Federal Income Tax Changes – 2025

Contents

Introduction to the Course

Each year, various limits affecting income tax preparation and planning change. Some changes commonly occur each year as a result of inflation indexing, while others occur because of new legislation or the sunsetting of existing law. This course will examine the tax changes affecting 2025 as a result of passage of the SECURE Act 2.0 and the inflation-changed limits effective for 2025 that are more significant from the perspective of an income tax preparer. Some context will be supplied, as appropriate, to assist readers in understanding the changes.

Learning Objectives

Upon completion of this course, you should be able to:

- List the 2025 changes in various amounts including the –
    - Standard mileage rates,
    - Standard deduction,
    - AMT exemption amount,
    - Limits related to income from U.S. Savings Bonds for taxpayers paying higher education expenses, and
    - Deductions for qualified long-term care insurance premiums;
- Identify the 2025 tax credit changes affecting the –
    - Saver's credit,
    - Additional Child Tax Credit,
    - Earned income credit, and
    - Adoption credit;
- Recognize the 2025 changes affecting –
    - Health Savings Account (HSA) and Archer Medical Savings Accounts (MSA) requirements and contribution limits,
    - Roth IRA eligibility, and
    - Traditional IRA contribution deductibility for active participants in employer-sponsored qualified plans;
- List the changes effective for 2025 with respect to the –
    - Small employer premium tax credit, and
    - Applicable large employer mandate; and
- Determine the changes to retirement plans resulting from the Secure Act 2.0 that affect income tax preparation.

Chapter 1 – Changes in Various Limits

Introduction

Federal tax law requires that various limits be adhered to in the preparation of tax returns, and such limits may change from year to year based on an inflation adjustment or on other factors. Included in those changes for 2025 are individual tax rates, standard mileage rates, standard deductions and various other limits.

This chapter will examine these changes for 2025 and will offer some context within which they apply.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Identify the individual income tax rate changes affecting taxpayers;
- Calculate the standard mileage deductions for –
  - Use of a personal vehicle for business purposes,
  - Use of a personal vehicle to obtain medical care, and
  - Charitable use of a personal vehicle;
- Identify the 2025 standard deduction amounts available to taxpayers;
- Recognize the changes made to the alternative minimum tax exemption amount for 2025;
- Apply the tax-free United States savings bond income limits for taxpayers who paid qualified higher education expenses in 2025;
- Calculate the tax-deductible premiums for and tax-free benefits received under qualified long-term care insurance contracts;
- Determine the amount of assets that may be passed tax-free at death; and
- Identify the qualified business income (QBI) threshold amount.

Individual Tax Rates

The individual tax brackets for 2025 are as follows:

2025	**Bracket for Income in Excess of…**				
Tax Bracket	**MFJ**	**HOH**	**Unmarried**	**MFS**	**Estates & Trusts**
10%	$0	$0	$0	$0	
12%	$23,850	$17,000	$11,925	$11,925	
22%	$96,950	$64,850	$48,475	$48,475	
24%	$206,700	$103,350	$103,350	$103,350	$3,150
32%	$394,600	$197,300	$197,300	$197,300	
35%	$501,050	$250,500	$250,525	$250,525	$11,450
37%	$751,600	$626,350	$626,350	$375,800	$15,650

Standard Mileage Rates

The standard mileage rates enable a taxpayer using a vehicle for specified purposes to deduct vehicle expenses on a per-mile basis rather than deducting actual car expenses that are incurred during the year. The rates vary, depending on the purpose of the transportation.

Accordingly, the standard mileage rates differ from one another depending on whether the vehicle is used for:

- Business purposes;
- Charitable purposes; or
- Obtaining medical care or moving.

Rather than using the optional standard mileage rates, however, a taxpayer may choose to take a deduction based on the actual costs of using the vehicle.

Business Use of a Taxpayer's Personal Vehicle

As a result of the passage of the TCJA, taxpayers may no longer deduct unreimbursed employee expenses—including unreimbursed expenses related to business use of a personal vehicle—as "miscellaneous itemized deductions" to the extent the total of such expenses exceeds 2% of his or her AGI. However, the 2025 alternative standard mileage rate applicable to ***eligible*** business use of a vehicle is 70¢ per mile, up from 67¢ in 2024. In order for such expenses to be deductible, they must have been:

- Paid or incurred during the tax year;
- For the purpose of carrying on the taxpayer's trade or business; and
- Ordinary and necessary.

In addition to using the standard mileage rate, a taxpayer may also deduct any business-related parking fees and tolls paid while engaging in deductible business travel. However, parking fees paid by a taxpayer to park his or her vehicle at the usual place of business are considered commuting expenses and are not deductible.

Personal Vehicle Use for Charitable Purposes

A taxpayer may deduct as a charitable contribution any unreimbursed out-of-pocket expenses, such as the cost of gas and oil, directly related to the use of a personal vehicle in providing services to a charitable organization. Alternatively, a taxpayer may use the standard mileage rate applicable to the use of a personal vehicle for charitable purposes. The standard mileage rate applicable to a taxpayer's use of a personal vehicle for charitable purposes is based on statute and remains unchanged at 14¢ per mile. The taxpayer may also deduct parking fees and tolls regardless of whether the actual expenses or standard mileage rate is used.

Use of a Taxpayer's Personal Vehicle to Obtain Medical Care

A taxpayer who uses a personal vehicle for medical reasons is permitted to include the out-of-pocket vehicle expenses incurred—the expenses for gas and oil, for example—or deduct medical travel expenses at the standard medical mileage rate. For 2025, the standard medical mileage rate is 21¢ per mile, unchanged from 2024. The taxpayer may also deduct any parking fees or tolls, regardless of whether the actual expense or the standard mileage rate is used.

Moving Expenses in Military Relocations

Although the Tax Cuts and Jobs Act (TCJA) suspended the moving expense deduction and made any moving expense reimbursement taxable income for non-military relocations, the inclusion of reimbursed moving expenses in the recipient's gross income does not apply to military relocations meeting certain criteria. In the case of a military relocation, the taxpayer's move must be pursuant to a military order and involve a permanent change of station. If those criteria are met, no paid or incurred moving and storage expenses:

- Furnished in kind, or
- For which reimbursement or allowance is provided to the service member, spouse or dependents

…are includible in gross income or reported.

In addition, if the moving expenses paid or incurred in connection with a military relocation are furnished or reimbursed (or an allowance is provided) to the service member's spouse and dependents to move:

- To a location other than the one to which the service member moves, or
- From a location other than the one from which the service member moves

…such expenses are likewise neither includible in gross income nor reported.

Standard Mileage Rates

Activity	**2024 Mileage Rate**	**2025 Mileage Rate**
Eligible business use	67¢	70¢
Medical or moving purposes	21¢	21¢
Charitable purposes*	14¢	14¢

*Set by statute; not subject to inflation adjustment

Standard Deduction Increased

The standard deduction has increased for 2025. The standard deductions for 2025 are:

- $30,000 for married couples whose filing status is "married filing jointly" and qualifying surviving spouse;
- $15,000 for singles and married couples whose filing status is "married filing separately"; and
- $22,500 for taxpayers whose filing status is "head of household."

A taxpayer who can be claimed as a dependent is generally limited to a smaller standard deduction, regardless of whether the individual is actually claimed as a dependent. For 2025 returns, the standard deduction for a dependent is the greater of:

- $1,350; or
- The dependent's earned income from work for the year plus $450 (but not more than the standard deduction amount, generally $15,000).

Standard Deduction for Blind and Senior Taxpayers

Elderly and/or blind taxpayers receive an additional standard deduction amount added to the basic standard deduction. The additional standard deduction for a blind taxpayer—a taxpayer whose vision is less than 20/200—and for a taxpayer who is age 65 or older at the end of the year is:

- $1,600 for married individuals; and
- $2,000 for singles and heads of household.

The additional standard deduction for taxpayers who are both age 65 or older at year-end and blind is double the additional amount for a taxpayer who is blind (but not age 65 or older) or age 65 (but not blind). For example, a 65 year-old single blind taxpayer would add $4,000 to his or her usual standard deduction: $2,000 for being age 65 plus $2,000 for being blind. ($2,000 x 2 = $4,000). Thus, his or her standard deduction would normally be 19,000. ($15,000 + $4,000 = $19,000)

Standard Deduction Eligibility

The general rule with respect to deductions is that a taxpayer may choose to take a standard deduction or itemize his or her deductions. Although that general rule applies in the case of most taxpayers, certain taxpayers are ineligible to take the standard deduction and must itemize.

Taxpayers who are ineligible to take the standard deduction are the following:

- Taxpayers whose filing status is "married filing separately" and whose spouse itemizes deductions;
- Taxpayers who are filing a tax return for a short tax year due to a change in their annual accounting period; and
- Taxpayers who were nonresident aliens or dual-status aliens during the year.

Standard Deductions

	2024	**2025**

Filing Status	Standard	Blind/Age 65+	Standard	Blind/Age 65+
Married filing jointly & qualifying surviving spouse	$29,200	$1,550	$30,000	$1,600
Unmarried (other than qualifying surviving spouse or head of household)	$14,600	$1,950	$15,000	$2,000
Married filing separately	$14,600	$1,550	$15,000	$1,600
Head of household	$21,900	$1,950	$22,500	$2,000
Dependent	$1,300 or earned income + $450		$1,350 or earned income + $450	

Alternative Minimum Tax Exemption Amount Increased

The tax code provides for an AMTI exemption for purposes of determining the alternative minimum tax amount. The amount of the AMTI exemption varies according to the taxpayer's filing status and the tax year. The applicable AMTI exemption amounts are as follows:

AMTI Exemption Amounts

	2024		2025	
Filing Status	**Exemption Phaseout Begins**	**AMTI Exemption**	**Exemption Phaseout Begins**	**AMTI Exemption**
Married filing jointly & qualifying surviving spouse	$1,218,700	$133,300	$1,252,700	$137,000
Unmarried (other than qualifying surviving spouses)	$609,350	$85,700	$626,350	$88,100
Married filing separately	$609,350	$66,650	$626,350	$68,500
Estates and trusts	$99,700	$29,900	$102,500	$30,700

The AMTI exemption amounts are indexed for inflation.

The AMTI exemption amount is reduced (but not below zero) by 25 percent of the amount by which the taxpayer’s alternative minimum taxable income exceeds the amount at which the exemption phaseout begins.

Education Savings Bond Program

A taxpayer may exclude some or all interest income received on qualified U.S. savings bonds if the taxpayer:

- Paid qualified education expenses for the taxpayer, a spouse or a dependent claimed as an exemption;
- Has a modified adjusted gross income (MAGI) not exceeding specified maximum amounts that are adjusted for inflation each year; and
- Has a federal income tax filing status other than married filing separately.

Qualified Education Expenses

Education expenses considered qualified education expenses under the education savings bond program are education expenses incurred at an eligible educational institution by the taxpayer for the taxpayer, the taxpayer's spouse or a dependent claimed by the taxpayer. Such expenses include:

- Tuition and fees;
- Contributions to a qualified tuition program; and
- Contributions to a Coverdell education savings account (ESA)

Room and board expenses **are not** qualified education expenses for purposes of the education savings bond program.

Eligible Educational Institutions

The definition of an eligible educational institution includes virtually all accredited U.S. public, nonprofit, and proprietary post-secondary institutions.

Qualified Education Expenses Reduced by Certain Tax-free Benefits Received

To determine the amount of tax-free interest, the qualified education expenses incurred must be reduced, for purposes of the education savings bond program, by certain tax-free education benefits received. The resulting education expenses, reduced as required, are referred to as "adjusted qualified education expenses."

Thus, *adjusted* qualified education expenses are equal to the qualified education expenses reduced by all of the following tax-free benefits:

- The tax-free part of scholarships and fellowships;
- Expenses used to figure the tax-free portion of Coverdell ESA distributions;
- Expenses used to figure the tax-free portion of qualified tuition program distributions;
- Any tax-free payments received as education assistance, including –
    - Veterans' educational assistance benefits,
    - Qualified tuition reductions, and
    - Employer-provided educational assistance; and
- Any expenses used in figuring the American opportunity and lifetime learning credits.

Neither gifts nor inheritances received, however, reduce qualified education expenses for purposes of the education savings bond program.

Figuring the Tax-Free Amount

If the total amount received by the taxpayer when eligible bonds are cashed in, including both the bond investment and accrued interest, does not exceed the adjusted qualified education expenses, all interest received may be tax free. (Note, the taxpayer must still be eligible based on income.) If the total amount received on liquidation of the bonds is greater than the adjusted qualified education expenses, only a portion of the interest may be tax free.

Determining the tax-free amount of the interest distributed when the bonds are cashed in **and the adjusted qualified education expenses are less than the distribution** requires that the interest received be multiplied by a fraction. The numerator of the fraction is the adjusted qualified education expenses, and the denominator of the fraction is the total proceeds received on liquidation of the bonds during the year the bonds were cashed in.

Education Savings Bond Program Eligibility Subject to Income Limits/Filing Status

The exclusion of interest under the education savings bond program reduces as the taxpayer's income increases and is eliminated at higher income levels. Under the bond program rules, the amount of a taxpayer's interest exclusion is gradually reduced if the taxpayer's modified adjusted gross income (MAGI) exceeds the applicable dollar amount for the taxpayer's filing status. (See **Determining Taxpayer's Modified Adjusted Gross Income** below.)

When the part of the bond interest that normally would be tax free under the education savings bond program is determined, the taxpayer's MAGI is compared to the applicable dollar amount for the tax year to calculate the amount of the potentially tax-free interest that is excludible by the taxpayer. If a taxpayer whose filing status is married filing jointly has a MAGI that exceeds the applicable dollar amount by $30,000 or more, no interest may be excluded under the program. Similarly, if a taxpayer whose filing status is single, qualifying surviving spouse or head of household has a MAGI that exceeds the applicable dollar amount by $15,000 or more, no interest is excludible under the program.

The applicable dollar amounts with which taxpayers' MAGI are compared are as follows:

Taxpayer's Filing Status	2025 Applicable Dollar Amount	Phase-Out Income Range	Completely Phased-Out
Single, qualifying surviving spouse or Head of Household (HH)	$99,500	$99,500 - $114,500	$114,500
Married filing jointly	$149,250	$149,250 - $179,250	$179,250

The amount of excludible savings bond interest to which a taxpayer whose MAGI is in the phase-out income range is entitled, if any, can be determined using the following equation that calculates the part of the interest that is includible:

$$\frac{\text{(MAGI – Applicable dollar amount)}}{\text{\$30,000 (\$15,000 single or HH)}} \quad \text{X} \quad \text{Maximum tax-free interest} \quad = \quad \text{Includible interest}$$

The amount determined under the equation is then subtracted from the maximum tax-free interest amount to figure the amount of excludible savings bond interest.

When figuring the excludible interest amount, use IRS Form 8815, a replicated sample of which is shown in Appendix A. The excludible interest amount should be shown on Form 1040.

Qualified Long-Term Care Insurance Premiums and Benefits

In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA). The law clarified the tax treatment of long-term care insurance policies by defining "qualified long-term care insurance." In addition, it provided for the tax-deductibility of qualified long-term care insurance premiums and the tax-exemption of long-term care insurance benefits within certain limits for individuals deemed to be chronically-ill.

Those limits generally change yearly.

