Anchin
ACCOUNTANTS & ADVISORS

2025/2026 Tax Planning Guide

ARCHITECTURE & ENGINEERING AND CONSTRUCTION GROUPS

Welcome to the 2025/2026 Tax Guide for A&E and Construction Professionals

As we approach the final stretch of the year, it's critical to focus on 2025/2026 tax considerations and strategize actions to best position you and your company for optimal tax treatment. There is constant evolution in the architecture, engineering and construction (A/E/C) industries. Navigating this ever-evolving industry combined with the intricacies of the One Big Beautiful Bill Act (OBBBA) enacted earlier this year requires more than just a compass; it requires some serious thinking, especially when it comes to tax strategies and planning. That's why we've put together this 2025/2026 tax guide.

The parts of the bill that most directly impact A/E/C firms are as follows:

- **Changes in contract reporting methods for construction**: For certain types of residential and large-scale residential-like projects (apartments, dorms, senior-living facilities), the bill expands exemptions from the "percentage-of-completion" (PCM) method under the new tax law.

- **Restoration of full expensing for Domestic Research & Experimental (R&E / R&D) Costs**: The OBBBA restores full expensing of domestic R&E expenditures in the year incurred under new Code Section 174A. The change is applicable to tax years beginning after December 31, 2024.

- **IRC Section 179D Enhancements**: The enhanced 179D tax benefits make 179D-compliant projects extremely attractive to A/E/C businesses if they can comply with the requirements associated with the enhanced benefits, but to qualify, construction must begin prior to June 30, 2026.

- **Expanded Section 179 limits**: The OBBBA has significantly increased the Section 179 deduction. For tax year 2025, the maximum deduction under Section 179 is $2,500,000.

- **100% bonus depreciation / immediate expensing**: The OBBBA reinstates full (first-year) expensing for qualifying machinery, equipment, and certain short-lived assets acquired and placed in service after January 19, 2025.

Please note: This guide cannot cover every tax planning opportunity that may be available to you and your business. Therefore, we urge you to meet with your tax advisors who should be able to provide you with a comprehensive review of tax-saving opportunities appropriate for your individual situation and your business.

*If you would like to discuss any of these techniques or planning ideas, please contact **Paul Gevertzman**, **Joe Molloy** or any member of **Anchin's Architecture & Engineering and Construction Industry Groups** at your earliest convenience.*

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Residential Construction Tax Method Change

OBBBA provided a significant law change for construction contractors who engage in residential construction. If the requirements are met, a contractor can take advantage of significant deferral of income as explained below.

Before the enactment of the OBBBA, Section 460 of the Internal Revenue Code (IRC) generally mandated that all long-term contracts use the percentage of completion (PCM) method to recognize revenue and costs over the life of that contract. Included exceptions to this rule were for:

- home construction contracts, or
- contracts with an expected duration of two years or less, for contractors with average gross receipts under $31 million (adjusted for inflation for 2025) for the prior 3 tax years.

Taxpayers only qualified for the home construction exemption if they were building or improving dwellings in buildings with no more than four dwelling units. Contracts meeting the home construction exception could utilize another method such as the cash flow friendly completed contract method (CCM) rather than using the percentage of completion method or 70/30 hybrid method (allowed for residential contracts related to more than four dwelling units) to recognize revenue and costs.

The OBBBA expands the home construction exception to apply to all residential construction contracts for contracts entered into in tax years beginning after July 4, 2025.

Below is a simple illustration showing how the CCM method can be used to defer recognition of income for tax purposes, thus improving cash flow. Under PCM, the recognition each year is based on the project's progression, while under CCM no revenue is recognized until the year of completion.

Contract Year	Percentage of Completion Method (PCM)	Completed Contract Method (CCM)
Year 1 (20% Completed)	$2,000,000	0
Year 2 (90% Completed)	$7,000,000	0
Year 3 (100% Completed)	$1,000,000	$10,000,000
Total Profit	**$10,000,000**	**$10,000,000**

An Update on Research & Development (R&D) Tax Credits

The availability of the Internal Revenue Code (IRC) Section 41 R&D tax credit for A/E/C companies stems from the recognition by the U.S. government of the crucial role these industries play in advancing technology and innovation within the built environment.

The nature of A/E/C projects often involves significant research and development activities aimed at improving design methodologies, construction techniques, and overall project efficiency. These sectors continuously strive to enhance sustainability, safety, and functionality, driving innovation in building materials, methods, and technologies.

By making the Research and Development Tax Credit accessible to A/E/C companies, the government aims to incentivize investment in creative and forward-thinking solutions, ultimately fostering progress and excellence in the construction and infrastructure development fields. This tax credit serves as a catalyst for these industries to push boundaries, adopt cutting-edge technologies, and contribute to the overall advancement of the built environment.

The Current Interplay Between Section 41 R&D Credit and Section 174 Research and Experimental (R&E) Capitalization

IRC Sections 41 and 174 both play pivotal roles in shaping the landscape of tax incentives for R&D expenses, yet they differ significantly in their scope and application. Section 41 focuses specifically on the Research and Development Tax Credit, which allows businesses to claim a credit for a percentage of qualified research expenses, including wages, supplies, and contract research expenses.

Section 174 is more expansive, encompassing a broader range of expenses related to research and experimentation, and applies irrespective of whether the taxpayer has claimed a tax credit.

The OBBBA restores full expensing of **domestic** R&E expenditures in the year incurred under new Code Section 174A. The change is applicable to tax years beginning after December 31, 2024. Under the OBBBA, the treatment of **foreign** R&E expenditures will continue to be capitalized and amortized over a 15-year period. The difference between domestic and foreign R&E expenses reflects a continued policy focus on incentivizing U.S. based research and development activity.

