HARPER | PEARSON
Tax Newsletter

Seek Protection for Charitable Remainder Trusts
Lock in tax breaks now and later

With proper planning, a charitable remainder trust (CRT) can provide a bevy of tax breaks for high-income individuals while ultimately providing rewards to their favorite charities. But the IRS is putting one version of this technique, the charitable remainder annuity trust (CRAT), under the microscope. **Reason:** It considers some CRATs promoted by individuals to be “abusive” in nature. This type of trust has appeared multiple times on the list of the Dirty Dozen Tax Scams cited by the IRS each year.

Nevertheless, you may continue to benefit from all forms of CRTs, including CRATs, if you strictly adhere to the tax rules.

Background: The basic concept is relatively simple. You set up the CRAT with a professional’s assistance and transfer appreciated property—typically stock, real estate or a business interest—to it for either your lifetime or a specific term of years. The trust provides annual payments to the designated "income beneficiary" during the CRT's existence. Usually, the beneficiary is a spouse or a child, but it can even be yourself.

The income beneficiary pays tax on the annual trust distributions. At the end of the term, the remainder goes to the charity named when the trust was created.

The tax benefits are plentiful and begin almost instantly. During the term of the trust, you may reap the following tax rewards:

- You are entitled to a current tax deduction for the value of the remainder interest eventually passing to the charity. The deduction is based on special IRS tables.
- You may avoid a potentially large capital gains tax on the sale of appreciated property.
- The trust reduces your exposure to the “net investment income tax” (NIIT) that often applies to high-income individuals.
- The income beneficiary can rely on a steady stream of income from the trust.
- Even though the assets are removed from your taxable estate, you effectively retain the right to receive income from those assets.
- With proper planning, you can eliminate or minimize any potential gift tax liability on the transfer of property to the CRT.
- The trust may be used as a tax-favored vehicle for transferring business interests.

- You make a substantial gift to the charity of your choice. If the charity subsequently sells the property, it can invest the proceeds in assets that would produce a high-income yield without paying tax on the gain.

CRATs and CRUTs: There are two basic types of CRTs. The one mentioned above, the CRAT, must provide an annual payment of a fixed amount equal to at least 5% of the initial value of the trust property. In contrast, a charitable remainder unitrust (CRUT) requires an annual payment of a fixed percentage, not less than 5%, of trust assets (recalculated annually). In either event, the income beneficiary must be entitled to an annual payment each year for life or a period of no more than 20 years. That is a hard-and-fast rule.

Be aware that there are certain other potential obstacles. For instance, a trust cannot qualify as a CRT if the annual payout exceeds 50%. Furthermore, it must be clear that the charity will receive at least 10% of the donated assets. Finally, any type of CRT is irrevocable. Once you set up the trust, you cannot regain your assets—ever.

Practical advice: Do not take anything for granted. Enlist the services of a reputable tax professional to safeguard your CRT from any IRS challenges.

Six Key Write-Offs for Self-Employeds
How to make your own tax breaks

For decades, the tax law appeared to favor incorporated business owners over self-employed entrepreneurs. Not anymore. Due to several tax law changes over time, self-employed individuals can now reap tax rewards comparable to corporate bigwigs. Following are six common deductions that can reduce tax liability.

1. Self-employment tax: This is the equivalent of the payroll taxes employees must pay. Instead of the usual 6.2% Social Security tax on amounts up to the annual wage base ($184,500 for 2026) and the 1.45% Medicare tax on all wages, the tax rates for self-employment tax are doubled to 12.4% and 2.9% respectively, for a total 15.3% tax. **Silver tax lining:** You can deduct half the self-employment tax paid "above the line," thereby reducing adjusted gross income (AGI) for other tax purposes.

2. QBI deduction: Like owners of pass-through entities like S corporations, partnerships and limited liability companies (LLCs), self-employed individuals may qualify for a deduction of up to 20% of their qualified business income (QBI). But the QBI deduction is subject to a phase-out based on income. **Note:** The phase-out range is lower for certain taxpayers working in a specified service trade or business (STB) such as physicians, plumbers and many other entrepreneurs. Have your tax professional crunch all the numbers.

3. Health insurance: The cost of health insurance keeps going up in many parts of the country. Fortunately, the tax law provides a reprieve for self-employeds. If you qualify, you can deduct health insurance premiums paid during the year—including amounts on behalf of your spouse and dependents—above the line. This tax break is only available for months in which you and your spouse are not eligible to participate in an employer-sponsored health insurance plan.

4. Retirement plan contributions: Generally, you may choose from wide range of plans—including SEPs, SIMPLEs, Keogh plans and solo 401(k)s—to build a retirement nest egg with deductible contributions. The basic rules and limits are the same for self-employed individuals as employees, but you may have even more leeway. For instance, if you are the only eligible participant in your SEP, you may wait until April 15, 2027 to contribute to the plan and still reduce your tax liability for 2026.