Favorable Benefits Tax Treatment Reserved for Chronically-Ill

In order for long term care benefits to receive favorable tax treatment, the individual on whose behalf they are paid must meet the "chronically-ill" definition included in HIPAA. A *chronically-ill individual* is defined as an insured individual who has been certified by a licensed health care practitioner within the previous 12 months as an individual who:

- Is unable, for at least 90 days, to perform at least two activities of daily living (ADLs) without substantial assistance from another individual, due to loss of functional capacity; or
- Requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

Tax-Qualified Long Term Care Premiums Deductible within Limits

Premiums paid for tax-qualified long term care insurance may be deductible. Tax-qualified long term care insurance policy premiums are included in the definition of "medical care" and are, therefore, eligible for income tax deduction subject to the following limits:

Attained Age Before Close of Tax Year	2024 Limitation on Premium*	2025 Limitation on Premium*
40 or younger	$470	$480
41 to 50	$880	$900
51 to 60	$1,760	$1,800
61 to 70	$4,710	$4,810
Older than 70	$5,880	$6,020
** Indexed for inflation*		

Tax-Qualified Long Term Care Insurance Benefits Tax-Free within Limits

Benefits received under tax-qualified long term care insurance policies that may be excluded from income are those benefits not exceeding the greater of:

- The applicable *per diem* limitation for the year; or
- The costs incurred for qualified long term care services provided for the insured.

The applicable *per diem* limitation for 2025 is $420.

Social Security Taxable Earnings Limit

Social Security taxes are comprised of two components: OASDI (old age, survivors and disability income) and HI (health insurance) taxes. OASDI is a tax imposed on a worker's wages up to the applicable Social Security taxable earnings limit. That limit is $176,100 in 2025 and generally increases annually. The employee tax rate for the OASDI part of Social Security is 6.2%.

HI, the second component of Social Security taxes, is a tax of 1.45% imposed on all taxpayer wages—no earnings limit applies, in other words—to fund Medicare Part A.

Maximum Capital Gain/Dividend Tax Rate Increased for High-Income Taxpayers

- High-income taxpayers are subject to higher capital gain and qualified dividend tax rates. For tax years beginning in 2025, the long-term capital gain and qualified dividend tax rate is as follows:
- The 0% rate applies to –
    - Single filers and married filers filing separately with income up to $48,350,
    - Head of household filers with income up to $64,750,
    - Joint filers with income up to 96,700,
    - Trusts and estates with income up to $3,250;
- The 15% rate applies to –
    - Single filers with income between $48,350 and $533,400,
    - Married filers filing separately with income between $48,350 and $300,000,
    - Head of household filers with income between $64,750 and $566,700,
    - Joint filers with income between $96,700 and $600,050,
    - Trusts and estates with income between $3,250 and $15,900; and
- The 20% rate applies to –
    - Single filers with income exceeding $533,400,
    - Married filers filing separately with income exceeding $300,000,
    - Head of household filers with income exceeding $566,700,
    - Joint filers with income exceeding $600,000,
    - Trusts and estates with income exceeding $15,900.

Estate and Gift Tax Exemption

Every taxpayer is entitled to gift or bequeath assets during lifetime or at death tax free insofar as such assets do not exceed a basic exclusion amount. The gift and estate tax exemption is increased to $13.99 million in 2025. The resulting unified credit for decedents dying in 2025 is $5,541,800.

Section 199A Threshold Amount

The TCJA impacts many taxpayers; among those for whom it has a more significant effect, however, are owners of businesses organized as pass-through entities, i.e. as sole proprietorships, partnerships (including certain LLCs) and S corporations. Such entities may qualify for a special tax deduction, generally referred to as the Section 199A pass-through deduction, which enables eligible taxpayers to deduct up to 20% of their qualified business income (QBI).

In general, the pass-through deduction under section 199A is available as follows:

- All pass-through business owners whose personal taxable income does not exceed a threshold amount are eligible for the deduction;
- Pass-through business owners of certain types of business known as "specified service trades or businesses (SSTBs)" whose personal taxable income is greater than the threshold amount but less than the sum of the threshold amount and $50,000 or $100,000, based on their filing status, are eligible for a reduced deduction; and
- Pass-through business owners of non-SSTBs, irrespective of their personal taxable income, are eligible for the deduction.

The applicable threshold amounts are adjusted annually for inflation and, for 2025, are as shown in the chart below:

Taxpayer's Filing Status	2025 Threshold Amount	Phase-In Range
Married filing jointly	$394,600	$100,000
Married filing separately	$197,300	$50,000
Single & head of household filers	$197,300	$50,000

Thumbnail Summary of 2025 Changes

Subject	2025 Change
Standard mileage rates	Charity - 14¢ Medical & moving – 21¢ Business – 70¢
Standard deduction	Married filing jointly & qualifying surviving spouses - $30,000 Married filing separately & single - $15,000 Head of household - $22,500 Additional standard deduction for blind or elderly: Married - $1,600 Head of household and single - $2,000
Alternative minimum tax	• **Single and head of household** - $88,100 exemption; 25% phaseout beginning at $626,250 taxable income

	• **Married filing jointly and qualifying surviving spouse** - $137,000 exemption; 25% phaseout beginning at $1,252,700 taxable income • **Married filing separately** - $68,500 exemption; 25% phaseout beginning at $626,350 taxable income • **Estates and trusts** - $30,700 exemption; 25% phaseout beginning at $102,500 taxable income
Education savings bond interest exclusion	• **Single, head of household and qualifyingsurviving spouse**– MAGI of $99,500, phased-out to $114,500 • **Married filing jointly** - $149,250, phased-out to $179,250
Qualified LTCi premiums & benefits Limit on premium deduction	Age of taxpayer: 40 or younger - $480 41 to 50 - $900 51 to 60 - $1,800 61 to 70 - $4,810 71 or older - $6,020
Per diem limit on benefit exclusion	$420
Social Security taxable earnings limit	$176,100
Estate and gift tax exclusion	Increased to $13.99 million
Taxable income threshold amount applicable to section 199A pass-through deduction	Increased to: • $394,600 for taxpayers with MFJ filing status • $197,300 for taxpayers with MFS filing status • $197,300 for taxpayers with all other filing statuses

Chapter Review

1. Philip uses his personal vehicle for charitable purposes. If he drove 1,400 miles, spent $50 on gas and oil, $40 on parking fees, $60 on tolls and elected to use the standard mileage deduction, how much of the expenses would be tax-deductible?

   A. $0

   B. $196

   C. $296

   D. $346

2. Karl received qualified long term care insurance benefits in 2025 of $440 per day. How much of such daily benefits must he include in income, if any, assuming his actual long term care costs were $350 per day and the applicable per diem limitation is $420?

   A. $0

   B. $20

   C. $70

   D. $90

Chapter 2 – Tax Credit Changes

Introduction

Although the U.S. Tax Code serves as the legal authority facilitating the nation's funding, it is also an instrument through which the government attempts to bring about social change by encouraging certain types of behavior and discouraging other types. Many of the behaviors the federal government wishes to promote are encouraged through the use of tax credits. Principal among the tax credits providing such encouragement are the retirement savings contribution credit—often referred to as the "saver's credit"—and the child adoption credit. Other tax credits—the earned income credit, for example—are designed to provide additional funds to working taxpayers whose income is below certain levels. The limits affecting these and other credits may change from one year to the next.

This chapter will briefly discuss the principal tax credit changes for 2025.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Calculate the retirement savings contribution credit available to eligible taxpayers;
- Recognize the rules and income limits applicable to eligibility for the earned income credit; and
- Apply the adoption credit rules.

Retirement Savings Contribution Credit

The retirement savings contribution tax credit is a *nonrefundable* credit that is limited to the applicable percentage of the taxpayer's eligible retirement savings contributions; the credit cannot exceed $1,000 per taxpayer. A nonrefundable tax credit is a tax credit that is limited by the individual's tax liability and acts to reduce the amount of federal income tax payable.

The retirement savings contribution tax credit, if any, for which a taxpayer is eligible does not affect the tax treatment to which the contribution would normally be subject.

Saver's Credit Applicable to Range of Retirement Contributions

The retirement savings contribution credit is available to taxpayers who make retirement plan contributions to:

- 401(k) plans;
- 403(b) tax sheltered annuity plans;
- Section 457 governmental plans;
- SIMPLE IRAs; and
- Salary reduction SEPs (SARSEPs).

In addition, the SECURE Act amends the term "compensation," for purposes of the retirement savings tax deduction to include any amount included in the taxpayer's gross income and paid to the taxpayer in the pursuit of graduate or postdoctoral studies.

Saver's Credit Eligibility Based on Income and Filing Status

The percentage of the retirement savings contribution (not exceeding $2,000) available to the taxpayer as a tax credit, up to the $1,000 maximum tax credit, depends upon the individual's adjusted gross income and income tax filing status. The applicable percentages for 2025 retirement contributions are as shown below:

Saver's Credit Adjusted Gross Income Limits (2025)[1]

[1] Note that the adjusted gross income limits may change from year to year.

Joint Return		Head of Household Return		All Other Statuses		Applicable Credit
Over	Not over	Over	Not over	Over	Not over	Percentage
$0	$47,500	$0	$35,625	$0	$23,750	50%
$47,500	$51,000	$35,625	$38,250	$23,750	$25,500	20%
$51,000	$79,000	$38,250	$59,250	$25,500	$39,500	10%
$79,000		$59,250		$39,500		0%

When taking the credit, a taxpayer must subtract the amount of any distributions received from his or her retirement plans from the contributions made. The distributions that must be subtracted for purposes of determining the saver's credit are those received:

- During the two years before the year the credit is claimed;
- In the year the credit is claimed; and
- The period after the end of the credit year but before the due date (including any extensions) for filing the return for the credit year.

The saver's credit is not available to a taxpayer who a) is single, married filing separately or a qualifying surviving spouse with a 2025 income of more than $39,500, b) is a head of household with a 2025 income of more than $59,250, or c) files a return as married filing jointly with a 2025 income of more than $79,000.

Additional Child Tax Credit Increased

The Internal Revenue Code provides a Child Tax Credit for each of a taxpayer's qualifying child. A qualifying child, for purposes of the Child Tax Credit, is a child who:

- Is the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendent of any of them;
- Is under age 17 at the end of the tax year;
- Does not provide more than one half of his or her own support during the year;
- Lives with the taxpayer for more than half of the year;
- Is claimed as a dependent on the taxpayer's return;
- Does not file a joint return for the year, or files it only as a claim for refund; and
- Is a U.S. citizen, a U.S. national, or a resident of the United States.

The Child Tax Credit is $2,000 but is reduced by $50 for each $1,000 (or fraction) by which the taxpayer's MAGI exceeds the threshold amount. The threshold amount is:

- $400,000 for taxpayers filing as married filing jointly; and
- $200,000 for taxpayers filing as other than married filing jointly.

If a child tax credit is reduced because of the taxpayer's high MAGI or because the taxpayer's tax liability is lower than the credit to which the taxpayer would otherwise be eligible, the ***additional*** child tax credit may be payable. The additional child tax credit is a credit for certain individuals who get less than the full amount of the child tax credit. Unlike the child tax credit, the additional child tax credit is a refundable tax credit and, for 2025, is $1,700.

Earned Income Credit

The earned income credit (EIC) is a tax credit for certain low-income working taxpayers who meet income, filing status and other requirements. Eligibility to claim the credit requires, among other things, that the taxpayer have an earned income; the taxpayer must also have an adjusted gross income (AGI) below a specific level. The applicable AGI level generally changes annually. Unlike the saver's credit, EIC is a *refundable* credit and, accordingly, it is available to eligible individuals regardless of whether or not they have a federal income tax liability.

In order to receive EIC, the taxpayer must meet certain rules. The EIC rules fall into three categories:

- Rules that apply to everyone;
- Rules that apply if the taxpayer has a qualifying child; and
- Rules that apply if the taxpayer does not have a qualifying child.

EIC Rules Applicable to Everyone

Determining whether a taxpayer qualifies for EIC begins with the seven rules that apply to everyone. If the taxpayer meets all of the seven rules that apply to everyone, the taxpayer must then meet the additional rules that apply a) if the taxpayer has a qualifying child, or b) if the taxpayer does not have a qualifying child.

The rules for everyone relate to:

- Adjusted gross income (AGI) limits;
- Social Security number;
- Tax filing status;
- Citizenship or residency;
- Foreign earned income;
- Investment income; and
- Earned income.

If the taxpayer does not meet all seven of the rules applicable to everyone, the taxpayer cannot receive the earned income credit, regardless of whether or not the taxpayer has a qualifying child.

Adjusted Gross Income Limits

To meet the rule concerning adjusted gross income limits, a taxpayer must have an AGI that is less than the maximum amount for his or her filing status and number of qualifying children. The applicable AGI limits generally change each year and, for 2025, are as shown in the following chart:

2025 EIC ADJUSTED GROSS INCOME LIMITS		
Children	**Married Filing Jointly**	**Other Than Married Filing Jointly***
3 or more qualifying children	$68,675	$61,555
2 qualifying children	$64,430	$57,310
1 qualifying child	$57,554	$50,434
No qualifying children	$26,214	$19,104

*Taxpayer's filing status cannot be married filing separate.

Valid Social Security Number Required

In order to claim the EIC, the taxpayer—and spouse, if filing a joint return—must have a valid social security number issued by the Social Security Administration. In addition, if a qualifying child is listed on Schedule EIC the child must also have a valid social security number. A social security card stating "Not valid for employment" is not sufficient for purposes of the EIC.

Tax Filing Status

A married taxpayer cannot qualify for the EIC if he or she has a "married filing separate" filing status. If the taxpayer is married, he or she must normally file a joint return to claim the EIC. (An exception may apply if the taxpayer's spouse did not live with the taxpayer during the last 6 months of the year. In such a case, the taxpayer may be able to file as head of household and claim the EIC.)

Citizenship or Residency

If the taxpayer (or spouse, if married) was a nonresident alien for any part of the tax year, the taxpayer cannot claim the EIC unless the taxpayer's filing status is married filing jointly. (Such filing status is available only if one spouse is a U.S. citizen or resident alien and chooses to treat the nonresident spouse as a U.S. resident.) If the taxpayer or spouse was a nonresident alien for any part of the year and the taxpayer's filing status is other than married filing jointly, the EIC is not available.

> Note: Making the election to treat the nonresident spouse as a U.S. resident will cause the worldwide income of both spouses to be subject to U.S. taxation.

Foreign Earned Income

A taxpayer is ineligible for the EIC if he or she files Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion. These forms are used to exclude income earned in foreign countries from the taxpayer's gross income or to exclude a foreign housing amount.

Investment Income

The 2025 investment income of a taxpayer eligible for EIC cannot be greater than $11,950. If the taxpayer's investment income is greater than $11,950, the taxpayer is ineligible for the EIC.

Earned Income

A taxpayer eligible for the EIC must work and have earned income. The requirements of the earned income rule are met if the taxpayer is married, files a joint return and at least one spouse works and has earned income.

Although earned income generally excludes non-taxable pay, a taxpayer can elect to include non-taxable combat pay in earned income for purposes of the EIC.

EIC Rules That Apply if Taxpayer Has a Qualifying Child

In addition to meeting the EIC rules that apply to everyone, a taxpayer who has a qualifying child must meet certain other rules in order to qualify for the EIC. The rules applicable to a taxpayer with a qualifying child are:

- The relationship, age, residence and joint return tests;
- The qualifying child of more than one person rule; and
- The qualifying child of another taxpayer rule.

EIC Rules That Apply if Taxpayer Does Not Have a Qualifying Child

A taxpayer may claim the EIC without a qualifying child, provided the taxpayer meets all the rules that apply to everyone and all the following rules that apply to taxpayers without qualifying children. The EIC rules applicable to a taxpayer with no qualifying children are:

- The age rule (at least age 25 but less than age 65 at the end of the tax year);
- The dependent of another person rule (EIC claimant cannot be the dependent of another person);
- The qualifying child of another taxpayer rule (EIC claimant cannot be a qualifying child of another taxpayer; and
- The main home rule (EIC claimant must have lived in the United States—other than Puerto Rico or a U.S. possession—more than half the year).