For tax years beginning after December 31, 2021, the Tax Cuts and Jobs Act (TCJA) eliminated the option to deduct Section 174 R&E expenditures. Whether or not taxpayers claimed a tax credit for R&D costs under Section 41, Section 174 required taxpayers to capitalize and amortize R&E expenditures over five tax years for U.S. spend and fifteen years for foreign expenses.

Taxpayers may choose one of the following three options to recover any unamortized domestic research costs:

1. Continue the 5-year amortization period under the TCJA.

2. Amortize the remaining capitalized domestic costs in full over the first taxable year beginning after Dec. 31, 2024.

3. Amortize the remaining capitalized domestic costs ratably over two years, beginning with the first taxable year after Dec. 31, 2024.

Small business taxpayers with average annual gross receipts of $31 million or less for the first taxable year beginning after Dec. 31, 2024, have the additional option to amend prior filings and have the reinstated domestic research cost expensing provisions apply retroactively to taxable years beginning after Dec. 31, 2021, instead of Dec. 31, 2024.

In summary, the reinstatement of full expensing for domestic R&E expenditures under the OBBBA marks a significant win for businesses investing in innovation. By allowing immediate deductions for qualifying domestic R&E costs — or flexible amortization options — businesses gain greater control over cash flow, tax planning, and investment strategy. The ability to retroactively apply these provisions or accelerate remaining amortization further enhances the financial benefits, particularly for smaller businesses. However, careful consideration of the available elections and required accounting method changes is critical to fully leverage the new law.

For companies with ongoing or planned R&E investments, these changes provide a renewed incentive to invest in U.S.-based research and development activities. These rules are favorable in allowing but not requiring the deduction of previously capitalized and unamortized R&E over one or two years. The result gives taxpayers the ability to avoid any unfavorable tax consequences while catalyzing U.S. innovation and R&D once again.

IRC Section 179D (Green) Deduction – Enhancements

The 179D tax deduction provides building owners a deduction for new or remodeled commercial buildings that meet specific energy-efficient qualifications. This deduction is also available to be allocated to the designers of buildings owned by government entities and non-profit organizations that were responsible for the energy efficient components or improvements. The IRS requires designers to obtain a formal allocation letter signed by the qualifying builder owner, officially transferring the right to claim the deduction. Since the designers did not pay for the costs, the allocation is really a “free” deduction. Eligible designers include architects, engineers, contractors, and energy consultants.

Caution:

The OBBBA has eliminated the section 179D tax deduction for energy-efficient commercial building improvements for properties beginning construction after June 30, 2026.

The Inflation Reduction Act of 2022 (“IRA”) increased credits and/or deductions for various green energy credits, including the 179D deduction, if the owner/designer meets certain prevailing wage and apprenticeship requirements. The IRA also lowers the minimum required savings in total annual energy and power cost from a 50% reduction to a 25% reduction. If the requirements are satisfied, the maximum 179D deduction is increased for property placed in service in 2025 to an inflation adjusted $5.81/sq. ft. when there is a 50% reduction in energy and power costs, and $2.90/ sq. ft. when a 25% reduction is achieved. If the prevailing wage/ apprenticeship requirements are not met, the Act reduces the deduction amount range to $.58 per sq. ft. (for a 25% reduction) and to $1.16 per sq. ft. (for a 50% reduction).

Prevailing Wage Determinations

The prevailing wage requirements of the IRA provide that taxpayers must ensure that all laborers and mechanics employed by the taxpayer (or any contractor or subcontractor) on the construction, alteration, or repair of a qualified facility are paid wages at rates that are not less than the prevailing rates determined by the Department of Labor in accordance with subchapter IV of chapter 31 of title 40 of the U.S. Code (the Davis-Bacon Act) for the type of work performed in the geographic area of the facility. The Davis-Bacon Act requires the taxpayer to pay at minimum, the local prevailing wage and fringe benefits on federally funded construction projects in excess of $2,000.

Apprenticeship Requirements

A taxpayer complies with the apprenticeship requirement if a sufficient amount of labor hours are performed by qualified apprentices as a ratio to total labor hours for the project. For 2025, 15% of total labor hours must be performed by qualified apprentices. The apprenticeship requirements only apply with respect to construction, alteration, or repair of a facility that occurs prior to the facility being placed in service. There are no apprenticeship requirements with respect to alterations or repairs after a facility is placed in service.

Under a Good Faith Effort Exception, the taxpayer will be considered to have made a good faith effort in requesting qualified apprentices if the taxpayer requests qualified apprentices from a registered apprenticeship program in accordance with usual and customary business practices for registered apprenticeship programs in a particular industry and either:

1. the request was denied for reasons other than the taxpayer, contractor, or subcontractor's refusal to comply with the established standards and requirements of the registered apprenticeship program, or
2. the registered apprenticeship program failed to respond within five business days of receiving a request.

The Good Faith Effort Exception only applies to the specific portion of the request for apprentices that was not responded to or was denied.

Below are some examples of the 179D deduction that illustrate how various factors impact the amount of tax credits available.	
1	ABC Engineers (ABC) is engaged by the City of New York (NYC) to design a municipal building. NYC allocates the entire 179D deduction to ABC. The new building is 500,000 square feet. NYC incurs $100 million of costs to place the building into service. ABC implements a design that achieves a 50% enhancement in energy efficiency and meets the requirements for prevailing wage and apprenticeship. ABC is entitled to a $2,905,000 tax deduction (500,000 x $5.81) in the year in which the building is placed in service. If the project did not begin prior to January 29, 2023, and ABC does not meet the prevailing wage requirements, the deduction decreases to $580,000 (500,000 x $1.16).
2	The American Red Cross contracts with Smith Architects to design the construction for their 300,000-square-foot new headquarters at a cost of $60 million. Smith devises a building plan which reduces energy usage by 25% and also meets the requirements for prevailing wage and apprenticeship. Smith will generate a $870,000 tax deduction (300,000 x $2.90). If the project did not begin prior to January 29, 2023, and Smith does not meet the prevailing wage requirements, the deduction decreases to $174,000 (300,000 x $.58).

