August 2026

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# Tax Newsletter

**To Convert to a Roth or Not To?**
**Key question for retirement-savers**

If you are like many well-to-do individuals, you may have been thinking about a Roth conversion for some time. Is it now or never? Do not make any knee-jerk reactions. This decision requires a thorough analysis of your personal circumstances.

**Basic rules:** Assuming you have accumulated significant funds in traditional IRAs— through annual contributions or rollovers from 401(k)s or other plans, or both— you will have to withdraw at least some of the money sooner or later. Generally, required minimum distributions (RMDs) must begin after age 73 (scheduled to increase to age 75 in 2033). These distributions are taxed at ordinary income rates currently reaching up to 37%.

Conversely, with a Roth IRA, you can continue to build up your account without taking any lifetime RMDs. For a Roth in existence at least five years, qualified distributions— usually, those made after age 59½—-are completely tax-free, while other payouts may be wholly or partially free of tax under favorable IRS "ordering rules."

It may sound like converting to a Roth is a no-brainer, but there is a big catch: The amount transferred from a traditional IRA to a Roth is treated as a taxable distribution subject to ordinary income tax. Facing this current tax liability may leave you in a quandary.

To determine whether to make the leap into a Roth or not, consider all the relevant aspects, including your health status and personal needs. This may vary from person to person, but there are usually four main financial factors.

**1. Tax rates:** Compare tax rates for now and later. For instance, if you are in a low bracket this year and expect to pay tax at higher rates for 2027 and beyond, you might go ahead and convert. But you may not be so quick to make the move if you will owe a conversion tax at a high rate in 2026—say, the 37% rate—and expect to be in a lower bracket in retirement. It won't hurt as much to take RMDs if you are in the 22% tax bracket or lower when you retire.

**2. Living expenses:** Will IRA funds be needed to help pay for your living expenses during retirement? A conversion to a Roth is not as advantageous if you have to start drawing down funds right away. On the other hand, if you have sufficient other income to live on, you may be more inclined to convert.

**3. Time horizon:** Generally, a conversion makes more sense if you are not ready to retire yet, so you have more time to build up your savings. Therefore, if retirement is imminent or you have already retired, you may have missed the bus. But a conversion still may be viable late in life if one of your main objectives is to preserve assets for your heirs.

**4. Other resources:** If you have to tap into your IRA funds to pay the conversion tax now, you are reducing the size of your nest egg and diluting future tax benefits. It may be better to convert in a year in which you can pay all or most of the resulting tax bill from independent sources.

**Final thoughts:** You are not required to convert the entire balance in your IRA in one fell swoop. In fact, it is often recommended that you convert through a series of transactions spanning several years. You may reduce the overall tax hit by managing your tax brackets year-to-year.

**Tap Dancing Around Business Records**
**"Cohan rule" may salvage deductions**

Generally, you may deduct business expenses, subject to certain requirements, only if you can substantiate the amounts through adequate records. However, as shown by a new case, you may be able to fall back on the "Cohan rule" if you come up short (*Branch, TC Memo 2026-51, 6/17/26)*. Nevertheless, this is not a foolproof solution.

**Background:** The Cohan rule stems from a case involving the legendary vaudeville star George M. Cohan known for tapdancing as the "Yankee Doodle Dandy" and other performances. Cohan claimed deductions for business travel and entertainment (T&E) expenses on his tax returns, but asserted that he was too busy with his show business career to document the expenses. Naturally, the IRS disallowed the deductions.

After several appeals, the case landed in the lap of Judge Learned Hand of the Second Circuit Court of Appeals, as famous in judicial circles as Cohan was in his element. Instead of kicking up the case to the U.S. Supreme Court, Hand tackled the issue head-on.

In effect, the learned judge ruled that Cohan should be allowed to deduct at least some expenses because there was credible evidence that he had, in fact, incurred expenses. As a result, the Cohan rule was born, giving a last shot at deductions to taxpayers without all the necessary records (*Cohan, 39 F.2d 540, 543–44, 2d Cir. 1930*).