Figuring the Amount of the Earned Income Credit

If the taxpayer meets all of the rules applicable to his or her claiming EIC, the next step is figuring the amount of EIC. Determining the earned income credit is done on either EIC Worksheet A or EIC Worksheet B, found in the instructions for IRS Form 1040, as discussed below:

- **EIC Worksheet A** is used if the taxpayer was not self-employed at any time during the tax year and was not a member of the clergy, a church employee who files Schedule SE, or a statutory employee filing schedule C or C-EZ.
- **EIC Worksheet B** is used if the taxpayer was self-employed at any time during the year or was a member of the clergy, a church employee who files schedule SE or a statutory employee filing schedule C or C–EZ.

Adoption Credit/Exclusion

The adoption credit is a nonrefundable tax credit designed to offset qualified adoption expenses for eligible taxpayers adopting an eligible child or children. The adoption assistance program enables a taxpayer to exclude from income amounts a) paid by the taxpayer to adopt an eligible child or b) paid for the taxpayer by an employer to offset qualified adoption expenses under a qualified adoption assistance program.

Eligible Child

An eligible adopted child, for whose adoption expenses an adoption credit or exclusion could apply, may be a) a U.S. citizen or resident, or b) a foreign child who is:

- Under age 18 (if the child turned age 18 during the year, the child is an eligible child for the part of the year he or she was under age 18); or
- A disabled individual physically or mentally unable to care for himself or herself, regardless of age; such a child is generally referred to in connection with the adoption credit and exclusion as a "special needs" child.

Qualified Adoption Expenses

Qualified adoption expenses are those expenses that are reasonable and necessary and which are related to, and for the principal purpose of, a legal adoption of an eligible child. Such expenses include:

- Adoption fees;
- Attorney fees;
- Court costs;
- Travel expenses, including meals and lodging, while away from home; and
- Re-adoption expenses relating to the adoption of a foreign child.

Expenses that are not considered qualified adoption expenses for purposes of the adoption credit or exclusion include expenses:

- For which the taxpayer received funds under a state, local, or federal program;
- That violate state or federal law;
- For carrying out a surrogate parenting arrangement;
- Paid or reimbursed by the taxpayer's employer or any other person or organization; or
- Allowed as a credit or deduction under any other provision of federal income tax law.

The Benefit

A taxpayer may be able to take the adoption credit or exclusion if the following criteria are met:

1. The taxpayer's filing status is single, head of household, qualifying surviving spouse, or married filing jointly. In most cases, a married taxpayer must file a joint return in order to take the credit or exclusion;
2. The taxpayer's modified adjusted gross income (MAGI) is less than the applicable limit for the year; and
3. The taxpayer reports the required information concerning the eligible child in part I of IRS Form 8839.

Timing of the Credit/Exclusion

The year in which the taxpayer can take the adoption credit or exclusion depends upon whether the eligible child is a citizen or resident of the United States at the time the adoption effort began. If the eligible child is a U.S. citizen or resident—an adoption referred to as a "domestic adoption"—the taxpayer can take the adoption credit or exclusion even if the adoption never became final.

The year in which a taxpayer may take the credit or exclusion in connection with a domestic adoption is as shown in the following table:

Domestic Adoptions

Qualifying Expenses Paid by Taxpayer in…	**Credit Taken in…**
Any year before the year the adoption becomes final	The year after the year of the payment
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in…	**Exclusion Taken in…**
Any year	The year of the payment

A taxpayer who adopts a U.S. child with special needs may be able to exclude up to the maximum amount **and** take a credit for additional expenses up to the maximum amount. The exclusion may be available even if neither the taxpayer nor the taxpayer's employer paid any qualified adoption expenses.

The year in which a taxpayer may take the credit or exclusion in connection with a foreign adoption is similarly shown in the chart below (foreign adoption rules that vary from domestic adoption rules are highlighted):

Foreign Adoptions

Qualifying Expenses Paid by Taxpayer in…	**Credit Taken in…**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in…	**Exclusion Taken in…**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

Unlike the rules applicable to domestic adoptions that permit a taxpayer to take the adoption credit or exclusion even if the adoption never became final, an adoption credit or exclusion for a foreign adoption is available to a taxpayer only if the adoption becomes final.

Benefit Phased-Out at Higher Taxpayer MAGI

In 2025, the maximum adoption credit is $17,280 per child. Similarly, the maximum amount of employer-provided adoption assistance that a taxpayer may exclude from gross income in 2025 is $17,280 per child. The amount of the adoption credit or excludable assistance, however, is phased out for taxpayers whose 2025 modified adjusted gross income (MAGI) exceeds $259,190 (the "applicable amount") and is eliminated for taxpayers whose MAGI is $299,190 or more.

The reduction in the maximum adoption credit or exclusion for taxpayers whose MAGI exceeds the applicable amount may be determined by using the following equation:

$$\text{Maximum adoption credit/excludable amount} \times \frac{\text{MAGI} - \text{Applicable amount}}{\$40{,}000} = \text{Reduction in maximum adoption credit/excludable amount}$$

Thumbnail Summary of 2025 Changes

Subject	**2025 Change**
Saver's credit	Available at AGI up to: Married filing jointly - $79,000 Head of household - $59,250 All other statuses - $39,500
Earned income credit AGI limits	Married filing jointly: 3 or more children - $68,675 2 children - $64,430 1 child - $57,554 No children - $26,214 Other qualifying statuses: 3 or more children - $61,555 2 children - $57,310 1 child - $50,434 No children - $19,104
Adoption credit/excluded assistance Maximum amount Phase-out MAGI range	 $17,280/child $259,190 to $299,190

Chapter Review

1. Hank is single and has a $30,000 adjusted gross income in 2025. What would his saver's credit be if he deferred $1,000 in his employer's 401(k) plan and received a $500 employer match?

   A. $100

   B. $150

   C. $200

   D. $500

2. Sally made a $4,000 traditional IRA contribution in 2025 and received a $1,000 saver's credit. If she would be eligible to deduct the contribution in the absence of a saver's credit, how much of her contribution may she deduct?

   A. $0

   B. $2,000

   C. $3,000

   D. $4,000

Chapter 3 – PPACA-Related Tax Changes

Introduction

In addition to its various healthcare-related provisions, the PPACA also brought about several changes that affect the tax liability of many taxpayers. They include changes in allowable health flexible spending arrangement contributions, unreimbursed medical expense deductions and Social Security tax rates for higher-income taxpayers. In 2025 additional changes may affect taxpayers, including a) an increase in the limit for employee contributions to an employer-sponsored health care flexible spending arrangement, b) an increase in the level of a small employer's average annual wages at which the health care premium credit is phased out, and c) changes in the employer mandate under which large employers employing 50 or more full-time employees are required to offer affordable health insurance coverage and make contributions toward premiums or potentially pay a penalty.

In this chapter we will briefly summarize the principal tax changes that became effective as a result of passage of the healthcare law and will then discuss the changes effective in 2025.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to identify the changes effective in 2025 related to the –

- Health flexible spending arrangement contribution limits;
- Small business health care tax credit; and
- Large employer shared responsibility provision.

Health Flexible Spending Arrangement Contributions

Health FSAs enable workers to contribute before-tax amounts to an account that may then be accessed tax-free to pay various out-of-pocket health-related expenses. Although annual caps on the amount that can be contributed to a health FSA are generally imposed by employers—usually as a way to limit their risk of pre-funding—no limit was previously imposed by the federal government. That changed for years 2013 and later.

For years 2013 and 2014 a $2,500 per year limit was imposed on the amount that may be contributed to a flexible spending arrangement for medical expenses. That limit may be increased annually by a cost of living adjustment and, for 2025, is $3,300.

Refundable Premium Tax Credit to Assist in Purchase of Qualified Health Plan

Although the tax penalty for a taxpayer's failure to maintain health coverage has been reduced to zero, individuals who meet specified income, coverage and other criteria are eligible to receive a refundable tax credit to enable them to purchase a qualified health plan. Since the tax credit is a *refundable* tax credit, the taxpayer may receive the credit even though he or she has no income tax liability.

Eligibility for Credit

Individuals are eligible to receive a refundable tax credit for purchase of one or more qualified health plans provided they meet all of the following criteria:

- The covered individuals are enrolled in a qualified health plan through an Affordable Insurance Exchange;
- The taxpayer's expected contribution toward health insurance under the second-lowest cost Silver plan in 2025 would exceed 8.5% of household income;
- Covered individuals are legally present in the United States and not incarcerated;
- Covered individuals are not eligible for other qualifying coverage, such as Medicare, Medicaid, or affordable employer-sponsored coverage; and

- The individual cannot be claimed as a dependent by another person.

In order to be eligible for a premium tax credit, a taxpayer who is married at the close of the taxable year must file a joint income tax return, unless he or she meets the criteria that allow victims of domestic abuse to claim the premium tax credit for the year while using the Married Filing Separately filing status.

Federal Poverty Level

The federal government's poverty level is based on the amount of income received in a year relative to annually-published poverty guidelines. The incomes in the guidelines, which are published by the federal government in January each year, generally increase annually to account for the higher prices for goods and services that result from inflation.

The federal poverty guidelines are as shown in the chart below:

HHS Poverty Guidelines			
Persons in family/household	**48 Contiguous States and D.C.**	**Alaska**	**Hawaii**
1	$15,060	$18,810	$17,310
2	$20,440	$25,540	$23,500
3	$25,820	$32,270	$29,690
4	$31,200	$39,000	$35,880
5	$36,580	$45,730	$42,070
6	$41,960	$52,460	$48,260
7	$47,340	$59,190	$54,450
8	$52,720	$65,920	$60,640
For each additional person add	$5,380	$6,730	$6,190

Amount of the Credit

The amount of the tax credit for an eligible taxpayer is generally equal to the difference between the premium for the benchmark plan and the taxpayer's expected contribution, a contribution that increases as the taxpayer's income increases. The amount of the credit is capped at the premium for the plan chosen. Thus, the tax credit will never be larger than the premium for the plan.

Tax Credit = Benchmark Plan Premium - Taxpayer's Expected Contribution

Benchmark Plan

The "benchmark plan," as the term is used in connection with the insurance premium tax credit, is the second-lowest-cost plan that would cover the family at the silver level of coverage. The PPACA defines[2] such a silver level plan as one "designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan." In other words, the plan pays at least 70 percent of covered charges.

Taxpayer's Expected Contribution

The taxpayer's expected contribution, as the term is used with respect to the premium tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income applicable in 2025 increases—from 2.0% of income for families at less than 150% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level—as the taxpayer's income increases. The amount a family actually pays for coverage will be less than the expected contribution if the family chooses a plan that is less expensive than the benchmark plan.

The income percentages, based on the taxpayer's household income as a percentage of the federal poverty line, are as shown in the table below:

[2] Affordable Care Act §1302(d)(1)(B).

Household Income Percentage of Federal Poverty Line – 2025	Initial Percentage	Final Percentage
Less than 150%	0.0%	0.0%
At least 150% but less than 200%	0.0%	2.0%
At least 200% but less than 250%	2.0%	4.0%
At least 250% but less than 300%	4.0%	6.0%
At least 300% but less than 400%	6.0%	8.5%
At 400% or more	8.5%	8.5%

Calculating the Credit

The tax credit available for premium assistance for a coverage month is equal to the lesser of:

1. The premiums for the month for one or more qualified health plans in which a taxpayer or member of the taxpayer's family enrolls; or
2. The excess of the adjusted monthly premium for the benchmark plan over 1/12th of the product of a taxpayer's household income and the applicable percentage for the taxable year. (see **Adjusted Monthly Premium** below.)

Although the language of the regulations makes the calculation of the second part of the tax credit appear complicated, the calculation is fairly simple and is more readily understood by considering an equation. Thus, in the form of an equation, the calculation of the second component of the tax credit is as follows:

$$\text{Adjusted monthly premium for the benchmark plan} - \frac{\text{Taxpayer's household income x applicable \%age}}{12} = \text{Tax credit (component 2)}$$

We can illustrate how component 2 is determined by looking at an example. For purposes of the example, assume the following:

Adjusted monthly premium: $2,000
Taxpayer's household income: $71,005
Members of taxpayer's family: 3
Applicable poverty level guideline: $25,820

The only value that we need to calculate before substituting them into the equation is the applicable percentage that is multiplied by the taxpayer's household income.

The following steps will produce the correct applicable percentage for the equation:

1. Divide the taxpayer's household income ($71,005) by the applicable poverty level guideline for a three-person household ($25,820); by doing so, we can see that the taxpayer's household income is 275% of the poverty level. ($71,005 ÷ $25,820 = 2.75 = 275%)
2. Consult the household income percentage chart (above) to determine the initial and final percentages for the taxpayer's household income; by doing so, we see that the initial percentage for a taxpayer whose household income is between 250% and 300% of the federal poverty level is 4.0%; the final percentage is 6.0%.
3. Determine the excess of the taxpayer's federal poverty line percentage over the initial household income percentage in the taxpayer's range; that amount is 25. (275% - 250% = 25)
4. Determine the difference between the initial household income percentage and the final household income percentage in the taxpayer's range, which is 50. (300% - 250% = 50)
5. Divide the result in step 3 by the result in step 4; the answer is .50. (25 ÷ 50 = .50)
6. Subtract the initial percentage (4.0%) from the final percentage (6.0%) in the taxpayer's range; the amount is 2.0. (6.0 – 4.0 = 2.0)
7. Multiply the result obtained in step 6 by the result obtained in step 5; that calculation yields 1.0. (2.0 x .50 = 1.0)
8. Add the result obtained in step 7 (1.0) to the initial premium percentage in the taxpayer's range to calculate the applicable percentage; the result is 5.0%. (4.0% + 1.0% = 5.0%)

Now that we have the applicable percentage value, we can substitute the amounts into the equation to determine component 2 of the tax credit calculation as follows:

$$\$2{,}000 \quad - \quad \frac{\$71{,}005 \times .05}{12} \quad = \quad \$1{,}704.14$$

By solving the equation, we see that component 2 of the tax credit calculation for any month is $1,704.14. Since $1,704.14 is less than the $2,000 monthly premium (component 1), it is the tax credit available as a premium assistance amount. The balance of the monthly premium—$295.85 in this case—is the taxpayer's contribution. The tax credit for the entire year would be $20,449.68. ($1,704.14 x 12 = $20,449.68)

Adjusted Monthly Premium

The term used for the monthly premium in the final regulations implementing the PPACA when calculating the tax credit is *adjusted monthly premium* rather than simply *monthly premium*. The "adjusted monthly premium" used in the calculation of the credit is the premium an issuer would charge for the applicable benchmark plan to cover all members of the taxpayer's coverage family, *adjusted only for the age of each member*.

Special Rules Applicable to the Tax Credit

Although tax credits are normally applied at the conclusion of the year, the premium tax credit may be advanced if desired by the taxpayer. Such advance payments are made directly to the insurer on the taxpayer's behalf. When the taxpayer's federal income tax return is filed, the advance payments are reconciled with the amount of the taxpayer's actual premium tax credit. Although a repayment of the advance payment may be due, any repayment due from the taxpayer may be subject to a cap. (See **Reconciling Advance Premium Tax Credits** below.)

Tax credits are also available to qualified individuals who are offered, but not enrolled in, employer-sponsored insurance. Such tax credits are available only if:

- The self-only premium payable by the taxpayer under the employer-sponsored insurance would exceed 9.5% of household income (8.39% in 2024 and 9.02% in 2025); or
- The employer-sponsored insurance does not provide a minimum value, i.e. it covers less than 60% of total covered costs.

Note that the 8.5% of income applicable to the premium tax credit **does not** apply to taxpayers covered by employer-sponsored insurance that provides at least minimum value. For such employees to be eligible for premium tax credits, the employer-sponsored coverage providing at least minimum value must cost more than 9.02% of the individual's household income.

Reconciling Advance Premium Tax Credits

If advance premium tax credits are provided for a taxpayer, the individual must file a federal income tax return for that year. Such advance credits must be reconciled at the time of filing the individual's federal income tax return for the year in which advance credits were received.