Conclusion

The enhanced 179D tax benefits make 179D-compliant projects extremely attractive to A/E/C businesses if they can comply with the requirements associated with the enhanced benefits, but to qualify, construction must begin prior to June 30, 2026.

Accelerating Depreciation Opportunities

As the 2025 year-end nears, a part of your year-end tax planning should be to review fixed assets placed in service during 2025 to ensure utilization of the most favorable depreciation deduction method and, if considering additional fixed asset purchases, to acquire and place the assets in service before year-end. Most businesses can benefit from the rules accelerating the amount of fixed/capital assets that can be expensed.

Below is an overview of some of the methods available for A/E/C businesses to accelerate depreciation. There are several options and scenarios businesses need to consider when assessing which is the most beneficial for them.

Bonus Depreciation

Under the Tax Cuts and Jobs Act (TCJA), the percentage of bonus depreciation was reduced to 40% in 2025. However, the One Big Beautiful Bill Act (OBBBA) eliminates the scheduled phase-out and permanently restores the 100% bonus depreciation for qualifying assets acquired and placed in service after January 19, 2025. Qualifying property that was acquired before January 20, 2025, but placed in service during 2025 will still be subject to the 40% bonus depreciation cap.

To qualify, the property must have a recovery period of 20 years or less and be depreciated using the modified accelerated cost recovery system. Typically, this can include, but is not limited to, furniture and fixtures, construction and office equipment, and qualified leasehold improvement property. The OBBBA act also created a new class for qualified production property which includes certain nonresidential real property used in manufacturing, production, or refining for construction that begins after January 19, 2025, and before January 1, 2029, and that is placed in service before January 1, 2031. Such property is eligible for a deduction equal to 100% of the cost in the year it is placed in service, instead of depreciating the property over 39 years.

When considering bonus depreciation, businesses need to assess the state implications for their owners. Many states do not conform to federal bonus depreciation. At the state level, there is typically an addition and subsequent subtraction adjustment that reverses the bonus depreciation enjoyed at the federal level. For taxpayers who can fully utilize federal depreciation, this usually does not present a major issue. A transitional rule is available to allow taxpayers to elect 40% bonus depreciation instead of 100% for most qualified property placed in service during their first tax year ending after January 19, 2025, if it aligns better with their tax planning.

Section 179 Expensing

Under IRC Section 179, eligible taxpayers may elect to expense qualifying property up to certain dollar limitations. To be eligible, property must be purchased for use in a trade or business. Tangible personal property (e.g., furniture, equipment, etc.) is eligible for this deduction.

The OBBBA has significantly increased the annual section 179 deduction. For tax year 2025, the maximum deduction under Section 179 is $2,500,000. There is a dollar-for-dollar phase-out once the amount of qualified Section 179 property placed in service exceeds $4,000,000. For example, if a taxpayer has $4,100,000 of qualifying property, the maximum deduction they can claim for tax year 2025 is reduced by $100,000 ($4,100,000 less the $4,000,000 ceiling) to $2,400,000. The deduction is completely phased out if $6,500,000 of qualifying property is placed in service during 2025.

This limitation is potentially calculated twice: once at the business level and then again at the owner level if the business is a pass-through entity (e.g., partnership or S-Corporation).

In addition to the limitations discussed above, Section 179 expensing is limited to the trade or business income of an activity. Unlike bonus depreciation, it cannot create a net loss for the business. For purposes of this deduction, trade or business income is calculated before factoring in any deduction under Section 179.

Pass-through entities also need to consider their owners' basis before electing to utilize Section 179. Trusts and estates are ineligible to utilize the deduction, although grantor trusts are eligible for the deduction. In addition, owners that are considered passive are not entitled to the deduction, even if the business is eligible, since the income from the activity is not deemed trade or business.

Disallowed deductions due to trade or business limitations are carried forward indefinitely and can potentially be utilized in a future tax year.

As with bonus depreciation, A/E/C businesses also need to understand the state tax implications. For example, New York follows the federal treatment of Section 179; however, New Jersey limits the deduction to $25,000.

Cost Segregation

Property owners are generally required to depreciate residential rental property over 27.5 years and commercial property over 39 years.

A cost segregation study is a process that looks at the components of a property and breaks them down into different categories, allowing the property owner to benefit from shorter time frames (5, 7, or 15 years) and from the aforementioned accelerated depreciation options for some of those building components.

Conclusion

The above discussion highlights some of the high-level items that an A/E/C company must analyze when strategizing how to maximize their depreciation. Careful planning and analysis of future projects is critical to make sure depreciation is utilized in the most efficient manner.

State & Local Tax (SALT) Updates and Tax Planning Opportunities

The SALT world is constantly evolving to meet the needs of taxpayers while adapting to conform or decouple from the various previous federal modifications. The following is a brief review of some of the current trends in state and local taxes.