Ironically, under current law, the Cohan rule cannot be applied where specific records are required by the tax code or regulations, as is the case for T&E expenses. In addition, deductions for business entertainment expenses are completely banned after 2017. But the Cohan rule can provide a tax respite in other instances.

**New case:** The taxpayer owned and operated a sole proprietorship that cared for about 100 adult clients with physical and mental disabilities. The business was heavily regulated with most of its income coming from Medicaid payments.

During the tax years in question— 2015 through 2017— the taxpayer failed to file federal income tax returns, despite generating millions of dollars in revenue. After the IRS flagged the taxpayer for an audit, it assessed a number of deficiencies.

The taxpayer conceded the gross receipts amount depicted by the IRS but argued that the agency failed to account for offsetting business expenses and itemized deductions. This included various T&E expenses, rent, utilities and the cost of contract labor. Significantly, the taxpayer relied on the Cohan rule to justify the deductions.

Overall, the Tax Court lent a sympathetic ear, approving deductions for business expenses that were not specifically required. However, it denied deductions for T&E expenses that are subject to strict substantiation requirements under Section 274 of the tax code and accompanying regulations.

*Footnote:* The Court indicated that merely using Google or a comparable internet source to support your claim is not sufficient. Along the same lines, you cannot qualify for deductions just because you relied on the advice of a tax professional.

**Caution:** The Cohan rules should be viewed as a last resort. There is no substitute for keeping detailed and accurate records.

**Five Issues for Business Start-Ups**
**Key items for new owners to focus on**

Are you starting a new business from the ground up? Before you open up your pocketbook, be aware that there are numerous practical considerations from a business, tax and legal perspective. In other words, there is much more involved in a start-up than just fronting the money, even for small business ventures.

Although the "to-do list" is too long to enumerate and explain here, following are five primary legal issues that deserve your immediate attention.

**1. Form of ownership:** One of the first decisions for prospective small business owners is the form of business ownership. Typically, you must choose between operating the company as a C Corporation, S corporation, partnership, limited liability company (LLC), or, if you are on your own, a sole proprietorship.

Notably, C corporations, S corporations and LLCs generally provide protection against liability from most creditors. In addition, taxes may be a major factor, especially in light of recent tax law changes reducing corporate tax rates and authorizing "qualified business income" (QBI) deductions for pass-through entities. Obtain expert tax advice for your situation.

**2. Place of incorporation:** You may choose to incorporate your company in the state of your main location or in a state such as Delaware, which promotes favorable rules for businesses. Consider all the costs and tax ramifications of being incorporated in Delaware versus the main place of your business.

**3. Structure of ownership:** For most corporations, the simplest ownership structure requires you to issue fully-vested shares of stock for a designated price. But this approach is not always preferred if you are seeking financing from outside sources. In that case, you might impose vesting restrictions. Discuss the options with your legal advisor.

**4. Intellectual property:** Does your company have a "secret sauce" or other recipe for business success that will set it apart from the competition? Protecting your brand is vital to the growth of the company There are various legal means of protecting intellectual property, including use of patents, copyrights, trademarks and domain names. Furthermore, have employees sign nondisclosure agreements concerning trade secrets of your company.

**5. Recordkeeping:** As you might imagine, keeping good records is essential to avoiding legal battles and winning the ones you are forced to fight. Resist the temptation to do things informally as your business gets off the ground. The time invested in documenting actions and business relationships, including contracts and other agreements establishing responsibilities and obligations, is time well spent.

**In summary:** Do not overlook these issues and other related matters. If you do things right from the start, you may avoid problems later. Fortunately, you can rely on your professional advisors for the necessary guidance.