5. Business vehicle expenses: Self-employed individuals often use their own vehicle for business travel. If you keep accurate and detailed records, you can deduct vehicle costs based on the business use percentage. For example, if a car is used 80% for business driving, you can write off 80% of your gas, oil, repairs, insurance, etc., plus a generous depreciation allowance. However, other special rules, such as limits on deductions for "luxury vehicles," may limit write-offs.

6. Home office deductions: Usually, you cannot claim home office deductions if you are a corporate employee, but there is no such prohibition for self-employed individuals. The deduction is generally available if you use the home office "regularly and exclusively" as your principal place of business or a place to meet or deal with clients in the normal course of business. This may also apply if you do administrative work at home. The deduction may include direct expenses and a percentage of regular household expenses based on the business use of the home.

In summary: By no means is this list complete. Consult with your professional tax advisor concerning your situation.

IRS Answers FAQs on Overtime Pay
New deduction allowed for premium

The One Big Beautiful Bill Act (OBBBA) signed last year creates a brand-new deduction for overtime pay from 2025 through 2028 subject to a phase-out for high-income taxpayers. The IRS recently provided more guidance on this tax break for hourly workers by answering several frequently asked questions (FAQs).

Despite a common misconception, the new tax break is a deduction and NOT an exemption from taxation. Plus, only a portion of overtime pay is deductible.

Background: If an employee works more than 40 hours during a week, they must be paid "time-and-a-half" their regularly hourly rate under the landmark Fair Labor Standards Act (FLSA). For example, if an employee is paid $50 an hour and works 60 hours in a week, their overtime pay is $1,500 ($75 times 20 hours) before any payroll deductions are subtracted.

Conversely, employees who are "exempt employees" under the FLSA are not entitled to overtime pay. This generally includes employees earning amounts over an established weekly threshold with jobs in executive, administrative or professional capacities. Typically, most small business owners or officers in a company are salaried workers and classified as exempt employees under the FLSA.

Similarly, workers who are classified as independent contractors are not entitled to overtime pay. This arrangement is often preferred by employers because they do not have to offer fringe benefits to the workers or pay the employer's share of payroll taxes on their compensation. In any event, wages paid to employees—regular and overtime pay—are fully taxable.

New rules: Going back to January 1, 2025, single filers can deduct up to $12,500 and $25,000 for joint filers. Key point: The deduction is limited to the "premium" portion of overtime pay that is attributable to the time-and-a-half rate. In our previous example, the employee may deduct $1,500 for the one week of overtime.

What's more, the deduction is phased out based on your modified adjusted gross income (MAGI). The phase-out begins at $150,000 of MAGI for single filers and $300,000 of MAGI for joint filers. Once you exceed the threshold, the deduction is reduced by $100 for each $1,000 above the threshold. So high-income employees may receive little or no tax benefit from this new rule. **Note:** Unlike many comparable phase-out limits in the tax law, these thresholds are not indexed for inflation.

The new IRS guidance clarifies certain issues relating to the overtime pay deduction. For instance:

- A taxpayer who receives qualified overtime compensation must have a Social Security number (SSN) valid for employment and must include the SSN on the tax return claiming the deduction.

- If the taxpayer is married, both the taxpayer and their spouse must file a joint return to claim the deduction. If both spouses received qualified overtime compensation, both spouses must have an SSN valid for employment and they must include both numbers on the tax return claiming the deductions.

Reminder: The tax deduction for overtime pay is scheduled to expire after 2028 unless Congress extends it. Therefore, this tax break may be relatively short-lived. We will report on any new developments.

Angles on Short-Term Rentals

Say that you and your family will not be using your vacation home anymore this summer. So, you decide to rent out the place for the last two weeks of the season. Are there any tax consequences?

Answer: Yes and no. Unlike the usual situation, you cannot deduct any expenses attributable to the activity for a rental lasting 14 days or less, but you do not have to report any taxable income either. It is effectively a non-event as far as the IRS is concerned.

What if you allow another family member or friend to stay for free during the two weeks? This will not trigger any tax liability, but the days count as “personal use” days that could affect any deductible loss. Check in with your tax advisor.

Facts and Figures
Timely points of particular interest

New Penalty Program—The IRS has announced a new automatic process to provide penalty relief for taxpayers with a history of filing and paying on time, reducing the need for them to request assistance. This new “Automatic Exemption from Penalty” will replace the long-standing First Time Abate administrative relief and is designed to simplify the process and reduce burden for those with a timely compliance history. Although there is no official word on when the new program will begin, it is slated to launch sometime soon.

Slam-Dunk Decision—Long-time NBA star Lebron James is debuting for the Philadelphia 76ers this fall. According to media reports, James intends to commute via helicopter from a luxury condo in Manhattan to the City of Brotherly Love. But there is an additional tax wrinkle for James to consider. New York City now imposes a special “Pied-á-Terre” tax on certain residents of condos and co-ops that are not used as a primary residence. James can avoid this unexpected tax result if he establishes the Manhattan condo as his main home.