualified veterans. The IRS encourages employers to learn more about this opportunity and take advantage of the program before it expires at the end of 2025.

Tax Preparer Found in Contempt for Violating Court-Ordered Injunction

Velarde, DC Calif. 2025-2 USTC ¶50,238

A tax preparer was found in contempt of a court-ordered injunction. The District Court found that the preparer failed to comply with due diligence requirements during the tax years at issue. It determined that the preparer knowingly submitted federal income tax returns containing fabricated Social Security numbers for qualifying persons, in violation of an injunction prohibiting conduct that breaches Code Sec. 6695. The preparer admitted to using random nine-digit numbers as a workaround to what she considered a "flaw" in the software she used to prepare tax filings. She explained that, based on her understanding, she did not need to provide a social security number for qualifying persons. However, she failed to make reasonable inquiries or obtain accurate information, as required under Reg. §1.6695-2(b)(3)(i).

The Court found this conduct to be a violation of the injunction and imposed a civil sanction to compel future compliance. Although the Government also alleged improper use of head of household status under Code Sec. 6694, the Court concluded that clear and convincing evidence had not been presented to support that claim. Prior penalties imposed by the IRS for similar conduct were noted as a factor in determining the need for sanctions.

TAX BRIEFS

Penalties

A medical doctor was found liable for deficiencies in income tax and civil fraud penalties for the tax years at issue. The Tax Court found no genuine dispute of material fact regarding the deficiencies and fraud. The Court held that the IRS complied with Code Sec. 6751(b)(1) by securing timely written supervisory approval of the civil fraud penalties.

Gottesman, TC, Dec. 62,713(M)

Plug-In Vehicle Credit

A married couple was not entitled to claim a plug-in vehicle credit after the year in which their vehicle was first placed in service. The Tax Court explained that Code Sec. 30D provides a one-time credit available only in the year a qualified vehicle is first placed in service, meaning when it is ready and available for its intended function.

Moon, TC, Dec. 62,712

Tax Exempt Organizations

Two organizations were denied tax-exempt status for not operating exclusively for exempt purposes under Code Sec. 501. In the first case, the organization was operated to benefit the private interest of organization's artists. In the second case, the organization did not meet the operational test under Code Sec. 501(c)(3) because its activities further substantial non-exempt social and recreational purposes.

IRS Letter Ruling 202537004; IRS Letter Ruling 202537005