Nexus

Nexus can be defined as the minimum contact required by a state on an out-of-state business to impose state taxes. Two U.S. Supreme Court cases, *National Bellas Hess Inc. v Department of Revenue of Illinois* (386 US 753 (1967) and *Quill Corp. v. North Dakota* (504 US 298 (1992) established that nexus required physical presence in a state (having property or payroll in the state) before a business can be taxed by that state. However, the U.S. Supreme Court in *South Dakota v. Wayfair (138 S.Ct. 2080 (2018) (Wayfair))* overruled both the *National Bells Hess* and *Quill* decisions and eliminated the need to have physical presence in a state to establish nexus. The Supreme Court in *Wayfair* found in part that the physical presence test in *Quill* and *National Bellas Hess, Inc.* was unsound and incorrect as it gave out-of-state sellers an unfair advantage which created distortion in the marketplace. While the 2018 U.S. Supreme Court decision in *Wayfair* was not about state income and/or franchise tax, it did empower states to expand and apply this same concept (commonly referred to as economic nexus) for income/franchise taxes. Despite the Supreme Court's determination in *Wayfair*, having a physical presence in a state is still important. For example, having one employee working from home in a state (remote working) creates sufficient minimum connections to permit that state to tax the employer on its revenue. Some activities that can create physical presence nexus include, among other things: Remote workers, ownership of a warehouse or having inventory in a state, having an office in the state, attending trade shows in a state, independent contractors performing services in the state, or having members or general partners residing and performing services in the state.

Additionally, having customers in a state can create economic nexus. The Market-based sourcing methodology for sourcing service revenue (sourcing the revenue to the state where the customer receives the benefit of the service rather than where the service is performed) continues to expand the economic nexus principles as more states move to adopting market-based sourcing.

Anchin Observation:

If you have not already done so, we recommend that you and your tax advisors perform a state nexus study given the vast changes that have taken place over the past few years. If certain tax exposures are identified, note that most states offer voluntary disclosure agreement (VDA) programs. Eligibility for such programs is generally automatic unless you had been contacted by the state prior to your application. A VDA will usually wave any penalties that may be assessed. Many states sometimes will also offer amnesty programs, which are similar to VDAs, but are open to all taxpayers (even those who were already contacted by the state).

Employees working in multiple states can also create payroll withholding and state tax nexus issues for the employer. This includes deciding where to pay supplement unemployment insurance. Failure to properly withhold and/or remit payroll taxes can come at a high price if a state imposes a penalty on the employer. If a state considers the employer's failure to do so intentional, it may have the power to impose a penalty as high as 100% of the amount not withheld. Consideration must be given to employees that have transitioned to remote working permanently or that have relocated during the pandemic as those work arrangements are no longer deemed temporary and will most likely require a change in reporting. This, of course, assumes the employer is knowledgeable of such changes on a timely basis.

States are continuing their attempts to implement and enforce their laws to find nonresident, non-filing taxpayers. Nexus remains a crucial element of managing a business's state tax risk. With state budget shortfalls expected to continue into 2026 and beyond, taxpayers should expect to receive nexus inquiries from various state and local taxing authorities.

Practice Tip:

For those A/E/C employers allowing employees to work remotely, nexus implications need to be thought out not only for income, non-income, and sales taxes but also for state payroll withholding taxes and unemployment insurance. Both physical presence and economic presence must be thoroughly analyzed for all potential state taxes when undergoing a nexus study to understand and better manage risk.

Caution:

As states continue to face fiscal constraints and are looking for ways to raise revenues, all signs point to an increase in state audit activity. State letters with an intention to audit as well as nexus questionnaires and notices should be taken seriously and should be addressed timely. We stand ready as your specialist advisor to assist you in handling such communications and to help you proactively plan.

Anchin Observation:

Businesses should, if they have not already done so, communicate with their employees to obtain the necessary information to determine possible state filings.

SALT Pass-Through Entity Taxes (PTET)

The TCJA of 2017 limited an individual's federal itemized SALT deduction to $10,000 (SALT deduction cap), thereby causing states to explore workarounds. In 2018, Connecticut became the first state to enact a Pass-Through Entity Tax (PTET) which when enacted was mandatory (now elective since the 2024 tax year). After Connecticut passed its PTET, 35 additional states, plus New York City have passed PTET workarounds with varying applications. In general, the PTET authorizes qualified pass-through entities (partnerships, S Corporations and Limited Liability Companies) to pay state taxes at the entity level, which allows the pass-through entity to take a deduction for state taxes paid on its federal return. By paying tax and taking the state taxes paid deduction in full, the entity can reduce its net income that passes through to the partners/members/shareholders. Qualified pass-through entities may be required to pay quarterly estimated tax payments. Any excess payments over the actual PTET liability are refunded to the entity. If the entity decides to deduct the full amount of the PTET payments and then receives a refund of the excess taxes, the Internal Revenue Code's tax benefit rule will require that entity recognize income in the following year to account for the refunded payments.

The OBBBA did not modify the PTET. However, during the legislative process a proposal was made which would have limited the application of the PTET for specified services trade or businesses (but would not have affected architects and engineers). However, that proposal failed to make the final bill. Instead, the OBBBA increased the SALT deduction cap for the 2025 tax year to $40,000, with a further increase for the 2026 tax year to $40,400. Thereafter, the bill established an additional 1% increase each year for the years 2027 through 2029 before reverting to $10,000 in 2030. Moreover, the OBBBA created a phaseout of the higher deduction for taxpayers with modified adjusted gross income greater than $500,000 for the 2025 tax year. The phaseout increases to $505,000 in 2026, and an additional 1% thereafter until 2030.

