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Tax Newsletter

New Window for Obtaining Tax Refunds

Landmark new case opens the door

According to National Taxpayer Advocate (NTA) Erin M. Collins, millions of taxpayers may be eligible for refunds of tax penalties and interest incurred during the COVID-19 pandemic. The NTA's advisory follows in the wake of a significant new case, *Kwong v. United States*, that extends the period for claims made by qualified taxpayers. (Recent legislation has revised these rules.)

Background: The tax law imposes numerous deadlines for filing and paying taxes for both individuals and businesses. When back taxes are due, delinquent taxpayers may also be assessed penalties and interest on top of the regular tax liability.

However, if extenuating circumstances exist, the IRS will often postpone these filing and payment deadlines, so taxpayers won't be unfairly harmed. This may include tax payments due during a period when a natural disaster, such as a hurricane or wildfire, has damaged a specific geographic part of the country.

The declaration of a disaster area may allow taxpayers to postpone a wide range of responsibilities, including—

- Payment of income tax;
- Filing tax returns;
- Claims for refunds and credits;
- Lawsuits for tax refunds;
- Involuntary conversions;
- Filing Tax Court petitions;
- Responding to IRS notices; and
- Making certain tax elections (e.g., switching from the C corporation form of business ownership to S corporation status).

In addition to the prescribed “disaster period” when deadlines are postponed, the tax law allows you to tack on an extra 60 days to the allowable deadline.

Note that the IRS does not issue refunds or reduce assessed tax liability until a taxpayer files a claim. A taxpayer generally is required to file their claim within three years from the date they filed their tax return or two years from the payment date.

Facts of the new case: Due to the COVID-19 pandemic, President Trump declared a federal disaster beginning on January 20, 2020. Unlike most disaster area designations, this directive was applied on a nationwide basis. The disaster period was eventually deemed to have ended on May 11, 2023.

The taxpayer, a resident of California, filed a lawsuit seeking a refund after the IRS denied a refund claim, arguing that the clock was paused during the entire disaster period spanning January 20, 2020, through May 11, 2023. Now the Federal Court of Claims has sided with the taxpayer. Thus, the effective deadline for the taxpayer is July 10, 2026. This opens up numerous opportunities for taxpayers all across the land.

Caution: The IRS is expected to appeal this decision. If you are affected by the outcome in the *Kwong* case, it is strongly recommended that you file a “protective claim” before **July 11, 2026**. Your professional tax advisor can help you with the mechanics.

How to Comply with Latest RMD Rules Recent legislation complicates requirements

Are you a participant in a qualified retirement plan, like a 401(k) plan, or a traditional IRA? Or have you inherited a plan or IRA accounts from relatives? In either event, you must begin taking required minimum distributions (RMDs) at some point in time, if you have not already started. (Other special rules apply to Roth accounts.)

But the rules for taking or postponing RMDs are complex. In addition, several key provisions have been revised by recent legislation. Following is a brief recap.

Background: Generally, the required beginning date (RBD) for taking RMDs from qualified plans and traditional IRAs is April 1 of the year following the year in which you reach a specified age. The amount of the annual RMD is based on IRS life expectancy tables, updated in 2022, and the value of the account on the last day of the previous year.

In other words, your RMDs for the 2026 tax year depend on the balance in your accounts as of December 31, 2025. RMDs are taxed at ordinary income tax rates currently as high as 37%.

For decades, the age threshold for beginning RMDs from qualified plans and IRAs was 70½. However, the initial SECURE Act increased the required beginning date (RBD) to age 72 before SECURE 2.0 bumped it up again to age 73. Furthermore, the RBD is scheduled to increase to age 75 in 2033.

If you do not comply with these rules, the IRS may assess a tax penalty on top of the regular income tax that is due. Previously, the penalty was equal to a staggering 50% of the amount that should have been withdrawn (or the difference between the required amount and any lesser amount actually withdrawn). For example, if you failed to take a \$10,000 distribution on time, the penalty was \$5,000, plus you still had to pay the regular tax.

SECURE 2.0 reduced the 50% penalty to 25% of the shortfall, beginning in 2023. Even better, the penalty is cut back to 10% for retirement account owners who fail to take an RMD but correct the error within two years. Thus, in our example above, a failure to take a timely \$10,000 RMD would result in a penalty of \$1,000 if corrected immediately.

The rules are even trickier for individuals who have inherited qualified plans or IRAs. Spousal beneficiaries have more options than non-spousal beneficiaries like the children of an account owner.

Specifically, a spousal beneficiary can elect to treat the IRA as their own, roll it into their own IRA or classify it as an inherited IRA, often deferring RMDs based on the original owner's RBD under prior law. For accounts inherited after 2019, certain individuals—including minor children, disabled or chronically ill individuals or beneficiaries less than 10 years younger than the deceased owner—may stretch distributions over their own life expectancy. Otherwise, non-spouse beneficiaries are generally required to empty out the account within ten years.

Wrap-up: There are plenty of other twists and turns to consider. It is easy to slip up and miss a deadline or fail to comply with all the requirements. Rely on your professional advisors to help you navigate the complex RMD rules.

