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Tax Newsletter

Learn the Tax Angles to Alimony
Tax Law Restraints on Deductions

The One Big Beautiful Bill Act (OBBBA) extends many tax provisions for individuals in the Tax Cuts and Jobs Act (TCJA) that were scheduled to expire after 2025. This includes, for example, a higher standard deduction, elimination of personal exemptions and crackdowns or modifications of various tax deductions. But not all individual tax provisions in the TCJA were temporary. Consider the tax rules for **alimony** deductions.

Background: Prior to the TCJA, payors could deduct alimony paid to recipients “above the line” on their federal income tax returns. The alimony payments constituted taxable income to recipients. Conversely, no deduction was allowed to payors of **child support**, while child support was not treated as taxable income to recipients.

To qualify as deductible alimony, the following requirements had to be met:

- The spouses do not file a joint return with each other.
- The payment is in cash. This includes monetary instruments like checks.
- The payment is made to or for a spouse or a former spouse under a divorce or separation instrument.
- The divorce or separation instrument does not designate the payment as not being alimony.
- The spouses are not members of the same household when the payment is made. (This requirement applies only if the spouses are legally separated under a decree of divorce or of separate maintenance.)
- There is no liability to make the payment after the death of the recipient spouse.
- The payment is not treated as child support or a property settlement.

But the TCJA permanently eliminated the alimony deduction for payors, and the corresponding income tax liability for recipients, for divorces and separation agreements executed (i.e., coming into legal existence under a court order) after 2018. That has not changed under the OBBBA. Therefore, payors cannot deduct either alimony or child support payments required by new divorce or separation agreements.

Special exception: The TCJA changes do not apply to existing divorce and separation agreements executed before 2019. Furthermore, if a prior agreement is modified after 2018, deductions are still available unless the modified agreement expressly states that the TCJA changes are applicable.

Accordingly, the tax treatment of these expenses may become a bargaining chip in divorce proceedings. For example, alimony and child support obligations may be increased or decreased due to tax factors, depending on your point of view. The specific language of an agreement should reflect the intent of the parties. In addition, these issues may be further complicated by state law.

Practical approach: This is clearly not a do-it-yourself proposition. Coordinate the tax issues with your professional advisory team, including your attorney.

Last Shot at Targeted Jobs Credit?
WOTC scheduled to expire in 2026

Do you need to expand your staff during the busy holiday season? If certain requirements are met, your company may be able to claim a generous tax credit for hiring certain disadvantaged workers. But this credit, which has expired and been reinstated multiple times in the past, is scheduled to go off the books for good after December 31, 2025.

Background: The "Work Opportunity Tax Credit" (WOTC) is currently available to employers that hire workers from designated "target groups" of individuals. Generally, the credit equals 40% of the first $6,000 of the employee's first-year wages, for a maximum credit of $2,400 per worker. However, for a veteran with a service-connected disability, the credit may be claimed on the first $24,000 of wages, for a maximum of $9,600 per worker.

There is no overall limit on the employer's credit amount. For instance, if your firm hires five qualified workers during the year, the maximum total credit on its 2025 return is generally $12,000, a dollar-for-dollar reduction of the firm's tax bill.

On its website, the IRS identifies the following target groups for purposes of eligibility for the WOTC:

- The formerly incarcerated or those previously convicted of a felony;
- Recipients of state assistance under part A of title IV of the Social Security Act (SSA);
- Veterans;
- Residents in areas designated as empowerment zones or rural renewal counties;
- Individuals referred to an employer following completion of a rehabilitation plan or program;
- Individuals whose families are recipients of supplemental nutrition assistance under the Food and Nutrition Act of 2008;
- Recipients of supplemental security income benefits under title XVI of the SSA;
- Individuals whose families are recipients of state assistance under part A of title IV of the SSA; and
- Individuals experiencing long-term unemployment.

Also, be aware that your business may qualify for a special summertime credit if it employed youths aged 16 or 17 residing in an empowerment zone or enterprise community. This credit is 40% for the first $3,000 of wages paid between May 1 and September 15, up to a maximum of $1,200 per qualified worker.

The credit has been extended numerous times in what has been a near annual ritual. However, the new law passed in 2025—the One Big Beautiful Bill Act (OBBBA)—does not restore this credit and it does not appear that any further extension is likely. In fact, there is a good chance that this is the last opportunity to secure the WOTC.

Caution: The WOTC requires a complex certification process with lots of paperwork. The favorable tax treatment is not automatic. Obtain expert professional guidance to ensure your business receives the maximum credit for its situation.

Locking Into Automatic Enrollment Plans
SECURE 2.0 requires employer action

Typically, if an employer chooses to add an automatic enrollment feature to a 401(k) plan, it will increase participation by employees, especially younger ones, while helping to meet nondiscrimination requirements. But some employers may not have a choice. Under the "SECURE 2.0" law enacted in 2022, automatic enrollment may now be mandatory for your firm.