In general, if the reconciliation of the premium tax credit with advance tax credit payments made on behalf of the taxpayer shows an excess payment, that excess is owed by the taxpayer as an additional income tax liability. In certain cases, however, the amount of any additional income tax liability resulting from such excess payment may be limited.

The additional tax imposed on a taxpayer because of excess advance credit payments is limited to the dollar amounts in the additional tax limitation table if the taxpayer's household income is less than 400% of the federal poverty line. The dollar limit on the additional tax depends upon the taxpayer's filing status and his or her household income as a percentage of the federal poverty line.

The limits for 2025 are as shown in the additional tax limitation table below:

2025 - Additional Tax Limitation Table*

	Limitation Amount for Unmarried Individuals (other than	**Limitation Amount for All**

Household Income Percentage of Federal Poverty Line	qualifying surviving spouse or heads of households)	Other Taxpayers
Less than 200%	$375	$750
At least 200% but less than 300%	$975	$1,950
At least 300% but less than 400%	$1,625	$3,250

*Subject to inflation adjustment.

Small Business Premium Tax Credit

Small employers may be eligible to receive a nonrefundable tax credit for premiums paid for employee health insurance coverage. The credit may be carried back one year and forward 20 years.

The credit is available to eligible employers for two consecutive taxable years and is subject to limitations based on:

- The number of employees; and
- The average annual wages paid to employees.

The maximum small employer health insurance premium credit available to eligible small employers is 50% of workers' healthcare premiums paid by small employers and 35% of such premiums paid by small tax-exempt employers, such as charities. If an employer receives a tax credit for premiums paid, its tax deduction for the cost of providing health insurance coverage is reduced by the amount of the credit.

Eligibility Requirements

Not all small employers are likely to be eligible to receive the small employer health insurance premium credit. The credit is available only if the employer meets the following three requirements:

1. The employer paid premiums for employee health insurance coverage under a qualifying arrangement—one under which the employer is required to pay at least 50% of the premium for the employee—obtained through a Small Business Health Options Program (SHOP);
2. The employer had fewer than 25 full-time equivalent employees, not counting employees with ownership interest, for the tax year; and
3. The employer paid average annual wages for the tax year of less than $50,000 (indexed for inflation) per full-time equivalent employee.

Small employer health insurance premium tax credits are available for no more than two consecutive years.

Limitations Affect Health Insurance Premium Credit

Various limitations may apply that have the effect of reducing any health insurance premium credit to which a small employer is entitled. Those limitations are the:

- Full-time equivalent employee (FTE) limitation;
- Average annual wage limitation;
- State average premium limitation; and
- State premium subsidy and tax credit limitation.

Full-Time Equivalent Employee (FTE) Limitation

A small employer's health insurance premium credit will be reduced if the employer had more than 10 FTEs for the tax year. If the employer had 25 or more FTEs for the tax year, the credit is reduced to zero. A small employer has 1 FTE for each 2,080 hours worked by an individual considered an employee.

Average Annual Wage Limitation

A small employer's health insurance premium credit is also reduced if the employer paid average annual wages of more than $25,000 (inflation-adjusted to $33,300 in 2025) for the tax year and is eliminated if the employer paid average annual wages of $50,000 or more for the tax year ($66,600 in 2025).

Average Premium Limitation

A small employer's credit is reduced if the employer premiums paid are more than the employer premiums that would have been paid if individuals who are considered employees enrolled in a plan with a premium equal to the average premium for the small group market in the rating area in which the employee enrolls for coverage.

The average premium for the small group market in the rating area in which the employee enrolls is determined by referring to the current table of average premiums for small group markets which is contained in the IRS Form 8941 instructions for the applicable tax year.

State Premium Subsidy and Tax Credit Limitation

A small employer's premium tax credit may be reduced if the employer is entitled to a state tax credit or a state premium subsidy for the cost of health insurance coverage it provides under a qualifying arrangement to individuals considered employees. Even though a state tax credit or premium subsidy does not reduce the amount of the employer premiums paid, the amount of an employer's credit cannot be greater than its net premium payments.

(Net premium payments are employer premiums paid less the amount of any state tax credits the employee or employer received or will receive and any state premium subsidies paid.)

Calculating the Credit

IRS Form 8941, **Credit for Small Employer Health Insurance Premiums**, is used to calculate the credit and is attached to the small employer's tax return. Several worksheets are used to assist preparers in figuring the amounts to report on various lines of the form, and those worksheets are contained in the instructions for Form 8941.

Large Employer Shared Responsibility: The Employer Mandate

The Affordable Care Act requires that large employers offer their full-time employees and dependents health plan coverage at least equal to minimum essential coverage or face a possible tax penalty. The possible penalties imposed on a large employer for failing to comply with the employer mandate vary, depending upon the nature of its noncompliance. Thus, liability for a penalty may arise as a result of:

- The employer's failure to offer coverage; or
- An employer's offering coverage whose employee received a premium tax credit.

Employers Not Offering Coverage

A large employer that does not offer full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan may be liable for a penalty[3] if one or more of its full-time employees enrolls in health insurance coverage through an exchange and receives a premium tax credit or cost-sharing reduction.

The penalty for each month in such a case is an amount equal to the number of the employer's full-time employees in excess of 30 multiplied by 1/12th of $2,000 adjusted for years after 2014. That penalty applies regardless of the number of employees who are enrolled in health insurance coverage obtained through a state exchange and who receive a tax credit or cost-sharing reduction. For calendar year 2025, the $2,000 penalty is adjusted to $2,900.

Since the liability imposed on a large employer for a failure to offer health insurance coverage to its full-time employees is triggered by an employee's obtaining health insurance coverage through a state exchange and receiving a tax credit or subsidy to assist in its purchase, an employer failing to offer such coverage may, nonetheless, avoid a penalty. Specifically, an employer who has no full-time employee whose income would qualify him or her for a subsidy when purchasing health insurance coverage through an exchange will not be liable for the penalty ***even though it offers no health insurance coverage to its full-time employees***.

[3] IRC §4980H(a).

Employers Offering Coverage

It is not only large employers who fail to offer coverage that may be liable for a penalty. In some cases, employers who offer health insurance coverage to their full-time employees may, nonetheless, be subject to a penalty. If a large employer offers coverage to its full-time employees but at least one full-time employee receives a premium tax credit or cost-sharing reduction, the employer is subject to a penalty. Thus, even if an applicable large employer offers coverage to at least 95% of its full-time employees and their dependents, it may be subject to a penalty if one or more of the full-time employees obtains a premium tax credit because the coverage fails to provide minimum value or its premium exceeds 9.02% (2025) of the individual's income[4] or the employee obtaining the premium tax credit is not one of the 95% of employees offered coverage.

Unlike the penalty to which an employer who fails to offer health insurance coverage to its full-time employees may be subject—whose penalty is based on the total number of full-time employees in excess of 30—the penalty applicable to an employer who offers coverage but whose employee purchases coverage through an exchange and receives a premium tax credit or subsidy is based solely on the number of full-time employees who actually purchase health insurance through a state exchange and receive a premium tax credit or cost-sharing reduction. For each full-time employee receiving a credit or subsidy through a state exchange, the penalty for any month is equal to 1/12th of $3,000, i.e. $250. ($3,000 ÷ 12 = $250) For calendar year 2025, the penalty amount is adjusted to $4,350 ($362.50 per month). Thus, if 25 employees of such large employer receive a credit or subsidy in 2025, the applicable employer penalty for that month would be $9,062.50. ($362.50 x 25 = $9,062.50)

The penalty for the month to which a large employer offering unaffordable coverage (or coverage failing to provide minimum value) to its full-time employees in 2025 would be subject is limited to no more than the penalty for which it would have been liable if it didn't offer coverage at all, i.e. an amount equal to the number of full-time employees in excess of 30 during the month multiplied by 1/12th of $2,900. Accordingly, if the large employer employed 50 full-time employees in 2025, and 25 of those employees received a credit or subsidy, the applicable penalty limit would be the lesser of:

a) 25 x $362.50 (25 x $362.50 = $9,062.50), or
b) (50 – 30) x $241.67 (20 x 241.67 = $4,833.40)

Clearly, in such a case, the applicable monthly penalty for the employer who offered coverage in which 25 employees declined to participate and purchased coverage through an exchange and received a credit or subsidy would be the smaller of the two possible penalties, i.e. $4,833.40. ((50 – 30) x $241.67 = $4,833.40)

Thumbnail Summary of 2025 Changes

Subject	**2025 Change**
Small business premium credit	Average annual wage at which small business premium credit begins to be reduced is increased to $33,300 in 2025.
Large employer mandate	Employers with 50 or more full-time employees must offer health coverage at least equal to minimum essential coverage to full-time employees and dependents or be subject to a possible tax penalty.

Chapter Review

1. If a taxpayer's household income of $30,000 places the taxpayer at 110% of the federal poverty level, what is the taxpayer's expected contribution when calculating the refundable tax credit for which the taxpayer may be eligible under the PPACA to purchase a qualified health plan in 2025?

[4] IRC §4980H(b).

A. $0

B. $300

C. $621

D. $1,200

2. Burger Barn is eligible for a small employer health insurance premium credit. If the company employs 10 full-time employees, all of whom have family coverage, and its monthly group insurance premium rates are $500 for employee-only coverage and $1,200 for family coverage, what is the minimum monthly premium contribution Burger Barn must make in order to qualify for the credit?

   A. $2,500

   B. $5,000

   C. $6,000

   D. $12,000

Chapter 4 – Changes in Archer MSAs, HSAs & IRAs

Introduction

Archer medical savings accounts and health savings accounts permit taxpayers to make deductible contributions annually to a trust from which they can take tax-free withdrawals, as needed, to pay qualified medical expenses. Individual retirement arrangements enable taxpayers to make annual contributions to a personal retirement plan that offers tax-deferred growth and either tax-deductible contributions or tax-free qualified distributions. The limits applicable to these tax-favored plans change from year to year.

This chapter will briefly discuss each of plans and the 2025 changes that affect them.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Recognize the eligibility rules applicable to Archer MSAs and HSAs;
- Calculate the maximum contributions that may be made to an Archer MSA;
- Apply the tax treatment rules to contributions to and distributions from Archer MSAs and HSAs;
- Calculate the traditional IRA tax deduction available to a taxpayer who is an active participant in an employer-sponsored retirement plan; and
- Recognize the MAGI limits that apply to a taxpayer's eligibility to make a Roth IRA contribution.

Medical Savings Accounts

Archer MSAs are trusts created solely to pay the qualified medical expenses of the individuals for whom established. Archer MSAs call for an individual to:

- Buy a high-deductible health insurance policy (HDHP), and
- Make tax-deductible contributions to the trust.

Trust earnings are tax-deferred and may be withdrawn tax-free to pay qualified healthcare expenses.

High Deductible Health Plan Requirement

To be eligible for an Archer MSA, an otherwise eligible individual must be covered under a high-deductible health plan. A "high-deductible health plan" is defined differently for individuals and families, and the deductible under the definition of such a plan tends to increase annually. For a policy that covers only the individual, a high deductible health plan in 2025 is one whose annual deductible is at least $2,850 but not more than $4,300. It must also provide that annual out-of-pocket expenses other than for premiums do not exceed $5,700.

A high-deductible health plan providing family coverage in 2025 must have an annual deductible of at least $5,700 but not more than $8,550 and must require annual out-of-pocket expenses other than for premiums of not more than $10,500. (These limits tend to be adjusted upward each year.) Since the term "family coverage" applies to any health plan coverage except self-only coverage, the term would apply to a health insurance plan covering only a husband and wife as well as one covering a husband, wife and multiple children.

High Deductible Health Plan (MSA) – 2025
Deductible and out-of-pocket limits in an Archer MSA high deductible health plan for a specific year depend on whether the plan provides self-only coverage or family coverage. The limits applicable to an Archer MSA in 2025 are the following:

	Minimum HDHP Deductible	***Maximum HDHP Deductible***	***Maximum Annual Out-of-Pocket***
Self-only coverage	$2,850	$4,300	$5,700
Family coverage	$5,700	$8,550	$10,500

Archer MSA Contributions

The maximum deductible contribution that may be made to an Archer MSA depends on whether the high deductible health plan provides self-only coverage or family coverage and the amount of the applicable deductible. An eligible individual may deduct the contributions he or she makes to an Archer MSA during the taxable year in an amount not to exceed:

- 65% of the annual deductible for individuals with self-only coverage; or
- 75% of the annual deductible for individuals with family coverage.

The time of the year the qualifying high deductible coverage began is important since the maximum amount that may be contributed to the trust for any year is based on a full calendar year; thus, if the MSA high-deductible health plan coverage began later than January 1st, the maximum trust contribution permitted for that calendar year would be reduced. (Note that this is different for health savings accounts, discussed next.)

Penalty for Excess Contributions

A taxpayer's contributions to an Archer MSA in excess of the limits are subject to a 6% excise tax penalty, not to exceed 6% of the value of the Archer MSA at the close of the tax year. If a taxpayer makes an excess contribution to his or her Archer MSA, it may be withdrawn, along with any net income attributable to it, on or before the last day for filing the individual's income tax return (including extensions) for the year.

Special Rules for Employer-Installed MSAs

Archer MSAs may be sponsored by small employers and self-employed individuals. Contributions made by an employer to employees' Archer MSAs are deductible by the employer on the "Employee benefit programs" line of the business income tax return for the year in which the employer made the contributions.

If an Archer MSA is installed by an employer, some additional rules come into play. The additional rules applicable to employer-installed MSAs that affect contributions to it include the following:

- In any year in which an employer makes a contribution to an Archer MSA, no contributions to the Archer MSA may be made by the individual account holder;
- The deduction for contributions made to an Archer MSA in any year cannot exceed the employee's compensation attributable to the employer maintaining the MSA. Likewise, a self-employed individual's Archer MSA contribution cannot exceed the individual's earned income from the self-employment with respect to which the plan is established; and
- Contributions for all employees of the employer must be comparable, but they are not required to be identical.

Archer MSA Distributions

Although distributions taken from Archer MSAs are designed principally to pay qualified medical expenses, they may be taken by the individual to meet any kind of need. The tax treatment of the distribution, however, is different—and less favorable—when distributions are taken to meet other than qualified medical expenses.

For Archer MSA purposes, ***qualified medical expenses*** are those expenses that would generally qualify for the medical and dental expenses deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, a spouse and dependents.

Archer MSA Rollovers

Not unlike other qualified funds, the funds in an Archer MSA can be rolled over to a different MSA or to an HSA. (See **Health Savings Accounts** below.) The applicable rollover rules are much like those that apply to IRA rollovers and rollovers from qualified plans insofar as they require the rollover to be completed within 60 days of a distribution and limited to once every 12 months.

Account Transfer Incident to Divorce

The account holder's divorce or death may cause the Archer MSA account to be transferred. If the account holder divorces, the Archer MSA interest may be transferred from one spouse (or former spouse) to another ***without income taxation***. To avoid taxation on the transfer it must be made under a divorce or separation agreement. (See IRC §71(b)(2)(A).) Upon such a transfer, the Archer MSA is treated as the MSA of the spouse (or former spouse) to whom it was transferred.

Account Transfer at Death

The disposition of an Archer MSA upon the death of the account holder depends on who the beneficiary is. The Archer MSA designated beneficiary may be:

- A spouse;
- A designated beneficiary other than a spouse; or
- The individual account holder's estate.

If the designated beneficiary of the Archer MSA is the account holder's surviving spouse, he or she becomes the new account holder. In such a case, no income needs to be recognized as a result of the original account holder's death. Alternatively, an Archer MSA designated beneficiary may be someone other than a spouse—a friend or the individual's estate, for example. In such a case, the account stops being an Archer MSA when the account holder dies, and the value of the Archer MSA must be recognized by the beneficiary to the extent its value exceeds the amount of the decedent's qualified medical expenses paid by the beneficiary within one year following the account holder's death.