Anchin Observation:

With the passage of the OBBBA, which extended the SALT deduction cap to at least 2030 and increased the SALT deduction cap to $40,000 for 2025 (with further increases for years thereafter), high income taxpayers will still benefit from the PTET deduction, as no change was made to the deductibility of PTET. Ten states (California, Colorado, Illinois, Iowa, Massachusetts, Michigan, Minnesota, Oregon, Utah and Virginia), when enacting their PTET laws either established a sunset date for the expiration of the PTET or set the PTET tax to expire concurrently with the repeal of the SALT deduction cap. As of the date of this publication, five of those ten states set their expiration of their PTET to end with the expiration of the Federal SALT deduction cap (Colorado, Iowa, Illinois, Massachusetts and Michigan). Virginia extended its PTET sunset date to December 31, 2026. However, Minnesota decided not to extend its PTET election beyond the 2025 tax year. To avoid joining Minnesota, Oregon and Utah will need legislative updates to extend their PTET regimes which are set to expire on December 31, 2025. California made the most significant changes to its PTE elective tax. California extended its PTE elective tax to 2031 and adjusted its PTE election process by allowing anyone who missed the June 15 estimate payment to be allowed to make the PTE election (prior to this change, if the required June 15th estimate was not made, the entity could not elect the PTE). However, the partner's/member's/shareholder's PTE elective tax credit amount will be reduced by 12.5 percent.

Not every state's PTET regime is the same. Careful analysis and planning of owners' tax attributes, the mechanics of calculating the PTET liability and limitations for taking credit for other state taxes paid, including the PTET as well as other implications to the owners' state tax filings, should be considered. When owners of a pass-through entity are residents of different states, the outcome of making the PTE elections can yield some odd results with some owners paying more tax while other owners pay less. This disparity can occur because in some of these 36 states, resident partners/members/shareholders pay tax on all of the entity's income, while nonresident partners/members/shareholders pay the PTET tax on that state's sourced (apportioned) income. If a state does not have any sourced income for that year, the PTET tax will be paid only on the resident portion of the income and would benefit only the resident partners. While the various state PTET regimes can be great for reducing overall tax liabilities, the importance of analyzing the implications of these elections on the owners' overall income tax picture prior to making the election(s) is paramount to avoid or prevent adverse tax results.

Practice Tip:

Qualified pass-through entities with partners/members/shareholders that are both residents and non-residents and have different profit and loss percentages should evaluate whether their partnership/membership/operating agreements have been updated to address special allocations of these tax deductions and corresponding credits. Without such amendments in place, partners/members/shareholders may find that their PTET deductions and/or credits are not equitable in relation to the amount of their partner's/member's/shareholder's distributive share of income taxed in the PTET calculation.

Remote Work and Residency Changes

Inquiries from A/E/C clients about moving out of high-tax states have increased each year since the early days of the COVID-19 pandemic, and 2025 was no different. The COVID-19 pandemic has proven that we can work remotely and has prompted many to explore and think about where they want to live and work. Moves from high-tax states such as New York, New Jersey, and California certainly pose residency audit risks due to the respective state's loss of anticipated tax revenues.

Generally, to change residency status, taxpayers must change their domicile. Your domicile is the place you consider to be your permanent home. Your domicile remains the same until you affirmatively abandon it and acquire a new one with the intention of making the new location your permanent home. Taxpayers who are attempting a domicile change should be aware that several factors are considered in this determination. Some of those factors include the individual's intent to use the residence as his/her permanent home, the number of days spent in each state, the individual's business connections, where the individual spends his/her holidays and important occasions, and where the items that are near and dear are located. Evidence to establish both a change of residency and change in domicile must be clear and convincing, manifested by unequivocal actions.

Caution:

A temporary relocation will not change a taxpayer's domicile. However, statutory residency issues may be triggered due to a temporary relocation, where some states will treat taxpayers who exceed a certain in-state presence threshold, such as 183 days, and are maintaining a place of abode for a substantial portion of the year (e.g. more than ten months), as a statutory resident in their state for tax purposes. It is therefore possible that a taxpayer can be treated as a resident of two states – one based on domicile and the other based on statutory residency. In most cases, the Resident State Tax Credit (Credits For Taxes Paid to Other States) will protect the taxpayer from double taxation of wages and other business income, but depending on the state, double taxation could apply to other types of income, such as investment income (i.e., interest, dividends and capital gains) and other intangible income. The potential double taxation could apply because interest, dividends and capital gains are generally sourced to the taxpayer's state of domicile. If a taxpayer is domiciled in one state and a statutory resident of another state, both states have a claim on that income. However, some states have specific provisions that exclude interest, dividends and/or capital gains from income that can be claimed as part of the resident state tax credit leading to double taxation.

Advanced planning is central to managing and mitigating this risk. Understanding each individual's facts, circumstances and intent are critical factors as well as researching and understanding each state's specific residency and domiciliary laws.

Excess Business Loss (EBL) Limitation Refresher

The EBL limitation was first enacted by the TCJA and, due to the passage of the Inflation Reduction Act (IRA), was set to sunset in 2028. With the passage of the OBBBA, the EBL provisions have been made permanent. The EBL provisions limit the amount of trade or business losses non-corporate taxpayers (individuals, trusts, and estates) can deduct in the current year.

An EBL occurs when your total deductions from all business activities exceed your total business income or gains from your trades or businesses, plus the threshold amount. The EBL limits the amount of trade or business deductions that can offset nonbusiness income. For 2025, trade or business losses are limited to $313,000 for single filers (or $626,000 for joint filers). Therefore, taxpayers expecting large losses from their underlying investment or business should be aware that EBL could potentially limit the loss allowed in the current year. An EBL not allowed in the current year is carried forward as a net operating loss (NOL). An NOL may offset up to 80 percent of current year's taxable income; any unused NOLs may be carried forward indefinitely.

Planning Opportunity:

Incorporating the application of the EBL rules is critical to tax planning for owners of pass-through entities. The timing of recognizing both business income and losses, as well as non-business income and losses, can have a material effect on a taxpayer's overall tax liability not only in the current year but in subsequent years as well. A lack of proper planning for the EBL limitation when making extension and estimated tax payments can result in significant penalties and interest.