The basics: With a 401(k) plan, employees can defer part of their salary on a pre-tax basis to their personal accounts, subject to generous limits. Also, the employer can make "matching contributions" up to a stated percentage of compensation. Amounts contributed to the plan compound without current tax until withdrawals are made—usually in retirement, when they are taxed at ordinary income rates.

For 2025, the deferral limit is $23,500 for most employees ($24,500 for 2026). If an employee is age 50 or older, they can add a "catch-up contribution" of $7,500 ($8,000 for 2026), for a maximum total of $31,000 ($32,500 for 2026). Furthermore, under SECURE 2.0, employees age 60 through 63 may benefit from a "super catch-up contribution" of $11,250 (the same in 2026) for a grand total of $34,750 ($35,750 in 2026).

However, highly compensated employees (HCEs) may be penalized if the plan does not meet strict nondiscrimination requirements. Automatic enrollment makes it easier to pass the tests. Reason: Lower-paid employees are automatically enrolled in the plan unless they proactively opt out. Usually, employees tend to simply go with the flow.

New rules: SECURE 2.0 requires many companies to implement automatic enrollment—like it or not. Here are some of the highlights.

- If an employer establishes a new 401(k) plan on or after December 29, 2022, it must provide automatic enrollment and meet certain "escalator" requirements, starting with plan years beginning after 2024. Therefore, if your company starts a new plan in 2026, it must provide automatic enrollment.

- The new plan must include an automatic enrollment feature with a uniform automatic enrollment percentage equal to at least 3%, but no more than 10%, for an employee's first year of plan participation.

- The plan must also include an automatic escalator feature increasing the contribution percentage automatically by 1% each year until the contribution reaches at least 10%, but no more than 15%.

- The plan must permit employees to opt out of the plan and withdraw amounts, plus earnings, that were automatically contributed to the plan within the first 90 days after contributions begin. These withdrawals are not subject to the 10% penalty tax on withdrawals prior to age 59½.

Note: The automatic enrollment and escalation provisions do not apply to Roth 401(k) plans that are based on after-tax contributions to the accounts of employees.
In any event, the new SECURE 2.0 requirements do not apply to all employers. For instance, your plan is "grandfathered in" if it was adopted before December 29, 2022. In addition, small businesses with ten or fewer employees or those in existence for three years or less are exempt from the requirements.

It may be your call: Nevertheless, your business may opt for automatic enrollment even if it is not legally obligated to do so. Contact your professional advisors for further insights.

Higher Retirement Plan Limits for 2026

The IRS just announced the annual cost-of-living adjustments (COLAs) for qualified retirement plans. Here is a comparison of 2025 and 2026.

	Limit for 2025	**Limit for 2026**
Maximum annual dollar benefit for a defined benefit plan	$280,000	$290,000
Maximum dollar limit on additions to a defined contribution plan	$70,000	$72,000
Maximum amount of compensation taken into account for qualified retirement plans	$350,000	$360,000
Dollar limit for elective deferrals to a 401(k) plan*	$23,500 ($31,000 if age 50 or over)	$24,500 ($32,500 if age 50 or over)
Dollar limit for contributions to a SIMPLE plan**	$16,500 ($20,000 if age 50 or over)	$17,000 ($21,000 if age 50 or over)

*Beginning in 2025, a "super catch-up contribution" limit applies to employees age 60-63. The limit for 2026 is $11,250 (the same as 2025) plus the regular contribution.

** Beginning in 2025, a "super catch-up contribution" limit applies to employees age 60-63. The limit for 2026 is $5,250 (the same as 2025) plus the regular contribution.

Note: The annual limit for contributions to **traditional and Roth IRAs** increases from $7,000 to $7,500 for the 2026 tax year (from $8,000 to $8,600 if age 50 or over). The phase-out levels for IRA and Roth contributions have also been adjusted upward.

Facts and Figures
Timely points of particular interest

Gift Tax Exclusion—The annual gift tax exclusion for 2026 is $19,000 per recipient, the same as it was in 2025. (It is indexed annually but only in $1,000 increments.) Thus, a single grandparent might give up to $19,000 to each of their five grandchildren in 2025 for a total of $95,000, without paying any gift tax. Then the grandparent can gift the same recipients another $95,000 free of gift tax in early 2026. Finally, the maximum limit of $190,000 over two years is doubled to $380,000 for "joint gifts" made by a married couple.

Social Security News—The Social Security Administration (SSA) has announced the new "wage base" for the Social Security tax portion of federal employment tax. For 2026, the 6.2% OASDI portion of employment tax applies to the first $184,500 of wages, up from $176,100 in 2025. The 1.45% HI portion of the tax continues to apply to all wages paid by employers to employees. Both employees and employers must comply with this federal employment tax obligation.