Archer MSA Taxation

A taxpayer who is an MSA account holder must file Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and attach it to Form 1040 or Form 1040NR if:

- The taxpayer or employer made contributions to the taxpayer's Archer MSA during the year;
- The taxpayer files a joint return and his or her spouse or spouse's employer made contributions to the spouse's Archer MSA during the year; or
- The taxpayer (or spouse, if filing jointly) acquired an interest in an Archer MSA because of the death of the account holder.

In addition, the taxpayer must report any contributions and/or taxable MSA distributions on Form 1040 or 1040NR, as appropriate.

Contribution Tax Treatment

When Archer MSA contributions are made by an individual account holder they are deductible above the line. When an individual's employer makes Archer MSA contributions to an account for the individual, the contributions are considered employer-provided coverage for medical expenses up to the allowable amount of Archer MSA contributions. They are generally deductible to the employer as a business expense but are not included in the employee's gross income for tax purposes.

Contributions made to an Archer MSA earn tax-deferred interest, and tax-deferral continues as long as the funds remain in the MSA. However, tax-deferral may be lost if the account holder pledges the Archer MSA as security for a loan.

Deductible contributions may be made through the due-date of the federal income tax return (without extensions). Such contributions should be reported on Form 1040 or Form 1040NR, as appropriate.

Distribution Tax Treatment

Distributions from an Archer MSA may be tax-free or taxable as ordinary income. The difference between the tax treatments lies in the use to which the distribution is put.

Archer MSA distributions are fully tax-free when the funds distributed are used to pay qualified medical expenses. For MSA purposes, ***qualified medical expenses*** are those expenses that would generally qualify for the medical and dental expense deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, spouse and dependents.

Archer MSA distributions are taxable and must be included in the account holder's gross income for tax purposes to the extent used for any purpose other than the payment of qualified medical expenses.

Archer MSA Distribution Tax Penalty

A taxable Archer MSA distribution may also subject the account holder to a substantial tax penalty. Archer MSA distributions are includible in income ***and subject to income tax penalties*** when they are used for other than qualified medical expenses and fail to meet specific exceptions.

An Archer MSA distribution includible in an account holder's income is subject to a 20% penalty tax levied on the amount of the distribution includible in income, unless one of the following exceptions applies:

- The distribution is received while the account holder is disabled;
- The distribution is received following the account holder's death; or
- The distribution is received by the account holder after reaching the eligibility age for Medicare, i.e. age 65.

Even if one of these exceptions to the tax *penalty* applies, however, a distribution *not used to pay qualified medical expenses* is still includible in the distributee's income for tax purposes.

Health Savings Accounts

Based, in part, on the experience of the Archer MSA pilot program, legislation was signed into law establishing health savings accounts (HSAs). HSAs are similar to Archer MSAs in many areas. Like MSAs, HSAs are trusts created solely to pay the qualified medical expenses of an account beneficiary and call for an individual to:

- Buy a high-deductible health insurance policy, and
- Make tax-deductible contributions to the trust.

Contributions made to the trust and any earnings are tax-deferred for as long as they remain in the trust. HSA account holders may withdraw funds from the trust to pay any qualified healthcare expenses. When the account holder's expenses for healthcare exceed the policy's deductible, those expenses are covered, in whole or in part, by the health insurance.

Although HSAs and their accompanying high-deductible health plans (HDHPs) are intended to provide insurance coverage for covered costs only to the extent they exceed the HDHP deductible, the CARES Act has modified this requirement, effective on and after January 1, 2020, by:

- Allowing HDHP participants with HSAs to obtain telemedicine[5] and other remote care services free of any cost sharing without jeopardizing the HSA;
- Eliminating the ACA ban on the pre-tax reimbursement of over-the-counter drugs not prescribed by a physician; and
- Treating expenses incurred for menstrual care products as qualified medical expenses.

Additionally, the Families First Coronavirus Response Act (FFCRA) requires all group health plans and health insurers to cover coronavirus tests and related services without any type of cost sharing. Thus, no deductible or coinsurance charges apply to testing for the coronavirus, and receiving such first-dollar benefits will not adversely affect the HSA or the individual's eligibility.

Distributions from an HSA may be taken by an account holder at any time. If taken to pay or be reimbursed for qualified healthcare expenses, such distributions are tax free provided they are not compensated by insurance or otherwise. If taken for any purpose other than to pay qualified

[5] "Telemedicine" refers to the use of technology to provide remote medical services to individuals over a smart phone or computer.

healthcare expenses, the distribution is taxable as ordinary income and may be subject to a tax penalty.

HSA Eligibility

An individual eligible to establish an HSA is one who meets all the following requirements. The individual:

- Is covered under a high deductible health plan (HDHP) on the first day of the month;
- Has no other health coverage except for certain specified coverages;
- Is not enrolled in Medicare; and
- Cannot be claimed as a dependent on another person's tax return for the year.

HSA High Deductible Health Plan Requirement

To be eligible for an HSA, an otherwise eligible individual must be covered under a high-deductible health plan. For a policy that covers only the *individual*, a high deductible health plan in 2025 is one whose annual deductible is at least $1,650 and which also provides that annual out-of-pocket expenses do not exceed $8,300. A high-deductible health plan providing *family* coverage in 2025 must have an annual deductible of at least $3,300 and must require annual out-of-pocket expenses of not more than $16,600. (These limits tend to be adjusted upward each year.)

High Deductible Health Plan (HSA) – 2025				
Contribution, deductible and out-of-pocket limits in an HSA high deductible health plan for a specific year depend on whether the plan provides self-only coverage or family coverage. The limits applicable to an HSA in 2025 are the following:				
Coverage Type	Minimum Deductible	Maximum Annual Out-of-Pocket*	Maximum Individual Annual Contribution	Individual Annual Catch-up Contribution
Self-only coverage	$1,650	$8,300	$4,300	$1,000
Family coverage	$3,300	$16,600	$8,550	$1,000
*The maximum out-of-pocket limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to figure whether the limit applies.				

HSA Contributions

Contributions to an HSA may be made up until April 15th of the year following the year for which contributions are made. Similar to Archer MSA contribution limits, the maximum deductible contribution that may be made to an HSA depends on whether the high deductible health plan provides self-only coverage or family coverage. However, the *amount* of the applicable deductible—a factor in determining the maximum MSA contribution—does not affect the maximum HSA contribution. The test to determine whether self-only or family coverage limits apply occurs on the first day of the month.

An eligible individual who has not attained age 55 by the end of the taxable year may deduct the contributions he or she makes to an HSA during 2025 in an amount not to exceed:

- $4,300 for account holders with self-only coverage; or
- $8,550 for account holders with family coverage.

HSA Contributions from Multiple Sources

Contributions made to an account holder's HSA may come from multiple sources. If the account holder has an HSA under an employer's plan, contributions may be made by the employer, the employee or both for the same year. In addition, family members or any other person may also contribute to an HSA on behalf of an eligible individual.

Additional Contributions for Age 55 and Older Account Holders

HSA account holders who attain age 55 before the close of a taxable year are eligible to make an additional contribution. The maximum additional contribution amount is $1,000. Thus, an HSA account holder who is age 55 or older and has self-only coverage may make a maximum contribution in 2025 of $5,300; such an individual with family coverage may make a maximum contribution of $9,550. (If both spouses are age 55 or older, each may make a catch-up contribution of up to $1,000.)

First-Year Contributions for New Account Holders

An individual who becomes an eligible individual (for HSA purposes) after the beginning of a taxable year and who is an eligible individual for the last month of the taxable year is treated, for purposes of maximum contributions, as being an eligible individual for the entire year. Thus, an individual who becomes eligible for an HSA in December 2025 and establishes the HSA may make a contribution not exceeding the applicable maximum for the entire year. (Note the difference from an Archer MSA.)

However, if such an individual fails, at any time during the following taxable year (the same "plan" year, in other words), to be an eligible individual (for HSA purposes), the taxpayer must include in his or her gross income the aggregate amount of all HSA contributions made by the taxpayer that could not have been made under the general rule. The amount includible in the former account holder's gross income is also subject to a 10% penalty tax for failure to maintain HDHP coverage. An exception exists if the failure to remain HSA eligible is the result of death or disability.

Maximum HSA Contributions may be Reduced

An HSA account holder must reduce the amount that can be contributed to the HSA, but not below zero, by any amounts contributed:

- To an Archer MSA, including employer contributions, for the year;
- To the HSA by any other person, including the HSA account holder's employer, that are excludible from the account holder's income; and
- Under a qualified HSA funding distribution, i.e. a distribution from the account holder's IRA to the HSA.

Penalty for Excess Contributions

If a taxpayer makes an excess contribution for the year the account holder must withdraw it or be subject to a 6% excise tax penalty, not to exceed 6% of the value of the HSA at the close of the tax year. An excess contribution to an HSA may be withdrawn, along with any net income attributable to it, on or before the last day for filing the individual's income tax return (including extensions) for the year. The excess contribution withdrawn before the tax-filing date is not includible in the distributee's income, nor is the contribution deductible. Any income that is attributable to the excess contribution being withdrawn must be included in gross income in the year in which received.

Employer HSA Participation

Contributions made by an employer to employees' HSAs are deductible by the employer on the "Employee benefit programs" line of the business income tax return for the year in which the employer made the contributions. If an employer makes contributions to employees' HSAs, the employer is required to make comparable contributions to all comparable participating employees' HSAs.

HSA Distributions

Although distributions taken from HSAs are designed to pay qualified medical expenses, they may be taken by the individual to meet any kind of need. The tax treatment of the distribution, however, is different—and less favorable—when distributions are taken to meet other than qualified medical expenses.

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expenses deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, spouse and dependents.

As noted earlier, the Cares Act also adds telehealth and other remote care services to the list of coverages that can be provided on a first-dollar basis, i.e. with no deductible, without adversely affecting the taxpayer's eligibility to establish and maintain an HSA. Without this provision, a taxpayer receiving first-dollar coverage for such services would be disqualified from establish an HSA or making tax-favored HSA contributions.

Health insurance premiums are not normally considered a qualified medical expense for HSA purposes; however, exceptions apply. The following health insurance premiums ***are*** deemed HSA-qualified medical expenses:

- Premiums for healthcare continuation coverage (such as coverage under COBRA);
- Premiums for long term care insurance; and
- Health plan premiums paid while the account holder is receiving unemployment compensation

HSA Rollovers

Funds in an HSA or Archer MSA can be rolled over to an HSA. The applicable rollover rules are much like those that apply to IRA rollovers and rollovers from qualified plans and require the rollover to be completed within 60 days of a distribution. Rollovers are limited to no more than one every 12 months.

Account Transfer Incident to Divorce

The account holder's divorce or death may cause the HSA account to be transferred. If the account holder divorces, the HSA interest may be transferred from one spouse (or former spouse) to another ***without income taxation***. To avoid taxation on the transfer it must be made under a divorce or separation agreement. (See IRC §71(b)(2)(A).) Upon such a transfer, the HSA is treated as the HSA of the spouse to whom it was transferred.

Account Transfer at Death

The disposition of an HSA upon the death of the account holder depends on who the beneficiary is. If the designated beneficiary of the HSA is the account holder's surviving spouse, he or she becomes the new account holder and no income needs to be recognized. If the beneficiary is other than a spouse, the account stops being an HSA when the account holder dies and the value of the HSA must be recognized by the beneficiary to the extent its value exceeds the amount of the decedent's qualified medical expenses paid by the beneficiary within one year following the account holder's death.

When the HSA account holder's estate is designated as the beneficiary, the account's fair market value is taxable in the account holder's final taxable year and included in the final income tax form prepared by the executor or administrator. In such a case, the assets in the HSA are distributed income tax-free according to the terms of the account holder's will or the intestacy laws if the account holder dies without a will.

HSA Taxation

The tax treatment of HSA contributions varies, depending on the source of the contributions. A taxpayer who is an HSA account holder must file Form 8889, Health Savings Accounts (HSAs), and attach it to Form 1040 or Form 1040NR if:

- The taxpayer or employer made contributions to the taxpayer's HSA during the year;
- The taxpayer files a joint return and his or her spouse or spouse's employer made contributions to the spouse's HSA during the year; or
- The taxpayer (or spouse, if filing jointly) acquired an interest in an HSA because of the death of the account holder.

In addition, the taxpayer must report any contributions and/or taxable distributions on Form 1040 or 1040NR, as appropriate.

Contribution Tax Treatment

When HSA contributions are made by an individual account holder they are deducted by the individual from his or her income for purposes of determining the account holder's adjusted gross income.

When an individual's employer makes HSA contributions to an account for the individual, the contributions are considered employer-provided coverage for medical expenses up to the allowable amount of HSA contributions. Accordingly, employer-provided HSA contributions are generally deductible to the employer as a business expense but are not included in the employee's gross income for income tax purposes. Contributions made to an HSA earn tax-deferred interest, and tax-deferral continues as long as the funds remain in the account.

Deductible contributions may be made through the due-date of the federal income tax return (without extensions). Such contributions should be reported on Form 8889, Health Savings Accounts (HSAs) and on Form 1040 or Form 1040NR.

Distribution Tax Treatment

Distributions from an HSA may be tax-free or taxable as ordinary income. The difference between the tax treatments lies in the use to which the distribution is put.

A distribution, including a rollover distribution, from an HSA must be reported on Form 8889, Health Savings Accounts (HSAs). The amount by which a distribution (other than a distribution that is rolled over) exceeds the account holder's unreimbursed qualified medical expenses must be reported as "Other income" on Form 1040 or Form 1040NR. On the adjacent dotted line, enter "HSA" and the amount. In addition, 20% of the taxable HSA distribution during the year that does not meet any of the exceptions to the tax penalty must be reported as "Other taxes" on Form 1040 or Form 1040NR. The amount of the additional tax and "HSA" should be entered on the adjacent dotted line.

Tax-Free HSA Distributions

HSA distributions are fully tax-free when the funds distributed are used to pay qualified medical expenses, including non-prescription over-the-counter medical products.

Taxable HSA Distributions

HSA distributions are taxable and must be included in the account holder's gross income for tax purposes to the extent used for any purpose other than the payment of qualified medical expenses.

An HSA owner who is at the age at which he or she is eligible for Medicare may withdraw funds from the account for other than to pay qualified medical expenses without incurring a tax penalty. Although the funds thus withdrawn are subject to income taxation as ordinary income—just as a distribution from a traditional IRA would be—no tax penalty applies.

HSA Distribution Tax Penalty

A taxable HSA distribution may also subject the account holder to a substantial tax penalty. HSA distributions are includible in income and subject to income tax penalties when they are used for other than qualified medical expenses and fail to meet specific exceptions. An HSA distribution includible in an account holder's income is subject to a 20% penalty tax levied on the amount of the distribution includible in income, unless one of the following exceptions applies:

- The distribution is received while the account holder is disabled;
- The distribution is received following the account holder's death; or
- The distribution is received by the account holder after reaching the eligibility age for Medicare.

Even if these exceptions apply, however, a distribution *not used to pay qualified medical expenses* is includible in the distributee's income for tax purposes.

Roth IRA Eligibility

A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings through qualified distributions. It does not provide for contribution deductibility. Eligibility for a Roth IRA is limited to individuals, regardless of age or qualified plan participation, whose income does not exceed certain modified adjusted gross income limits.

Limits on Contributions

The maximum amount an individual can contribute to a Roth IRA is $7,000 (in 2025) or, if he or she is age 50 or older, $8,000, less any amount contributed to a traditional IRA for the same year. The maximum contribution that may be made to a Roth IRA is reduced, based on the individual's modified adjusted gross income, according to the following formula:

$$\text{Contribution reduction} = \frac{\text{MAGI} - \text{applicable dollar amount}}{\$15{,}000\ (\$10{,}000 \text{ if married filing a separate return or jointly})} \times \text{Maximum contribution}$$

The "applicable dollar amount" in the Roth IRA formula is based on the individual's filing status, as shown in the following chart:

Federal Income Tax Filing Status	Applicable Dollar Amount (2024)	Applicable Dollar Amount (2025)
Individual	$146,000	$150,000
Married, filing a joint return	$230,000	$236,000
Married, filing separately	$0	$0

Traditional IRA Contributions by Active Participants

Every taxpayer who has earned income may make a traditional IRA contribution. In most cases, traditional IRA contributions are deductible by the taxpayer. However, when the taxpayer is an active participant in an employer-sponsored retirement plan, the usual deductibility of traditional IRA contributions may be changed, depending on the participant's MAGI and filing status.

