

# HARPER | PEARSON

## Tax Newsletter

### **Gearing Up for Car Loan Deductions** **OBBBA greenlights new write-off**

The new One Big Beautiful Bill Act (OBBBA) effectively provides a “tax discount” for certain car buyers on their 2025 returns. For the first time in decades, you can claim a deduction for interest paid on a loan for a qualified vehicle, up to an annual limit. But this unique tax break will not be around indefinitely.

**Starting point:** Generally, interest paid on personal debt is completely nondeductible, but there are several exceptions. For example, you may qualify for a generous deduction for interest paid on a home mortgage if you itemize, or up to \$2,500 of student loan interest, subject to a phase-out, whether you itemize or not. Otherwise—no deduction.

Now the OBBBA carves out another special exception for auto loan interest. Specifically, you may deduct up to \$10,000 of the interest paid on a car loan, beginning in 2025. Because most car buyers will pay less than \$10,000 a year in auto loan interest, they probably will be able to deduct the full amount of their interest payments, or close to it, in the early years of ownership. Currently, the new deduction is scheduled to expire after 2028.

However, this tax break is not automatic. To qualify, the vehicle must—

- Be a new vehicle purchased with a loan on or after January 1, 2025;
- Have been assembled in the U.S.;
- Be a car, minivan or van, SUV, pickup truck or motorcycle;
- Weigh less than 14,000 pounds; and
- Be used personally. In other words, the deduction is not allowed for vehicles used for business purposes.

If all these requirements are met, you may take a deduction for interest paid on a new car loan on the 2025 return you must file by April 15. Also, note that the deduction is available “above the line” to both itemizers and individuals claiming the standard deduction. But there is another catch: The deduction is phased out for taxpayers starting at relatively modest income amounts.

Specifically, the new deduction begins to phase out at \$100,000 of modified adjusted gross income (MAGI) for single filers and \$200,000 of MAGI for joint filers. It is reduced by \$200 for every \$1,000 above the threshold.

As a result, taxpayers may receive minimal or no benefit from the new deduction. For instance, joint filers with MAGI above \$250,000 cannot deduct a penny of interest.

Remember, this tax break is available only for new vehicles, not used ones. Similarly, leased cars do not qualify for any interest deduction.

On the other hand, the OBBBA also repeals the tax credit for electric vehicles (EVs) and plug-in hybrids, effective for EVs and hybrids purchased after September 30, 2025. The tax law previously allowed a credit of up to \$7,500 of the cost of a new EV or hybrid or \$4,000 for a used one.

**Final point:** Present all the relevant documentation to your professional advisor. This will help you secure the maximum deduction permitted under the latest laws of the land.

### **New Roth 401(k) Rule Kicks In Impact on catch-up contributions**

In recent years, Congress has passed legislation—primarily the so-called SECURE 2.0 law—enhancing the benefits of making “catch-up contributions” to 401(k) and other qualified retirement plans. Generally, older employees can now sock away more in their tax-deferred accounts than ever before. However, a new requirement for 401(k) participants that has been delayed for two years could have a significant impact on employees and employers alike.

**Background:** Employees may benefit from participating in a qualified retirement plan like a 401(k). With a traditional 401(k), deferrals are made on a pre-tax basis and accumulate tax-deferred within the participant’s account. The basic annual limit on contributions for 2026 is \$24,500 (up from \$23,500 for 2025). In addition, an employer may make “matching” contributions to the accounts of participating employees. Distributions are generally taxed at ordinary income tax rates.

Furthermore, the basic contribution limit has been raised for older employees under current law. If you are age 50 or older, you can contribute an extra \$8,000 for 2026 (up from \$7,500 for 2025). This brings the total maximum annual contribution to \$32,500 for a 401(k) for 2026 (\$24,500 + \$8,000).

**Icing on the cake:** SECURE 2.0 authorizes “super catch-up contributions” for employees age 60 through 63. If you fall into this select age group, you can boost your regular 401(k) deferral for 2026 by \$11,250 (the same as 2025). This provides a total maximum deduction of \$35,750 (\$24,500 + \$11,250).

There is, however, another twist to the rules. Beginning in 2026, if an employee’s wages for the prior year exceed an annual threshold of \$150,000 (indexed from \$145,000), all catch-up contributions—including both regular and super catch-up contributions—must be made to a Roth-type 401(k). The Roth version requires contributions to be made after-tax in exchange for the lure of future tax-free distributions.