Estate & Gift Tax Planning Reminders & Opportunities

Whether or not you would be subject to estate taxes under the current exemptions, it's a good idea to consider whether you can seize opportunities to potentially lock in tax savings today. Well-thought-out estate and gift planning helps preserve your wealth and pass it on to your beneficiaries at a minimal tax cost. Proper planning can result in your family and other beneficiaries receiving what you had intended.

Before describing specific strategies, a recap of the current law with respect to the annual exclusion and lifetime exemption is in order. Recall that the current federal gift and estate tax rate maxes out at 40 percent.

- Annual Exclusion: The 2025 annual gift exclusion is $19,000. This exclusion is the amount that can be gifted to per donee per year tax-free.
- Annual Exclusion gifting is an excellent way to reduce the value of a taxpayer's gross estate over time (without utilizing one's lifetime exemption), thereby lowering the amount subject to estate tax.

Caution:

Each year you need to use your annual exclusion by December 31st of that year. The exclusion does not carry over from year to year if not used.

- ***Lifetime Exemption***: The 2025 lifetime exemption is $13,990,000. With the passage of the OBBBA, the lifetime exemption will increase to $15,000,000 per individual in 2026, adjusted for inflation. This exemption is the total amount that can be gifted over the course of a donor's entire lifetime tax-free.

Anchin Observation:

Taxpayers living in states with no current state gift tax may wish to accelerate or focus on additional gifting of assets in 2025 and 2026. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.

- ***Portability Election:*** This election remains in effect under current law. It is a vital planning tool for the taxpayers, especially if the death of a spouse occurs while the increased exemptions are in place. Portability allows the surviving spouse to have the benefit of the deceased spouse's $13.99 million exemption, even if the surviving spouse dies when a lower exemption amount is in effect.

Caution:

An estate tax return will need to be filed timely when the frist spouse dies to make the portability election, even if the gross estate is under the filing threshold. States may have different rules related to portability; therefore, it is important to consider these rules and consult your tax advisor regarding the portability election.

Effective estate planning requires careful consideration of state-level estate tax laws, as many states have decoupled from federal regulations. For instance, in New York, if the estate exceeds the exemption amount by more than 5%, the entire exemption of $7.16 million is lost, and the full value of the estate becomes taxable. This approach is unique compared to states like Connecticut, Massachusetts, and Oregon, where taxes apply only to the portion exceeding the exemption threshold.

- ***Basis Step-up:*** Current law continues to allow a step-up in tax basis for most inherited appreciated assets (excluding retirement accounts and annuities). Generally, basis is the amount paid for an asset. Upon death, the beneficiaries are allowed to increase the tax basis of an inherited asset to the fair market value at the date of the decedent's death. This is a taxpayer-friendly provision that allows beneficiaries to be taxed on a much smaller capital gain, or none at all, should the inherited assets be greatly appreciated and the new owner desires to sell.

Some gift and estate tax planning strategies to consider:

Funding education through 529 plans by December 31, 2025 to apply 2025 annual gift tax exclusion treatment to the contributions. You can "front-load" 529 plans by making five years' worth of annual exclusion gifts to a 529 plan. In 2025, you can transfer $95,000 ($190,000 for a married couple splitting gifts) to a 529 plan without generating gift tax or using up any of your gift tax exemption. Also note that front-loading 529 plans may limit available state credits.

Caution:

Contributions to 529 plans are gifts to the beneficiary of the plan. Cash gifts and 529 contributions to the same beneficiary which total more than $19,000 ($38,000 for a married couple splitting gifts) will result in taxable gifts. Similarly, front-loading 529 plans limits the available tax-free gifts to that beneficiary to immediate family members.

- ***Pay tuition and medical expenses.*** You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider. These payments can be made on anyone's behalf and are not limited to immediate family members.

- ***Loans to Family Members.*** Intra-family loans can be a solution for parents who would like to help a child achieve specific goals, such as buying a home or starting a business, but would also like the child to have some "skin in the game" rather than simply gifting the funds to the child. Note that these loans could also be from the child to the parents or between other family members or family trusts.

The minimum interest rate charged between family members is known as the Applicable Federal Rate (AFR) where long-term (more than 9 years) loans can be made at rates as low as 4.46 percent (in December 2025) and rates on loans for shorter periods can be even lower. While AFRs are generally high today, they are still lower than the average mortgage rate, for example. It is a simple and effective estate planning mechanism for providing capital to children or grandchildren without gift tax. Note that when you make a loan to a family member, you must charge interest in order to avoid having the transaction treated as a gift. To the extent that the family member earns a higher rate of return on the borrowed funds than the interest rate being paid, the excess or difference is effectively transferred free of gift taxes.

Anchin Observation:

Taxpayers living in states with no current state gift tax may wish to accelerate or focus on additional gifting of assets in 2025 and 2026. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.

- ***Spousal Lifetime Access Trusts (SLAT).*** Married taxpayers may want to make lifetime gifts to use the balance of their exemption but may be wary of not having access to the gifted funds. The SLAT is an irrevocable trust that has the benefit of removing assets by gift from the estate but allowing the spouse and other beneficiaries to have access to the assets and their related income. The income from a SLAT is taxable to the creator of the trust (a "grantor" trust), whether or not there are distributions to beneficiaries. The creator's payment of the trust's tax might seem like an additional gift to the trust, but IRS rules do not count it as such, making this feature an added benefit as it allows the trust assets to grow without being depleted through the payment of taxes.