Tax Treatment of Contributions by Active Participants

There are three possibilities with respect to the tax deductibility of a traditional IRA contribution made by an active participant in an employer-sponsored retirement plan. The traditional IRA contribution may be:

- Fully deductible, or
- Partially deductible, or
- Not deductible

The tax status of the traditional IRA contribution for an active participant depends entirely on his or her modified adjusted gross income and filing status. Traditional IRA contributions made by active participants whose MAGI does not exceed the applicable dollar amount for his or her filing status are fully deductible.

The applicable dollar amounts for tax year 2025 are as shown in the chart below:

Active Participants – Applicable Dollar Amounts		
Taxable Year	**Married Filing Jointly Return**	**Single or Head of Household Return**
2020	$104,000	$65,000
2021	$105,000	$66,000
2022	$109,000	$68,000
2023	$116,000	$73,000
2024	$123,000	$77,000
2025	$126,000	$79,000

Reduced Deductibility of Traditional IRA Contributions for Active Participants

The reduction of the deductible amount of a traditional IRA contribution for an active participant filing a *single or head-of-household* federal tax return is determined by using the following formula:

$$\text{Reduction of Deduction (Single or HOH)} = \text{Maximum contribution} \times \frac{\text{MAGI – applicable dollar amount}}{\$10{,}000}$$

The reduction of the deductible amount of a traditional IRA contribution for an active participant filing a *joint* federal tax return is determined by using the following formula:

$$\text{Reduction of Deduction (Married filing jointly)} = \text{Maximum contribution} \times \frac{\text{MAGI – applicable dollar amount}}{\$20{,}000}$$

(Note: The difference between the two formulas shown above is in the denominator of the fraction. For active participants filing single or head-of-household federal tax returns, the denominator is $10,000; for active participants filing a joint federal tax return, it is $20,000.)

Notice that the formula is NOT a formula for determining the extent of the tax-deductibility of a traditional IRA contribution. It is the formula for determining an active participant's (or spouse's) REDUCTION in his or her traditional IRA deductibility.

Thumbnail Summary of 2025 Changes

Subject	**2025 Change**
MSA limits	Individual: Deductible - $2,850 to $4,300 Out-of-pocket maximum - $5,700 Maximum contribution – 65% of deductible Family: Deductible - $5,700 to $8,550 Out-of-pocket maximum - $10,500 Maximum contribution – 75% of deductible
HSA limits	Individual: Minimum deductible - $1,650 Out-of-pocket maximum - $8,300 Maximum contribution* - $4,300 Family: Minimum deductible - $3,300 Out-of-pocket maximum - $16,600 Maximum contribution* - $8,550 * HSA account holders aged 55 or older may contribute up to an additional $1,000 annually
IRA contribution maximum	Regular - $7,000 Catch-up - $1,000
Roth IRA contribution income limits	Single & head of household: Maximum MAGI for full contribution - $150,000 Contribution eliminated at MAGI of - $165,000 Married Filing Jointly: Maximum MAGI for full contribution - $236,000 Contribution eliminated at MAGI of - $246,000
Traditional IRA deductibility for active participants in employer-sponsored qualified retirement plan	Single & head of household: Maximum MAGI for full deductibility - $79,000 All deductibility eliminated at MAGI of - $89,000 Married Filing Jointly: Maximum MAGI for full deductibility - $126,000 All deductibility eliminated at MAGI of - $146,000

Chapter Review

1. Ellen has maintained self-only health insurance coverage with a $2,850 deductible under her Archer MSA throughout 2025. What is the maximum tax-deductible contribution she can make to the MSA in 2025?

   A. $1,900

   B. $1,852

   C. $5,700

   D. $4,300

2. Peter, age 45, had $5,000 in qualified medical expenses in 2025 and took an $8,000 Archer MSA distribution during the year. If the excess distribution fails to meet a specific exception applicable to the tax penalty, for what tax penalty will he be liable?

   A. $1,000

   B. $1,600

   C. $600

   D. $0

Chapter 5 – Secure Act 2.0

Introduction

The SECURE Act 2.0 became law as part of the Consolidated Appropriations Act, 2023 enacted on December 29, 2022. It contains a wide range of provisions designed to encourage retirement savings many of which affect tax preparation and planning. Additionally, it brings about changes affecting required minimum distributions, Roth IRAs and designated Roth accounts and addresses desirable outcomes, including:

- Creating improved retirement security;
- Ensuring retirement income preservation;
- Simplifying retirement plan rules; and
- Enhancing federal revenue.

This chapter will briefly describe the Act's provisions more likely to affect tax preparation and planning.

Chapter Learning Objectives

After completing this chapter, you should be able to describe the SECURE Act 2.0's provisions including:

- Identifying the provisions designed to expand retirement plan coverage and increase retirement savings;
- Describing the provisions designed to enable plan participants to preserve their retirement income;
- Listing the provisions that simplify retirement plan rules; and
- Identifying those provisions designed to enhance federal revenue.

SECURE Act 2.0 Provisions That Became Effective in 2023

Provisions of the Act effective in 2023 address the following:

- Tax credits for small employer plan startup costs;
- Small employer tax credits for hiring and accelerated inclusion of military spouses in qualified plans;
- Age at which required minimum distribution (RMDs) must begin;
- SEPs for domestic employees;
- RMD restrictions on life annuities;
- Penalty on partial annuitization;
- Tax penalties for RMD insufficiencies;
- Premature distribution tax penalties for private sector firefighters;
- Repaying certain retirement plan distributions;
- Qualified plan hardship distributions;
- Retirement plan tax penalty statute of limitations;
- Initial elective deferrals for sole proprietors;
- Penalties for IRA prohibited transactions;
- Retirement plan distributions to terminally-ill participants;
- Government retirement plan payment of health and long term care insurance premiums;
- Premature distribution tax penalty for public safety officers and corrections employees;
- Qualified federally-declared disaster rules;
- IRA excess contribution corrective distributions;
- RMD rules for special needs trusts;
- Roth contributions to SIMPLE and SEPs;
- Roth catch-up contributions; and
- Employer matching or nonelective contributions as Roth contributions.

Tax Credits for Small Employer Plan Startup Costs Expanded

The Act expands the tax credit for small employer plan startup costs for employers having 50 or fewer employees, by:

1. Increasing the percentage of plan startup costs considered (under the existing tax credit) from 50% to 100%; and
2. Adding an additional credit not exceeding $1,000 per employee of a percentage of employer contributions made to certain employees' defined contribution plan accounts equaling –
    - 100% of contributions in years 1 and 2,
    - 75% of contributions in year 3,
    - 50% of contributions in year 4, and
    - 25% of contributions in year 5.

Note: No employer contributions made for employees whose wages from the employer exceed $105,000 for 2025 are taken into account for purposes of the additional credit based on employer contributions. Additional credits are phased out at the rate of 2% per employee for employers employing 51 to 100 employees.

Tax Credits for Small Employers – Military Spouse Employment & Accelerated Plan Eligibility

The Act helps military spouses save for retirement and provides an additional credit for small employers—employers with no more than 100 employees who received compensation of at least $5,000 from the employer for the preceding calendar year—hiring military spouses who is:

- Made immediately eligible for participation in the employer's retirement plan within two months of hire;
- Eligible for any matching or nonelective contribution for which he or she would normally have been eligible at two years of service upon plan eligibility; and
- 100% immediately vested in all employer contributions.

The tax credit for which a small employer meeting the criteria is eligible is equal to the sum of (1) $200 per military spouse and (2) 100% of all employer contributions (up to $300) made on behalf of each military spouse. The credit applies for three years with respect to each military spouse and does not apply to highly compensated employees.

Required Minimum Distribution (RMD) Age Change

As life expectancy generally increases—and the need to provide income for a longer retirement period increases along with it—it is important to allow taxpayers an opportunity to give their funds some additional time to grow in a tax-deferred environment. Accordingly, the SECURE Act, in 2019, increased the age at which RMDs were required from 70 ½ to 72. The SECURE Act 2.0 has further raised the age at which RMDs must begin to age 73 for individuals who attain age 72 after 2022 and attain age 73 before January 1, 2033. Accordingly, traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. RMDs are further delayed to age 75 for an individual who becomes age 74 after December 31, 2032.

Reducing Tax Penalties for RMD Insufficiencies

As a result of the Secure Act 2.0, effective upon enactment, the tax penalty for a failure to take an RMD from an employer-sponsored retirement plan or traditional IRA is reduced to 25% of the insufficiency. Additionally, if a traditional IRA RMD insufficiency is timely corrected, the tax penalty is reduced to 10% of the insufficiency.

SEPs for Domestic Employees

The Act permits employers of domestic employees—nannies, gardeners and housekeepers, for example—to provide retirement benefits for such employees under a Simplified Employee Pension (SEP). Employer contributions in 2025 are limited to no more than the lesser of 25 percent of compensation and $70,000.

Removing RMD Restrictions on Life Annuities

Required minimum distributions (RMDs) have a single purpose: to enable the federal government to impose an income tax on a specified portion of the funds that had hitherto avoided taxation. Current law requires an actuarial test when commercial annuities are included in tax-favored retirement plans. That test causes annuities to be unable to provide certain guarantees seen as important by IRA owners and plan participants, such as providing increased periodic payments to offset inflation. The Act changes that by permitting an eligible retirement plan to provide one or more of the following types of payments on or after the annuity starting date:

- Annuity payments that increase by a constant percentage, applied annually or more frequently, at a rate less than 5 percent per year,
- A lump sum payment that—
    - results in a shortening of the payment period with respect to an annuity or a full or partial commutation of the future annuity payments, or
    - accelerates the receipt of annuity payments scheduled to be received within the ensuing 12 months, regardless of whether such acceleration –
        - shortens the payment period with respect to the annuity,
        - reduces the dollar amount of benefits to be paid under the contract, or
        - results in a suspension of annuity payments during the period being accelerated,
- An amount similar to a dividend, or
- A final payment at death not exceeding the amount by which the consideration exceeds total annuity distributions, i.e., a *refund* annuity.

Penalty on Partial Annuitization

A "partial annuitization" is a transaction in which the owner of a deferred annuity contract applies a portion of the annuity contract's cash value to purchase a stream of annuity payments under the contract, while leaving the remaining cash value accessible. Under current law, a tax-preferred retirement account that holds an annuity must be split (conceptually) between the portion of the account holding the annuity and the rest of the account for purposes of applying the required minimum distribution rules. This treatment may result in higher minimum distributions than would have been required if the account did not hold an annuity. The Act, effective on the date of enactment, permits the account owner to elect to aggregate distributions from both portions of the account for purposes of determining minimum distributions, thereby removing the possibility of a higher RMD from an account containing an annuity contract.

Compliance Resolution System (EPCRS) Expanded

The IRS has long had a system—the Employee Plans Compliance Resolution System (EPCRS)—under which retirement plan failures and mistakes can be fixed and, thereby, avoid plan disqualification. The Act expands the Employee Plans Compliance Resolution System (EPCRS) to:

- Allow more types of errors, such as plan loan errors, to be corrected internally through self-correction;
- Apply to inadvertent IRA errors; and
- Exempt certain failures to make RMDs from the otherwise applicable penalty tax.

Eliminating Premature Distribution Tax Penalty at Age 50 for Private Sector Firefighters

The premature distribution penalty tax—a tax equal to 10% of the amount of the plan distribution includible in income—generally is levied on taxpayers taking distributions from tax-favored retirement plans prior to reaching age 59 ½.

However, qualified public safety employees in governmental plans generally may retire upon attaining age 50 or completion of 25 years of service under the plan. For these taxpayers, the exemption from the premature distribution tax penalty applies to distributions taken at age 50 or upon completion of 25 years of service under the plan, whichever is earlier. The Act extends the age 50/25 years rule also to private sector firefighters. This amendment of existing law applies to distributions taken from qualified plans (but not from IRAs) after the date of enactment.

Repaying Qualified Birth or Adoption Distributions

The SECURE Act authorizes qualified birth or adoption distributions (QBAD) that taxpayers may repay in an aggregate amount not exceeding the amount of the qualified birth or adoption distribution. The SECURE Act 2.0 amends the QBAD provision to restrict the qualified birth or adoption recontribution period to 3 years from the day following receipt of the distribution. In the case of a qualified birth or adoption distribution taken before the date of the enactment of the Act, repayment of the QBAD may only be made after the distribution and before January 1, 2026 rather than during the 3-year period beginning on the day after the date on which such distribution was received.

Simplifying Hardship Distributions

Historically, obtaining a hardship distribution from a qualified plan and avoiding the tax penalty in the case of such a distribution prior to age 59 ½ has been difficult and required that the participant seeking a hardship distribution present documents evidencing the presence of an immediate and heavy financial need—a notice of eviction or medical bills, for example—and that all available alternatives for satisfying the need had already been accessed. A plan participant's statement that he or she was experiencing an immediate and heavy financial need was deemed insufficient. The Act, effective for 2023 and later, provides that employees may *self-certify* that they have had an event that constitutes a hardship for purposes of taking a hardship distribution.

Clarifying IRA Tax Penalty Statute of Limitations

Generally speaking, a statute of limitations is a period of time following an event during which legal proceedings related to that event may be brought. Prior to the passage of the Act, the statute of limitations applicable to an excess contribution or a required minimum distribution (RMD) insufficiency involving an individual retirement account (IRA) began only when the taxpayer filed IRS Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.*[6] The problem, however, was that a taxpayer who was unaware that he or she had erred in failing to take the full amount of an RMD from an IRA or who had unknowingly made an excess IRA contribution would also be unaware that IRS Form 5329 needed to be filed, possibly resulting in years of added penalties and interest. The Act, effective upon enactment, provides that a 3-year period of limitations generally begins when the taxpayer files either a Form 5329 or an individual income tax return for the year of the violation.

Authorizing Retroactive Individual 401(k) Elective Deferrals for Sole Proprietors

Prior to enactment of the SECURE Act on January 1, 2020, an employer interested in establishing and funding a new qualified retirement plan generally was required to establish the plan no later than December 31st of the year. Once established, the employer could then make a contribution to it up to the due date of the taxpayer's income tax return (including extensions) for that year. The SECURE Act made it easier for an employer interested in establishing a plan by allowing the employer to both establish and make a contribution to the plan by the due date of the employer's federal tax return. The SECURE Act 2.0 has extended the ability to establish and fund solo 401(k) plans to sole proprietors and other businesses treated as sole proprietors, i.e. single member LLCs, etc. The Act, effective beginning in 2023, provides that, in the case of an individual who owns the entire interest in an unincorporated trade or business and who is its only employee, elective deferrals made to the business's 401(k) plan by the individual before the due date for filing his or her federal income tax return (determined without regard to any extensions) after or at the end of the plan's first plan year, is treated as having been made before the end of the first plan year.

Limiting Penalties for IRA Prohibited Transactions

In certain cases, a taxpayer's multiple individual retirement accounts (IRAs) are treated as a single IRA. However, that treatment doesn't apply to prohibited transactions involving IRAs. The Act, effective upon enactment, clarifies that if an individual owning multiple IRAs engages in a prohibited transaction involving an IRA, only the IRA with respect to which the prohibited transaction occurred will be disqualified.

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[6] See https://casetext.com/case/paschall-v-commissioner-of-internal-revenue.