**Embracing The Adoption Credit**
**Welcome a bundle of tax joy**

Perhaps you, or someone else in your immediate family, is in the process of adopting a child. Besides the benefit of a new addition to the family, the adoptive parents may be in line for a recently-enhanced tax break.

Specifically, if certain requirements are met, the parents can claim a tax credit well into five figures for expenses incurred for adopting a child, whether or not they itemize on their personal tax return in 2026. Remember that a credit is a dollar-for-dollar reduction of your tax bill. Although the credit is phased out for certain high-income parents, the phase-out range is more expansive than it is for many comparable tax breaks.

**Background:** The amount of the adoption credit is indexed annually by the IRS. For the 2026 tax year, the maximum adoption credit equals $17,670 of the qualified expenses incurred to adopt an eligible child (up from $17,280 in 2025). For these purposes, an "eligible child" is one who is under age 18 or physically or mentally incapable of self-care. If you adopt a special needs child, you can claim the maximum credit even if your expenses are less.

The credit begins to phase out for taxpayers with a modified adjusted gross income (MAGI) above the threshold of 265,080 in 2026. No credit is available after MAGI reaches $305,080. In other words, the threshold is relatively high and there is a larger-than-usual phase-out range of $40,000 of MAGI for this credit.

The credit covers most costs directly related to the adoption, including the following:

- Reasonable and necessary adoption fees;
- Court costs and attorney fees;
- Traveling expenses (including amounts spent for meals and lodging while away from home); and
- Other expenses that are directly related to and for the principal purpose of the legal adoption of an eligible child.

On the other hand, certain expenses are not eligible for the credit, such as illegal fees, surrogate parenting fees or amounts reimbursed by a government entity or your employer.

Note that the adoption credit is generally available in the year that qualified expenses are paid or incurred. However, if the adoption is not finalized by the end of the year, the credit cannot be claimed until you file the tax return for the following year. In that succeeding year, you may claim the credit for previously-incurred expenses, even if the adoption is not finalized that year.

*Caution:* The credit cannot be claimed for a *foreign child* until the year in which adoption is final. This supersedes the previously stated rules.

Previously, the adoption credit was completely nonrefundable. Under the One Big Beautiful Bill Act (OBBBA), the credit is partially refundable, up to a maximum of $5,000, indexed for inflation. The threshold for the 2026 tax year is $5,120. This provides even more tax leeway for adoptive parents.

**Final words:** You do not have to go it alone. Obtain expert advice for your situation.

**Time Runs Out for Old Savings Bonds**

Did you receive U.S. Savings Bonds years ago as a gift? Be aware of a couple of important financial facts.

- Series EE Savings Bonds, the most common variety, **mature** in 30 years and stop paying interest after that. Thus, bonds issued in 1996 will mature in 2026.

- The full amount of the accumulated interest is generally **taxable** in the year of maturity, whether you redeem the bonds or not. So, you may as well cash them in.

Consult with your financial advisors if you have any other questions about U.S. Savings Bonds.

**Facts and Figures**
**Timely points of particular interest**

**Find a Friend?**—Don't expect the IRS to be clicking "likes" on Facebook anytime soon. Meta Platforms Inc., the parent company of Facebook, is challenging an assessment of nearly $16 billion in deficiencies. In its petition, Meta claims that periodic adjustments made by the IRS are "arbitrary, capricious or unreasonable and are legally barred by statute. The dispute goes back to a Tax Court decision in 2010 concerning Meta's valuation of intangible assets. A ruling from an appeals court is expected shortly.

**Tax Mileage**—The IRS is changing standard mileage rates in 2026 due to higher costs at the pumps. As it has done in other years when gas prices rose significantly, the IRS has announced higher rates for the last six months of the year. The rate for business driving goes from 72.5 cents per mile to 76 cents per mile (plus tolls and parking fees). The rate for medical and military moving expense costs increases from 20.5 cents per mile to 23.5 cents per mile. Finally, the statutory rate of 14 cents per mile for charitable travel remains the same.