This SECURE 2.0 change was initially scheduled to take effect on January 1, 2024, but was postponed to January 1, 2026, to allow employers more time to accommodate employees. New regulations also provide some transitional relief before 2027.

**Special exception:** The new requirement only applies to employees who have “wages” in the prior year. It does not affect self-employed individuals with self-employment income like many workers in the “gig economy.”

Finally, this rule does not apply to new-hires. They do not have wages from the prior year for these purposes.

Does an employer have to establish Roth 401(k) accounts if it does not already provide this option? The answer is “no.” There is no formal legal mandate to do so. However, if the Roth version is not implemented, catch-up contributions will be available only to lower-paid employees in the company. Thus, employers may want to consider the alternatives.

Of course, 401(k) contributions may be supplemented by contributions to traditional and/or Roth IRAs. IRA contributions for 2026 are limited to \$7,500 or \$8,600 if you are age 50 or older (up from \$7,000 and \$8,000 respectively, for 2025).

**Caution:** These changes can be confusing and befuddling. Do not hesitate to seek guidance from a professional advisor.

### **Don't Downplay the Kiddie Tax Be aware of tax return complications**

2025 was a good tax year for many stock market investors. For instance, you may have profited from gains in mutual funds and exchange traded funds (ETFs) and perhaps so did your children. Are there any potential federal income tax implications for them?

Yes. A young child may be liable for the “kiddie tax” on a 2025 return. In essence, they must pay tax on a portion of their investment income at a higher rate than usual.

**Background:** If your dependent child is under age 19, or is a full-time student under age 24, and receives unearned income” above a specified annual threshold, the excess is subject to the kiddie tax. This includes capital gains, interest and dividends from investments, but not wages.

The threshold is indexed annually for inflation. It is \$2,700 on 2025 returns and will remain the same in 2026.

Once the child’s income exceeds the threshold, the excess is taxed at the top tax rate of the child’s parents. For instance, if the parents are in the top 37% bracket, the additional income is taxed at the 37% rate instead of the child’s normal rate.

**Some consolation:** At least you may be able to elect to report your child's interest, ordinary dividends, and capital gains distributions on your return. If you make this election, your child will not have to file a tax return. To qualify for the special election on 2025 returns, you must meet the following requirements:

- Your child was under age 19, or a full-time student under age 24, by the end of the year.
- Your child's gross income was less than \$13,500 for the tax year.
- Your child had income only from interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends).
- No estimated tax payments were made for your child for the tax year and no overpayment from the previous tax year (or from any amended return) was applied to the current tax year under your child's name and Social Security number (SSN).

- No federal income tax was withheld from your child's income under the backup withholding rules.
- Your child does not file a joint return for the tax year.
- You are the parent qualified to make the election or you file a joint return with your child's other parent.
- Your child is otherwise required to file a return.

**Tax action now:** It may be too late to change the kiddie tax outcome for 2025, but what about 2026? Consider the following four practical suggestions.

- Stay under the annual \$2,700 threshold. For instance, you might delay gifts of income-producing assets to your child until they are past the kiddie tax age.
- Have your child make investments that do not produce current income.
- Have your child invest in tax-free municipal bonds.
- Hire your child who is a high school or college student to work part-time for your company. Remember that wages are not subject to the kiddie tax.

**Final words:** Last but not least, consult with your professional tax advisors concerning your personal situation.

## Facts and Figures

### Timely points of particular interest

**Working Overtime**—The One Big Beautiful Bill Act (OBBBA) creates a brand-new deduction for overtime pay for 2025 through 2028. Under the OBBBA, you can deduct up to \$12,500 of the “premium” part of overtime pay if you are a single filer or up to \$25,000 for joint filers. But the deduction is phased out for high-income taxpayers. The IRS recently posted a list of **frequently asked questions** (FAQs) about this new deduction. Find the FAQs and more information about the overtime pay deduction at [www.irs.gov](http://www.irs.gov).

**Local Lodging**—As a general rule, you cannot deduct business-related lodging expenses unless you are actually “away from home” on business. But IRS regulations may provide deductions under special circumstances. For instance, the regs may permit deductions for local lodging expenses when taxpayers attend conferences and seminars at a hotel and it is not conducive to going back to their homes. Another exception may apply for certain safety reasons. Find out if an exception applies to you.

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