Anchin Observation:

This type of trust can be structured to benefit multiple generations while not being subject to estate tax in subsequent generations.

- ***Sale of Assets to an Intentionally Defective Grantor Trust.*** Using this strategy, the taxpayer sells assets to a grantor trust in exchange for a promissory note. The use of a grantor trust allows the sale(s) to not trigger a gain or income tax on the sale. The payment of interest on the promissory note is not taxable (nor a deductible expense) for the grantor. In addition, the grantor will continue to pay the income taxes on the trust income, thereby allowing the trust assets to grow tax-free. This type of planning is perfect for assets with high appreciation potential.

- ***What about Grantor Retained Annuity Trusts (GRATs)?*** With market volatility and many assets (particularly real estate) trading at depressed values, a GRAT may be a great option for certain assets. It provides you with a fixed annual amount (an "annuity") from a trust for a term of years (as short as two years under current law). The annuity retained may be equal to 100 percent of the amount that you use to fund the GRAT, plus the IRS-prescribed rate of return (known as the 7520 rate) applicable to GRATs. After the trust term ends, the amount of assets (if any) left in the trust after the annuity payments have been made remain in the trust, free of gift or estate taxes. Because your beneficiaries will retain the full value of the GRAT assets at the end of the trust's term, if you survive the annuity term, the value of the GRAT assets in excess of your retained annuity amount will then pass to the beneficiaries with no gift or estate tax, either outright or through a continuing trust vehicle. If the grantor dies during the term of the GRAT, the entire balance will revert to the grantor as if the GRAT transaction never took place. In addition, if the value of the GRAT assets fall below the amount required for the requisite annuity payments, the GRAT pays everything in it back to the grantor as if the GRAT transaction never took place.

Planning Opportunity:

Consider using a "zeroed-out GRAT" – structured so that the value of the gift transferred to the beneficiary is *de minimis*, resulting in near zero gift.

Caution:

Although no changes to the GRAT rules have yet been made, various proposals have been set forth over the years that, if enacted, would make GRATs less beneficial. Among other things, some of the proposals would have required a 10-year minimum term for GRATs and a remainder interest greater than zero, effectively eliminating the ability to create a "zeroed-out" GRAT. For this reason. it may be wise to consider establising a GRAT sooner rather than later.

Planning Opportunity:

Instead of setting up one GRAT containing all transferred assets, why not set up multiple GRATs for different asset types – some conservatively invested and others with more risk? The winners, or appreciated GRATs, do their job of transferring wealth to the next generation; the losers collapse, as if the GRAT for these assets never took place.

- **Charitable Lead Trust (CLT):** CLTs are a powerful planning tool that can prove to be a tax-efficient way for a taxpayer to fulfill goals of both charitable giving and family wealth transfer.

A CLT is a charitable split-interest trust that can be created during life or at death, under a revocable trust or will. The lead income interest is paid to the charitable organization, and the remainder interest is transferred to a noncharitable beneficiary such as the donor or donor's family. The income interest can be in the form of a "guaranteed annuity" interest (a charitable lead annuity trust (CLAT), more on this in the Charitable Contribution section below) or it is a "unitrust interest" (a charitable lead unitrust (CLUT)).

- **Charitable Remainder Trust (CRT):** In a period of rising interest rates and record inflation, there are a couple of wealth transfer tax strategies that are more powerful and useful than others. One such strategy is the CRT. A taxpayer with an asset that has a large unrealized gain can effectively contribute that asset to this type of trust. The trust is tax-exempt (state tax laws may differ) and can effectively sell that asset on a tax-deferred basis. The taxpayer will also get a charitable income tax deduction on their personal tax return in the year of funding.

Taxpayers to Feel IRS Shutdown Shockwaves Past Federal Reopening

When the federal government shut down Oct. 1, the IRS was among the agencies forced to substantially reduce or halt most operations. While the short-term disruption captured headlines, the true cost will reveal itself after the government fully reopens.

For businesses and tax professionals, the shutdown triggered long-lasting operational and compliance challenges. Two of the most significant consequences are administrative backlogs and regulatory uncertainty, both of which are likely to persist in the months ahead.

Administrative Backlogs

Each day the IRS was closed, filings, correspondence, and taxpayer inquiries continued to accumulate. After the government fully reopens, the agency will confront a substantial backlog of unprocessed work, including returns, refund requests, amended filings, and correspondence that require review and response. These basic functions likely will take months to recover.

The backlog isn't just an inconvenience; it has tangible implications as well. Taxpayers rely on timely return processing and verification times to obtain refunds. Notice responses and other correspondence that carry specific due dates require agency review to avoid collection escalation activities. Pending audits may face prolonged uncertainty as to the outcome of the examination.

Likewise, some businesses still await employee retention credit refunds, research and development tax credits, or abatements of erroneous penalty assessment, resulting in ongoing financial constraints.

As operations resume, questions remain as to how the IRS will prioritize essential functions, such as processing returns, issuing refunds, and addressing notices, before turning its attention to lower-priority correspondence. Besides the mounting notice responses received during the shutdown, filings and submissions made before the shutdown need to be evaluated. This likely will mean that some matters could remain unresolved well into the future.

The reduction of the IRS workforce will further contribute to the administrative backlog strain. The IRS began the year with approximately 100,000 employees, but recent resignations and layoffs have reduced the workforce by 25%.

The combination of reduced staffing and the buildup of more than a month's worth of work creates significant strain on the agency's ability to resolve matters efficiently.

Regulatory Uncertainty

Beyond administrative delays, the shutdown hindered the IRS's ability to issue new guidance. Taxpayers rely on clarity from the IRS to plan their tax and financial strategies, and this uncertainty can be just as disruptive as the processing delays.