Locking In on Key-Person Insurance Important considerations for businesses

Virtually every business owner will tell you it takes more than one person to build up and maintain a profitable business. In fact, it is likely that several “key employees” contribute to the success of any given operation. However, while a business owner may be careful to make sure that they are adequately insured, the need to protect the business against the loss of key employees is often ignored or overlooked. Mistake!

Fortunately, there is a relatively painless way to help safeguard the business. Appropriately enough, it is commonly referred to as “key-person insurance.”

Typical situation: A company takes out a life insurance policy on someone whose presence is considered crucial to the business operation. In some cases, the proper insurance protection can mean the difference between solvency and bankruptcy for the business. The life insurance proceeds from the policy could be used for any or all of the following purposes:

- Finding, hiring, and training someone to take the place of a deceased worker;
- Paying bills to maintain the company's good credit rating;
- Paying off business loans, which lenders may call after the death of an owner/officer; or
- Making up for the loss of revenue caused by the subsequent disruption to the business.

Who should be covered by a key-person policy? Start with the owner and president of the company (who might also be the founder). The rest of the group depends on the type and size of the business. For example, it may be worthwhile to insure a crackerjack salesperson, a creative talent, or an indispensable manager.

Are the life insurance premiums tax deductible? No. However, when the key person dies, the business receives the proceeds of the policy tax-free. In addition, the life insurance proceeds generally are not part of the key person's estate. But if they are the sole or controlling shareholder, the proceeds may be taken into account for determining the value of the stock for estate tax purposes.

Finally, as long as there is a legitimate business reason for the insurance, the business should be able to avoid any accumulated earnings tax problems. What happens if the key person leaves the firm? Generally, there are three options. The company may (1) sell the ex-employee the policy as a fringe benefit, (2) transfer the policy to another key person or (3) surrender the policy for its cash value.

In summary: With astute planning, you should be able to cover all the insurance needs of your business, including any appropriate life insurance policies. Consider this to be an important aspect of the business planning process.

Answers to FAQs on Educational Assistance Plans IRS issues new tax guidance for EAPs

How can you attract the “best and brightest” job candidates to your company and then keep them in the fold? There are no guarantees, but your chances may improve if you sweeten your current fringe benefits package. For example, it may be helpful to offer a written educational assistance plan (EAP) to qualified employees.

As the name implies, such a plan provides education-related benefits to employees intending to further their careers. If certain requirements are met, the payments or reimbursements are *tax-free to employees* and *tax-deductible by employers*.

The IRS has just issued a new Fact Sheet with the answers to frequently asked questions (FAQs) in the wake of the One Big Beautiful Bill Act (OBBBA).

Background: An EAP is a formal written plan supporting advanced education and training for employees. It can pay educational expenses of employees directly or reimburse them for their qualified out-of-pocket expenditures.

The maximum annual exclusion of \$5,250 per year per employee is available for tuition, books, equipment, fees, and supplies for study with a reasonable relationship to your business or required as part of a degree program. The program may pay for graduate studies as well as courses leading to an undergraduate degree, but not any courses involving sports, games or hobbies or the cost of lodging, meals, or transportation. This is meant to encourage learning, not relaxation.

Note: Unlike other comparable tax law provisions, the \$5,250 limit for EAPs has not been indexed for inflation. Furthermore, the following requirements must be met to qualify for the tax exemption.

- The plan cannot discriminate in favor of highly compensated employees (HCEs).
- The plan cannot provide more than 5% of its benefits during the year to shareholders or owners who own more than 5% of the company.
- The plan cannot allow employees to choose to receive cash or other benefits that must be included in taxable income.
- The employer must provide reasonable notice of the program to employees eligible to participate.

An employer is able to create other standards. For example, it might require a grade of “B” or higher for employees to receive payment. Another idea is to require employees to remain with the company at least one year after completing a course or be forced to forfeit a portion of the reimbursement.

How does the OBBBA change the rules for EAPs? In addition to numerous technical clarifications, the new law provides indexing of the \$5,250 cap beginning in the 2027 tax year, extends tax-favored treatment for student loan repayments, authorizes other related borrowing changes, and makes the tax exemption a permanent part of the tax code.

Class dismissed: If you want to do more in-depth reading, you can find the IRS Fact Sheet at the IRS website.

Roughing It for Tax Deductions

If you are thinking about buying a recreational vehicle (RV) to take family trips this summer, you may be eligible for an unexpected tax break.

Key point: An RV can qualify as a “home” for tax purposes, assuming it has sleeping, cooking and toilet facilities. Thus, you can write off mortgage interest paid on an RV loan on your personal return, within generous limits, if you itemize deductions.

Furthermore, the sales tax paid on the RV purchase may also be deductible, depending on your situation. Obtain directions from your professional tax advisor.

Facts and Figures

Timely points of particular interest

Tax Outlook—A new tax-related bipartisan measure is working its way through Congress. The Doug LaMalfa Federal Disaster Tax Relief Certainty Act, named after the late long-time Representative from California, would allow individuals to deduct personal casualty losses incurred in designated disaster areas without itemizing deductions. It would also ensure that wildfire relief payments are not treated as taxable income. We will continue to monitor developments concerning this proposed legislation.

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