Federal Individual Income Tax Significant Changes Effective 2025

Tax year 2025 changes are plentiful! The One Big Beautiful Bill Act (OBBBA) made numerous changes. Please review the following most discussed items that are most likely to impact large numbers of people and may require additional information to be provided.

Please note items #1-#4 are "above line" deductions (you can claim them without itemizing) reported on a new form called Schedule 1-A. These are temporary for tax years 2025-2028 unless extended by future legislation. The changes in item #5 are permanent, unless changed or revoked by future legislation.

1. **New Senior Deduction:** Taxpayers age 65 and older by the end of 2025 may claim an additional deduction of up to $6,000 ($12,000 for married couples filing jointly if both qualify). The deduction is subject to income phaseouts for single taxpayers with Modified Adjusted Gross Income (MAGI) over $75,000 for single filers or $150,000 for married couples filing jointly. Taxpayers must have a Social Security Number valid for employment to be eligible for the deduction.

2. **No Tax on Tips:** Taxpayers with eligible occupations that "customarily and regularly receive tips" before December 31, 2024, can deduct up to $25,000 of qualified tip income. Important details to understand include the following:
   a. Qualified tips include those reported to employers (included on Forms W-2), tips not reported to your employer included on Form 4137, and tips included in self-employed income from qualified occupations.
   b. Married filing separately filers are not eligible for the deduction.
   c. The $25,000 maximum applies per tax return, not per taxpayer. The limit is the same for single, head of household, and married filing joint returns.
   d. The deduction is subject to income phaseouts for single taxpayers with Modified Adjusted Gross Income (MAGI) over $150,000 for single filers or $300,000 for married couples filing jointly.
   e. Tips must be voluntary cash or charged tips (including tip pool proceeds).
   f. Mandatory service charges or automatic gratuities are not eligible.
   g. Taxpayers must have a Social Security Number valid for employment to claim this deduction.

   Please review and complete our No Tax on Tips Organizer if this applies to you.

3. **No Tax on Overtime:** The Fair Labor Standards Act (FLSA) established mandatory overtime pay at "time-and-a-half" or 1.5 times normal rate of pay for nonexempt employees. The deduction is limited to this mandate. The deduction allows each taxpayer to reduce their otherwise taxable income by up to $12,500 of qualified overtime. Important details to understand include the following:
   a. Married filing separately filers are not eligible for the deduction.
   b. Only the "half" or "premium" portion of overtime hours worked is eligible for the deduction. For example, if a nonexempt employee's normal pay rate is $20 per hour, their overtime pay rate would be $30 per hour. Only the overtime premium portion,

$10 above their normal pay rate, is eligible for this deduction. The first $20 per hour for overtime hours is still taxable.

c. All overtime pay is still subject to federal withholding, Social Security, Medicare, and state withholding payroll taxes. For this reason, employees working overtime will not see an increase in net pay compared to overtime paychecks prior to the legislation. Tax savings will be found when filing tax returns rather than on payday.
d. If employers have more generous overtime policies based on company preference, union contracts, or state/city law policies than is required by FLSA, only the FLSA mandated portion is eligible. Examples of more generous policies include:
    i. Increased pay for weekend/holiday (only portions for hours above 40 per week are eligible),
    ii. Overtime for hours above 36 hours per week rather than 40 (only portions for hours above 40 per week are eligible),
    iii. Daily overtime for hours worked above 8 hours per day (only portions for hours above 40 per week are eligible)
    iv. Overtime paid at double the normal rate of pay (only one-half of normal pay rate is eligible).
e. If both spouses of a married filing joint couple have qualified overtime, they can exclude up to $12,500 of each of their qualified overtime pay (up to $25,000 total if they both have at least $12,500 qualified pay).
f. The deduction is subject to income phaseouts for single taxpayers with Modified Adjusted Gross Income (MAGI) over $150,000 for single filers or $300,000 for married couples filing jointly.
g. Self-employed taxpayers, as well as salaried employees exempt from the FLSA mandate, are not eligible for the deduction.
h. Taxpayers must have a Social Security Number valid for employment to claim this deduction.
i. Beginning with tax year 2026 code TT is required in box 12 of W-2 forms to report amount of qualified overtime premium. For tax year 2025 employers can include the amount on W-2 box 14, in a separate statement, on an online portal, or leave the calculation for the employee to perform.