Amid this uncertainty, there are lingering questions about the new tax legislation signed into law July 4. Taxpayers have been seeking guidance on the changes brought on by the new law, and the IRS plays a central role in translating this legislative language into practical, enforceable rules through guidance, FAQs, and updated forms. The shutdown has stalled this process, leaving filers unsure how to interpret some new provisions or comply with upcoming requirements.

For example, a recent IRS notice states that employers won't face penalties for failing to provide a separate accounting of qualified overtime compensation or tips. The announcement indicated that Form W-2s and 1099s haven't been updated to reflect the changes introduced by the new tax law.

Tips and qualified overtime pay can now be deducted for federal income tax purposes, but employers have a new informational reporting requirement to separately account for these items. Without updated forms and instructions, employers have no way to comply with the reporting obligation.

Changes to various rates and phaseouts, along with foreign income disclosures, remain central themes of the new tax law that still require regulatory guidance and compliance updates.

Conclusions & Recommendations

Administrative backlogs within the IRS delay critical decisions and tie up cash flow, while regulatory uncertainty clouds planning and compliance efforts. To mitigate these impacts, taxpayers can take several proactive steps.

Maintain comprehensive records and payment confirmations. Documentation is a taxpayer's best defense during and after a shutdown. Retain proof of filings, payments, and correspondence to support positions during the processing delays.

Monitor IRS announcements closely. When the IRS reopens after a shutdown, it often issues updated timelines, FAQs, and relief notices. Staying up to date on these communications allows taxpayers to adjust compliance strategies as needed.

Maintain communication with tax advisers. A trusted tax professional will proactively inform you about potential delays, realistic timelines for resolution, and the importance of maintaining compliance during the transition period.

The government shutdown may have been temporary, but its effects on the IRS and taxpayers will be enduring. By planning ahead, maintaining compliance, and staying informed, taxpayers can navigate the aftermath more effectively and help restore stability once operations return to normal capacity.

About Anchin

Anchin is a leading accounting, tax and advisory firm, specializing in the needs of privately-held companies, investment funds and high-net-worth individuals and families.

Its highly-focused industry specialization helps clients overcome challenges and achieve their financial objectives with exceptional confidence. Consistently recognized in respected “best of” lists for service, firm management and employee satisfaction, Anchin prioritizes partner-level engagement, and commitment to employee happiness. The full-service firm, with a staff of approximately 600 – including more than 70 partners, principals, and managing directors – provides a wide range of assurance, financial reporting, tax and advisory services, including tax strategies and compliance; tax credits and incentives; state and local and international tax strategies, family office strategies management and succession advisory; growth, transition and exit strategies; transaction advisory; client accounting advisory services; and litigation support, forensic accounting and valuation services. Anchin has offices in New York City, Uniondale, Boca Raton and Palm Beach Gardens, and is an independent member of BKR International, a network of more than 160 firms with over 500 offices in over 80 countries around the world. Discover what’s possible by visiting us online at www.anchin.com.

QUESTIONS? Contact Us:

PAUL GEVERTZMAN, CPA, J.D.
Tax Partner & Tax Leader
A&E and Construction Groups
paul.gevertzman@anchin.com

FREDERICK ACKERMAN, CPA, CGMA
Partner & Co-Leader
A&E and Construction Groups
fred.ackerman@anchin.com

STEFAN MYSZKA, CPA
Partner
A&E and Construction Groups
stefan.myszka@anchin.com

RUSSELL SHINSKY, CPA, CGMA
Managing Partner
A&E and Construction Groups
russell.shinsky@anchin.com

STEVEN LINDEN, CPA
Director
A&E and Construction Groups
steven.linden@anchin.com

MARTIN ARKING, CPA
Tax Senior Manager
A&E and Construction Groups
martin.arking@anchin.com

RACHEL LANGENTHAL, CPA
Tax Senior Manager
A&E and Construction Groups
rachel.langenthal@anchin.com

ROBERT SALERNO, EA
Tax Senior Manager
A&E and Construction Groups
robert.salerno@anchin.com

JOSEPH MOLLOY, CPA
Tax Partner
A&E and Construction Groups
joseph.molloy@anchin.com

JEAN DAVID CHERY, CPA
Tax Partner
A&E and Construction Groups
jean.chery@anchin.com

BRIAN SANVIDGE, CIG, CFE
Principal & Leader
Regulatory Compliance &
Investigations Group
brian.sanvidge@anchin.com

REED ELLISON, CPA
Director
A&E and Construction Groups
reed.ellison@anchin.com

DAVID RUBIN, CPA, CGMA
Director
A&E and Construction Groups
david.rubin@anchin.com

DEVON BERNARD, CPA, MST
Tax Senior Manager
A&E and Construction Groups
devon.bernard@anchin.com

JOHN MAGDZIAK, CPA
Senior Manager
A&E and Construction Groups
john.magdziak@anchin.com

PHILLIP ROSS, CPA, CGMA
Partner & Co-Leader
A&E and Construction Groups
phillip.ross@anchin.com

CHRISTOPHER KELLY, CPA
Partner
A&E and Construction Groups
christopher.kelly@anchin.com

ANISH SHAH, CPA
Partner
A&E and Construction Groups
anish.shah@anchin.com

SUE LU, CPA
Tax Director
A&E and Construction Groups
sue.lu@anchin.com

JOSEPH ZELLER, CPA
Director
A&E and Construction Groups
joseph.zeller@anchin.com

NICOLE CARBONE, CPA
Senior Manager
A&E and Construction Groups
nicole.carbone@anchin.com

DANIELLE MONTESANO, CPA
Senior Manager
A&E and Construction Groups
danielle.montesano@anchin.com