Exempting Tax Penalties for Premature Distributions by Terminally Ill

Funds allocated by a taxpayer to many retirement accounts are given tax benefits—both deductibility and tax deferral of earnings until distributed—designed to encourage taxpayers to make such contributions as a way of helping to ensure the creation of a retirement fund sufficient to provide the taxpayer with adequate income upon retirement. However, when accessed before reaching age 59 ½, the taxpayer normally is faced with a premature distribution tax penalty unless an exception to that penalty applies.

The Act provides an additional exception to the 10% premature distribution penalty tax in the case of a retirement plan distribution—from either an individual retirement plan or an employer-sponsored plan—to a terminally ill individual. A terminally-ill individual for purposes of the exception is an individual who has been diagnosed with a disease that is expected to result in death within 84 months. This additional exception is effective for distributions made after the date of enactment.

Repealing the Direct Payment Requirement for Health and Long Term Care Insurance Premiums

Prior to enactment of the Act, a retired public safety officer electing to have the premium for health or long term care insurance paid from his or her governmental plan on a pre-tax basis was required to have the premium paid *directly* from the plan to the insurer. The Act changes the requirement that a governmental retirement plan pay health and long term care insurance premiums directly for them to be excluded from a public safety officer's gross income effective upon enactment.

Modifying the Premature Distribution Tax Penalty for Public Safety Officers

Tax law, prior to enactment of the Act, provided for an exception to the 10% tax penalty on premature distributions for law enforcement and public safety officers at age 50. However, eligible law enforcement and public safety officers generally may retire at age 50 or after completing 25 years of service, whichever is earlier. Consistent with that retirement reality, the Act provides that the 10% tax penalty on premature distributions from tax preferred retirement savings plans does not apply to a distribution from a governmental plan to a public safety officer who is at least age 50 or who has at least 25 years of service with the employer sponsoring the plan. This modification became effective on enactment.

The Act also extends the public safety officer exception to the 10% premature distribution penalty tax to corrections officers and others included in the definition of "qualified public safety employee" aged 50 or older who are employees of state and local governments.

Providing Permanent Rules for Qualified Federally-Declared Disasters

Historically, the nation's legislative response to a disaster—wildfires, floods, and other adverse natural phenomena—has been backward-looking: only after a disaster occurs does Congress authorize financial assistance. The Act changes that approach by providing a permanent provision authorizing a distribution of up to $22,000 from an employer-sponsored retirement plan or IRA in the case of a qualified disaster.

The rules governing new plan loans for which individuals affected by a federally-declared disaster may be eligible from plans offering loans are modified with respect to maximum available amounts. Instead of plan loans being limited to the lesser of $50,000 or ½ the present value of the participant's nonforfeitable accrued benefit, new plan loans taken by individuals affected by a federally-declared disaster are limited to the lesser of $100,000 or the present value of the participant's nonforfeitable accrued benefit. In other respects the rules affecting new qualified plan loans remain the same.

The rules for existing plan loans under which borrowers are affected by a federally-declared disaster are also modified. In the case of existing plan loans, however, the modification for borrowers affected by a federally-declared disaster involve the maximum repayment term.

Under the Act, if repayment on an existing plan loan is due from an individual affected by a federally-declared disaster:

- During the 180-day period beginning on the first day of the incident period, the loan repayment due may be delayed one year,

- Subsequent repayments may be adjusted to reflect the delay in the due date and any interest accruing during the delay, and
- The five-year maximum loan period may be disregarded.

In other respects, the rules affecting existing qualified plan loans remain the same.

Eliminating Additional Tax Penalties on IRA Excess Contribution Corrective Distributions

The maximum contribution to an individual retirement account (IRA) in 2025 is $7,000 unless the taxpayer is age 50 or older, in which case the taxpayer may make an additional catch-up contribution of no more than $1,000. The Act exempts an IRA distribution of an excess contribution and earnings allocable to it from the 10% penalty tax on premature distributions.

Modifying RMD Rules Applicable to Special Needs Trusts

Special needs trusts (SNTs) are legal arrangements under which a bank or other trustee holds and manages funds for the benefit of a person with special needs. The Act clarifies that, in the case of a special needs trust established for a beneficiary with a disability, the trust may provide for a charitable organization as the remainder beneficiary. This provision became effective upon enactment of the legislation.

Roth Contributions to SEPs & SIMPLEs Authorized

The Act, effective for taxable years after December 31, 2022, amends the rules governing two individual retirement account-related retirement plans—simplified employee pensions (SEPs) and savings incentive match plans for employees (SIMPLEs)—by authorizing employers to offer employees the ability to treat employer and (in the case of SIMPLEs) employee contributions as designated Roth contributions.

Roth Requirement for Catch-up Contributions

The Roth catch-up contribution provision of the Act, initially scheduled to become effective for taxable years beginning after December 31, 2023, requires that all catch-up contributions to employer-sponsored retirement plans other than SEPs or SIMPLEs made by participants whose wages for the preceding calendar year exceed $145,000 be allocated to a Roth account. In late August 2023 the IRS announced in Notice 2023-62 that the first two taxable years beginning after December 31, 2023, will be regarded as an administrative transition period with respect to the catch-up requirement.

Employer may make Matching and Nonelective Roth Contributions

Although not mandatory, employers may offer plan participants in 401(k), 403(b) and 457(b) plans the ability to allocate some or all of their elective deferrals to a designated Roth account, but no employer contributions could be made to a Roth account. The Act, effective upon enactment, changes that and authorizes defined contribution plans to:

- Make employer matching and nonelective contributions to a plan participant's designated Roth account; and
- Provide employees making qualified student loan payments[7] with the option of receiving matching contributions on a Roth basis.

Matching and nonelective contributions made by a plan sponsor to a plan participant's Roth account are nonforfeitable at the time received and are includible in the participant's gross income.

SECURE Act 2.0 Provisions That Became Effective in 2024

Although the effective dates of many of the SECURE Act 2.0's provisions occured in 2023, several other important Act provisions did not take effect until 2024 or later. The provisions effective that began in 2024 address:

- Indexing of IRA catch-up limits;
- Authorization of emergency expense withdrawals from qualified retirement plans;

[7] Section 110 of the SECURE Act treats repayments of student loans by employees as elective deferrals to the employer's qualified retirement plan for purposes of employer matching contributions.

- Authorization of additional SIMPLE nonelective contributions;
- The Increase In SIMPLE Contribution Limits At Age 50;
- Authorization of starter 401(k) plans for employers with no existing retirement plans;
- Transfer of limited §529 funds to Roth IRAs;
- 401(k) replacement of SIMPLE IRAs;
- Former plan participant involuntary distribution limit;
- Domestic abuse distributions;
- Substantially equal periodic payments (SEPP);
- Lifetime distribution requirements for designated Roth accounts;
- Surviving spouse distribution options; and
- 403(b) hardship distribution rules.

Indexing of IRA Catch-up Limits

Beginning in 2024, the Act indexes catch-up contributions for IRA holders aged 50 and older. The cost-of-living adjustment in any year if not a multiple of $100 is rounded down to the next lower multiple of $100.

Emergency Expense Withdrawals

The Act, beginning after 2023, authorizes limited withdrawals not exceeding $1,000 in any calendar year to cover emergency expenses—meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses—from employer retirement plans and individual retirement accounts. Such distributions are exempt from the 10% premature distribution penalty tax and may be repaid within three years of the distribution. The distribution is nontaxable to the extent repaid.

Additional SIMPLE Nonelective Contributions

The Act, for years after 2023, authorizes employers sponsoring SIMPLE plans to make an additional nonelective contribution. Under that provision, the employer may make nonelective contributions of a uniform percentage (up to the lesser of 10% of compensation or $5,000($5,100 for 2025)) for each employee who is eligible to participate in the plan, and who has at least $5,000 of compensation from the employer for the year.

SIMPLE Contribution Limits Increased

The Act, effective beginning in 2024, provides for increased contribution limits for some employer SIMPLE plans. Pursuant to this provision of the Act, the deferral limits and the catch-up limits (for participants aged 50 or older) are increased by 10%:

- For SIMPLE plans maintained by employers with 25 or fewer employees; and
- For SIMPLE plans maintained by employers with between 26 and 100 employees if the employer increases –
    - Matching contributions from 3% to 4%, or
    - Nonelective contributions from 2% to 3%.

Starter 401(k) & 403(b) Plans Authorized

The Act, effective beginning in 2024, authorizes starter 401(k) plans or 403(b) tax sheltered annuity plans, as appropriate, for employers with no existing retirement plan. The plan provides only for elective deferrals to which employees meeting minimum age and service requirements are automatically enrolled unless they elect out. For 2024 and 2025, participants at any age are limited to contributions of not more than $6,000. Plan participants aged 50 or older also may make catch-up contributions of up to $1,000.

Transfer of Limited §529 funds to Roth IRAs

Beginning in 2024, the Act amends the existing tax law to provide for a limited penalty-free rollover from a §529 plan to a Roth IRA. Under the Act, a designated beneficiary may rollover funds from a §529 plan to a Roth IRA subject to the following rules:

- The §529 plan must have been in force at least 15 years at the time of the rollover;

- The amount distributed in any year cannot be greater than the total amount contributed to the §529 plan—along with the earnings on those contributions—before the five-year period ending on the date of distribution;
- The rolled over amount must be paid in a direct trustee-to-trustee transfer to a Roth IRA maintained for the benefit of the designated beneficiary;
- The amount rolled over in any year cannot exceed the amount to which the designated beneficiary was eligible to contribute to a Roth IRA, less the amount contributed to all IRAs for the taxable year; and
- The total amount rolled over from a §529 plan for all years to a Roth IRA cannot exceed $35,000.

401(k) Replacement of SIMPLE IRAs

The Act, effective for plan years after December 31, 2023, offers employers an opportunity to replace an existing SIMPLE with a safe harbor 401(k) plan. A safe harbor plan, for purposes of the SIMPLE replacement, is a cash or deferred arrangement (CODA)—a 401(k) plan, in other words—that provides:

- In the case of a vested participant who dies –
    - after the annuity starting date, that the accrued benefit payable to the participant is provided in the form of a qualified joint and survivor annuity, and
    - before the annuity starting date and who has a surviving spouse, that a qualified preretirement survivor annuity is provided to the surviving spouse of such participant;
- In the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan, that each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer that is equal to or greater than the benefit he or she would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated);
- That benefits under the plan may not be assigned or alienated; and
- For benefits or contributions not exceeding the limitations of section 415.

Former Plan Participant Involuntary Distribution Limit

The Act increases the $5,000 limit on the amount that may be involuntarily distributed in the case of terminated plan participants to $7,000 applicable to distributions made after December 31, 2023.

Domestic Abuse Distributions

The Act provides, effective in 2024 and later, that a victim of domestic abuse may be eligible to take a penalty-free distribution from an employer-sponsored retirement plan or traditional individual retirement account during the one-year period beginning on the date on which the individual is a domestic abuse victim by a spouse or domestic partner. The aggregate amount which may be treated as an eligible distribution to a domestic abuse victim by any individual is limited to no more than an amount equal to the lesser of:

- $10,000, or
- 50 percent of the present value of the nonforfeitable accrued benefit of the employee under the plan.

Domestic violence is defined in the Act as physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim’s ability to reason independently, including by means of abuse of the victim’s child or another family member living in the household by a spouse or domestic partner. The plan participant who has been a victim of domestic abuse may self-certify that he or she has experienced such abuse within the previous one-year period.

The plan distribution made on account of domestic abuse, while avoiding the premature distribution tax penalty, is includible in the plan participant’s income but may be repaid at any time during the 3-year period beginning on the day after the date on which the distribution was received. Repayments are treated as an eligible rollover contribution made within 60 days of distribution and result in the distribution being tax-free to the extent of repayment.

Clarifying the Substantially Equal Periodic Payments Rule

A pre-59 ½ distribution that is part of a series of substantially equal periodic payments (SEPP) is an exception to the premature distribution tax penalty. However, if the SEPP arrangement is subsequently modified, the penalty tax may reappear.

The Act—effective for transfers, rollovers and exchanges from a qualified retirement plan occurring after December 31, 2023—provides that the exception to the 10% premature distribution penalty tax applicable to SEPP distributions continues to apply in the case of a rollover of the account, an exchange of an annuity providing the payments, or an annuity that satisfies the required minimum distribution rules.

Lifetime Distribution Requirement for Designated Roth Accounts Eliminated

The required minimum distribution (RMD) rules apply to all employer sponsored retirement plans, including profit-sharing plans, 401(k) plans, 403(b) plans, and 457(b) plans. The RMD rules also apply to traditional individual retirement accounts (IRAs) and IRA-based plans such as simplified employee pensions (SEPs), salary reduction simplified employee pension plans (SARSEPs), and savings incentive match plans for employees (SIMPLE) IRAs.

The tax law concerning RMDs appeared to contain an anomaly in that the RMD rules do not apply to Roth IRAs while the owner is alive but DO apply to designated Roth accounts during the account owner's lifetime. The Act eliminates that anomaly effective for distributions after December 31, 2023, and RMDs will no longer apply to designated Roth accounts. Initial RMDs from designated Roth accounts required in 2023 but which may be taken by April 1, 2024 are not affected by the change in the law brought about by the Act.

Surviving Spouse Distribution Options

Upon the death of a qualified plan participant, plan benefits must be distributed to one or more beneficiaries. When the plan participant's surviving spouse inherits the retirement account, he or she has multiple options for receiving the benefits. The Act, effective for calendar years beginning after December 31, 2023, adds another option: the surviving spouse may elect to be treated, for purposes of receiving the plan benefits, as the deceased plan participant.

If a surviving spouse beneficiary elects to be treated as the now-deceased plan participant for purposes of the plan benefits, several advantages—particularly for a beneficiary older than the decedent—may ensue including:

- The ability to delay taking RMDs until the deceased plan participant rather than the surviving spouse would have been age 73. Calculation of RMDs at that time would be based on the surviving spouse's age;
- The calculation of RMDs using the Uniform Lifetime Table rather than the Single Life Expectancy Table (and reducing by 1 each succeeding year); and
- The eligible designated beneficiaries of the surviving spouse (who elected to be treated as the plan participant) would have enhanced options—including the ability to stretch the distributions over life expectancy—for receiving the plan benefits if the surviving spouse dies before commencement of RMDs.

403(b) Hardship Distribution Rules

The Act makes two changes concerning 403(b) tax sheltered annuity hardship distributions effective for plan years beginning after December 31, 2023. Specifically, the Act removes:

- The limitation of hardship withdrawals only to elective deferrals; and
- The requirement to access available plan loans before taking a hardship distribution.

So, the amounts that may be withdrawn as a hardship distribution from a 403(b) in plan years after December 31, 2023 include:

- Contributions made under a salary reduction agreement;
- Qualified nonelective contributions;
- Qualified matching contributions; and
- Earnings credited to the plan participant's account.

Additionally, the requirement that the plan participant access available plan loans to satisfy the need before taking a hardship distribution no longer applies for plan years after 2023.

SECURE Act 2.0 Provisions Effective Beginning in 2025

Participants in most 401(k), 403(b), governmental 457 plans and the federal government's Thrift Savings Plan who are 50 and older generally can contribute up to $31,000 each year, starting in 2025. Under a change made in SECURE 2.0, a higher catch-up contribution limit applies for employees aged 60, 61, 62 and 63 who participate in these plans. For 2025, this higher catch-up contribution limit is $11,250 instead of $7,500. At age 64, the limit reverts back to the standard catch-up amount.