Please review and complete our No Tax on Overtime Organizer if this applies to you.

4. **Car Loan Interest Deduction:** Taxpayers with qualifying loans originated on or after January 1, 2025, may deduct up to $10,000 of qualified interest paid per tax return. Important details to understand include the following:
    a. Only new vehicle purchases are eligible. Leases and used vehicles don't qualify.
    b. The vehicle's final assembly must have occurred in the U.S. You can verify this by entering the Vehicle Identification Number (VIN) into the NHTSA VIN Decoder for official verification. Instructions and links are available at nhtsa.gov/vin-decoder.
    c. The deduction is subject to income phaseouts for single taxpayers with Modified Adjusted Gross Income (MAGI) over $100,000 for single and married filing separately filers or $200,000 for married couples filing jointly.
    d. If a qualifying vehicle loan is refinanced, the interest on the original loan amount remains eligible for deduction if all other requirements are met.

e. The deduction is limited to vehicles purchased primarily for personal use. To meet this requirement the taxpayer must expect to use the vehicle for personal use more than 50% of the time. Business vehicle interest is typically deducted as a business expense. No double-dipping is allowed. If a vehicle has both business and personal use, the personal use portion of interest may be deducted on Schedule 1-A and business use portion of interest deducted as a business expense as long as it was purchased primarily for personal use.
    i. *If the vehicle has mixed use (both personal and business use): Mileage logs must be maintained to secure the deductions and allocate interest between personal use and business use for the year.

f. This deduction is limited to interest paid by the taxpayer who is legally responsible for the loan. If a taxpayer purchases a vehicle for a sibling who makes the payments, neither are able to deduct the interest due to the fact that the person paying the interest is <u>not</u> legally responsible and the person legal responsible has <u>not</u> paid any interest.

g. Beginning with tax year 2026, lenders will report interest paid and VIN on new Forms 1098-VLI (Vehicle Loan Interest) when qualified interest paid is at least $600. These new forms are <u>not</u> required for tax year 2025. Taxpayers will need to determine qualification and their total interest paid on their own. We suggest reviewing statements and online lender portals to find interest paid. If all else fails, you will need to contact your lender.

h. Single taxpayers and married couples filing jointly are limited to the $10,000 maximum deduction. Married couples filing separately may theoretically each claim up to $10,000 if they both have qualifying loan interest. Community property state filing requirements, tax bracket differences, loss of other credit and deduction items, and increased cost of preparing separate returns may render this option disadvantageous.

i. Taxpayers must have a Social Security Number valid for employment to claim this deduction.

<u>**Please review and complete our No Tax on Car Loan Interest Organizer if you qualify.**</u>

5. <u>**Trump Accounts:**</u> These accounts are brand new under the OBBBA and are available to children born in 2025-2028. <u>**Please see our separate Trump Account Information Sheet & complete a Trump Account Organizer if you wish to elect to open these.**</u>

6. <u>**529 College Savings Plans Improved:**</u> Contributions to 529 College Savings Plans are <u>not</u> deductible on federal tax returns, but some states (including Arizona) allow limited deductions. Earnings are shielded from taxation and qualifying distributions are tax & penalty free. This has been the case for many years. New changes have increased the effectiveness of these plans by:
    a. Grandparent Loophole: In prior years, the FAFSA form has considered grandparent owned 529 plan distributions as untaxed student income, reducing eligibility. This is no longer the case.
    b. Roth IRA rollovers: Limited rollovers to Roth IRAs from unused 529 plan balances can be tax & penalty free if qualifications are met.
    c. Improvements to what they can be used to fund include certain post-secondary credentialing and vocational training, expanded K-12 expenses including curriculum,

standardized tests (SAT, ACT, AP exams), tutoring, dual-enrollment courses, and online educational program subscriptions. The maximum distribution for K-12 education increases from $10,000 for 2025 to $20,000 for 2026.