Summary

As discussed in Chapter 5, the SECURE Act 2.0's provisions:

- Offer increased tax credits for small employer plan startup costs and improved participant treatment of military spouses;
- Increase the age at which required minimum distribution (RMDs) must begin to 73;
- Expand the use of SEPs for domestic employees;
- Index IRA catch-up limits based on a cost-of-living adjustment;
- Treat employees' payment of student loans as elective deferrals for employer matching purposes;
- Authorize emergency expense withdrawals from employer-sponsored qualified retirement plans;
- Authorize additional SIMPLE nonelective contributions;
- Increase SIMPLE contribution limits at age 50;
- Authorize starter 401(k) plans for employers with no existing retirement plans;
- Authorize transfer of limited §529 funds to Roth IRAs;
- Remove RMD restrictions on life annuities in qualified plans to provide –
  - annuity payments that may increase annually,
  - lump sum payments, and
  - a final payment at death;
- Eliminate the penalty on partial annuitization to reduce the RMD requirement in the case of an annuity in an eligible retirement plan;
- Reduce tax penalties for RMD insufficiencies;
- Expand the employee plans compliance resolution system (ECPRS) to allow more plan errors to be self–corrected;
- Eliminate the premature distribution tax penalty at the earlier of attainment of age 50 or 25 years of service for private sector firefighters, public safety officers and corrections employees;
- Clarify that repayment of qualified birth or adoption distributions is limited to three years from the day after the date of distribution;
- Clarify the IRA tax penalty statute of limitations;
- Authorize retroactive elective deferrals for sole proprietors;
- Limit penalties for IRA prohibited transactions to the IRA in which the prohibited transaction took place;
- Exempt terminally-ill taxpayers from tax penalties for premature distributions from individual retirement plans or employer-sponsored retirement plans;
- Provide permanent rules for qualified federally-declared disasters;
- Eliminate additional tax penalties on IRA excess contribution corrective distributions;
- Modify RMD rules applicable to special needs trusts;
- Authorize the replacement of an existing SIMPLE with a safe harbor 401(k) plan;
- Increase the $5,000 limit on the amount that may be involuntarily distributed from a qualified plan to $7,000;
- Permit victims of domestic abuse to take a limited penalty-free distribution from an employer-sponsored retirement plan or traditional individual retirement account during the one-year

period beginning on the date on which the individual is a domestic abuse victim by a spouse or domestic partner;

- Authorize repayment of a plan distribution made on account of domestic abuse, and make such repaid distributions tax-free to the extent of repayment;
- Clarify that the exception to the 10% premature distribution penalty tax applicable to SEPP distributions continues to apply in the case of a rollover of the account, an exchange of an annuity providing the payments, or an annuity that satisfies the required minimum distribution rules;
- Eliminate the requirement that a plan participant take RMDs from designated Roth accounts after December 31, 2023;
- Permit a plan participant's surviving spouse to elect to be treated, for purposes of receiving the plan benefits, as the deceased plan participant;
- Change 403(b) tax sheltered annuity hardship distributions effective for plan years beginning after December 31, 2023 by removing a) the limitation of hardship withdrawals only to elective deferrals, and b) eliminating the requirement to access available plan loans before being eligible for a hardship distribution;
- Authorize employee and employer Roth contributions to SIMPLE IRAs and SEPs; and
- Authorize employer matching and nonelective contributions to be allocated to designated Roth contributions, making them nonforfeitable at the time received and includible in the participant's gross income.

Chapter Review

1. Harry became age 73 in 2024. Which of the following choices is correct concerning his need to take required minimum distributions from his traditional individual retirement account?

   A. No RMD is required

   B. RMDs must begin by April 1, 2023

   C. RMDs must begin by April 1, 2025

   D. RMDs are delayed for Harry until December 31, 2025

2. Susan is required to take a $30,000 minimum distribution from her traditional IRA but decided only to take a distribution of $20,000. For what penalty tax, if any, is she liable?

   A. No tax penalty is imposed

   B. $1,000

   C. $2,500

   D. $5,000

Glossary

Active participant	An active participant for traditional IRA purposes is an individual that participates in his or her employer's retirement plan. An employer-sponsored retirement plan includes a pension plan, profit sharing plan, 401(k) plan, 403(b) tax sheltered annuity plan, SEP or SIMPLE.
Alternative minimum tax	A special tax applicable to taxpayers who benefit from the tax law by being afforded special treatment or special deductions and credits. The alternative minimum tax is designed to ensure such taxpayers are required to pay at least a minimum amount of federal tax.
Benchmark plan	A benchmark plan is the second-lowest-cost health insurance plan that would cover a family at the silver level of coverage.
Catch-up IRA contributions	Additional contributions for individuals who have attained age 50 before the close of the taxable year for which the IRA contribution is made.
Citizen or resident test	Although an exception applies in the case of adopted children who meet certain conditions, a taxpayer cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, or U.S. national or a resident of Canada or Mexico.
Deductible moving expenses	Suspended under the Tax Cuts and Jobs Act of 2017 except for certain military moves.
Deductible unreimbursed employee expenses	Suspended under the Tax Cuts and Jobs Act of 2017. These formerly deductible unreimbursed employee expenses include the employee's car expenses incurred in traveling: • From one workplace to another; • In order to meet with customers; • To attend business meetings at a location away from the taxpayer's regular workplace; and • From the taxpayer's home to a temporary place of work.
Dependent	A person who meets either the qualifying child test or the qualifying relative test.
Dependent exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Dependent taxpayer test	If a taxpayer can be claimed as a dependent by another taxpayer, he or she is not permitted to claim another person as a dependent.
Exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Individual mandate	The individual shared responsibility provision of the PPACA—sometimes referred to as the "individual mandate"—imposed a tax penalty for a non-exempt individual's failure to maintain minimum essential coverage. The tax penalty is reduced to zero for years after 2018.

Joint return test	Although certain exceptions apply, the joint return test generally prohibits a taxpayer from claiming as a dependent any married person if the married person's filing status is "married filing jointly."
Main home (first-time homebuyer's credit)	A home in which the taxpayer lives most of the time. It can be a house, houseboat, mobile home, cooperative apartment or condominium.
Minimum essential coverage	Minimum essential coverage refers to basic health insurance coverage that may be provided as a) employer-sponsored coverage, b) individual health insurance coverage, or c) coverage provided under government-sponsored programs.
Personal exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Premature IRA distribution tax penalty	In order to ensure that traditional IRAs are used for the purpose they were designed—specifically to accumulate retirement savings—Congress imposed a limitation on their liquidity by specifying a penalty for premature distributions. Usually, in order to avoid a premature withdrawal penalty, the individual must be at least age 59 1/2 before receiving a distribution from a traditional IRA.
Premium tax credit	A tax credit provided for purchase of a qualified health plan available to individuals who cannot be claimed as a dependent by another person and whose household income is between 100% and 400% of the federal poverty level.
Qualified distribution from Roth IRA	A qualified distribution from a Roth IRA is one that is made no earlier than five years after the year for which the owner made his or her first Roth IRA contribution and: • The individual is age 59 1/2 or older; • The distribution is a qualified first-time homebuyer distribution; • The individual is disabled; or • The distribution is made to a beneficiary on or after the individual's death.
Roth conversion	A qualified rollover contribution from a traditional IRA or any eligible retirement plan to a Roth IRA or rollover from a 401(k) or 403(b) plan to a designated Roth account.
Roth IRA	A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings. Eligibility for a Roth IRA is limited to individuals, regardless of age or qualified plan participation, provided their AGI doesn't exceed certain limits.
Saver's credit	The saver's tax credit is a nonrefundable credit that is designed to encourage certain lower-income individuals to contribute to a retirement savings plan and is limited to the applicable percentage of such contributions but not more than $1,000 per taxpayer.
Short-term coverage gap	A gap in healthcare coverage for less than three consecutive months.
Silver level plan	A silver level plan as one designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan.

Small business tax credit	A nonrefundable tax credit available to an employer equal to a percentage of premiums paid for employee health insurance coverage provided the employer a) paid average annual wages for the tax year of less than $50,000 per full-time equivalent employee (inflation adjusted), b) employed fewer than 25 full-time equivalent employees for the tax year, and c) paid premiums for employee health insurance coverage under a qualifying arrangement, i.e. one in which the employer pays at least 50% of the premium for employee-only coverage.
Standard deduction eligibility	With certain exceptions, any taxpayer generally may elect to take a standard deduction rather than itemize deductions.
Standard mileage rates	Per-mile amounts that a taxpayer may use to deduct car expenses in lieu of deducting the actual expenses incurred by the taxpayer.
Tax deferral	Tax deferral is a favorable tax treatment under which an account’s earnings are not subject to income taxation until distributed.
Traditional IRA	A traditional IRA is a personal retirement savings plan, funded by an annuity or a trust that meets certain requirements and may permit tax-deductible contributions and tax-deferral of earnings.
U.S. national	An individual who is not a U.S. citizen but who owes allegiance to the United States, such as an American Samoan or Northern Mariana Islander who chooses to be a U.S. national rather than a U.S. citizen.

Answers to Review Questions

Chapter 1

Question 1 Feedback

A. Your answer is incorrect. Although not all charitable expenses may be deductible, such expenses are normally deductible. Please try again.

B. Your answer is incorrect. Your answer identifies only the mileage as being deductible when using a personal vehicle for charitable purposes. However, more than just the mileage deduction is available. Please try again.

C. Your answer is correct. Philip's unreimbursed charitable expense deduction is limited to $296. Taxpayers are permitted to deduct personal vehicle expenses when used for charitable purposes. Since Philip traveled 1,400 miles, paid $40 for parking and $60 for tolls and chooses to use the standard mileage deduction, he may deduct $296. The money spent on gas and oil is not deductible, however, since the standard mileage deduction was elected.

D. Your answer is incorrect. Not all charitable expenses associated with a taxpayer's use of his personal vehicle are deductible. In this case, Philip elected to use the standard mileage deduction rather than actual costs. Since he did not choose to deduct actual costs, his expenses for gas and oil are not deductible. Please try again.

Question 2 Feedback

A. Your answer is incorrect. Qualified long term care insurance benefits are includible in the recipient's income to the extent such benefits exceed the greater of a per diem amount which is $420/day in 2025 or the actual costs for the care. Since the amount of benefits received exceeds those limits, some benefits must be included. Please try again.

B. Your answer is correct. Karl need include only $20 per day in his income. Benefits received under qualified long term care insurance policies that may be excluded from income are those benefits not exceeding the greater of:

- The applicable *per diem* limitation for the year; or
- The costs incurred for qualified long term care services provided for the insured.

The applicable *per diem* limitation for 2025 is $420.

C. Your answer is incorrect. It erroneously suggests that the difference between the per diem limitation and the actual expenses, if less, would be includible in income. In contrast, the amount includible is the amount of the benefit that exceeds the greater of the actual costs or the per diem amount. Please try again.

D. Your answer is incorrect. The amount of the difference between the long term care insurance benefits received and the actual expenses incurred for the care is not necessarily includible in income. Only the amount by which such insurance benefits exceed the *greater* of the expenses or the applicable per diem amount needs to be recognized as income. Please try again.

Chapter 2

Question 1 Feedback

A. Your answer is correct. Hank qualifies for a 10% retirement savings contribution tax credit. Since the credit is based on his retirement savings contribution during the year, his saver's credit is $100. ($1,000 x 10% = $100)

B. Your answer is incorrect. The saver's credit for which Hank qualifies is based on his contribution to the 401(k) plan multiplied by the percentage credit to which he is entitled. However, the employer match is not considered in determining the credit. Please try again.

C. Your answer is incorrect. Your answer indicates that Hank's saver's credit would be based on a 20% rate. Although he would qualify for a 20% saver's credit if he filed as head of household, the saver's credit rate for a single taxpayer is not 20%. Please try again.

D. Your answer is incorrect. Although Hank would be eligible for a saver's credit equal to 50% of his $1,000 401(k) deferral if he were married and filed a joint tax return, the saver's credit to which he is entitled as a single taxpayer is less. Please try again.

Question 2 Feedback

A. Your answer is incorrect. Sally's receipt of a saver's credit does not eliminate her deduction of a traditional IRA contribution. Please try again.

B. Your answer is incorrect. The saver's tax credit for which Sally is eligible does not reduce the deductible portion of her traditional IRA contribution. Please try again.

C. Your answer is incorrect. Sally's traditional IRA deduction is not netted by the saver's credit she receives. Please try again.

D. Your answer is correct. Sally may deduct the entire traditional IRA contribution, provided she is otherwise eligible to take the deduction. The retirement savings contribution tax credit, if any, for which a taxpayer is eligible does not affect the tax treatment to which the contribution would normally be subject.

Chapter 3

Question 1 Feedback

A. Your answer is correct. The passage of the American Rescue Plan Act (ARPA) on March 11, 2021 significantly expanded the reach of the health insurance premium tax credit for 2021 and 2022, and this expansion was extended by the Inflation Reduction Act to December 31, 2025. Under prior law, the taxpayer's expected contribution, as the term is used with respect to the tax credit, would have increased—from 1.92% of income for families at less than 133% of the federal poverty level to 9.12% of income for families at 400% of the federal poverty level—as the taxpayer's income increases. ARPA, however, reduced taxpayers' expected contribution to 0% for taxpayers with household incomes of less than 200%, and that level of taxpayer contribution continues through December 31, 2025.

B. Your answer is incorrect. The taxpayer's expected contribution, as the term is used with respect to the tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income increases under the American Rescue Plan Act (extended under the Inflation Reduction Act)—from 2.0% of income for families at 200% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level. Please try again.

C. Your answer is incorrect. Although the taxpayer's expected contribution if he or she has a household income equal to 133% of the federal poverty level in 2025 would have been 1.92% of such income, that was changed by the American Rescue Plan Act for 2021 and 2022 and then extended by the Inflation Reduction Act through 2025. Please try again.

D. Your answer is incorrect. The taxpayer's expected contribution, as the term is used with respect to the tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income increases under the American Rescue Plan Act (extended under the Inflation Reduction Act)—from 2.0% of income for families at less than 200% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level. Please try again.

Question 2 Feedback

A. Your answer is correct. Burger Barn must pay at least $2,500. In order for an employer to be eligible to receive the small employer health insurance premium credit, the employer must pay employee health insurance premiums *under a qualifying arrangement*. Although certain variations may be qualifying arrangements under the PPACA, a "qualifying arrangement" is generally one under which the employer is required to pay a uniform percentage—at least 50%—of the premium for the employee enrolled in health insurance coverage.

B. Your answer is incorrect. Although Burger Barn may elect to pay the entire employee monthly premium for health insurance coverage, it is not required to do so in order to qualify for the health insurance premium credit. Please try again.

C. Your answer is incorrect. Burger Barn is not required to pay any part of the premium for dependent coverage to qualify for the credit. Please try again.

D. Your answer is incorrect. A small employer need not pay any part of the premium for dependent coverage to qualify for the credit. Please try again.

Chapter 4

Question 1 Feedback

A. Your answer is incorrect. Ellen has self-only coverage under her MSA; accordingly, she is limited to a tax-deductible MSA contribution of no more than a specified percentage of her deductible. However, the answer chosen is based on an incorrect percentage. Please try again.

B. Your answer is correct. Ellen can contribute up to $1,852 to her MSA in 2025. An eligible taxpayer with self-only coverage may deduct the contributions he or she makes to an Archer MSA during the taxable year in an amount not to exceed 65% of the annual HDHP deductible.

C. Your answer is incorrect. That is the maximum out-of-pocket permitted under Ellen's high deductible health plan in 2025; however, it is not her maximum contribution. Please try again.

D. Your answer is incorrect. That is the maximum deductible Ellen could have under her Archer MSA in 2025; it is not the maximum contribution permitted her this year. Please try again.

Question 2 Feedback

A. Your answer is incorrect. The tax penalty is not applied to the portion of the distribution that is NOT in excess of the account holder's qualified medical expenses. Only the part of the distribution in excess of those expenses may be subject to it. Please try again.

B. Your answer is incorrect. Your selected answer would apply the tax penalty to the entire distribution. However, Peter's liability is assessed only against the amount of MSA distribution in excess of his qualified medical expenses. Please try again.

C. Your answer is correct. The tax penalty is $600. Only the $3,000 excess distribution is subject to the applicable tax penalty. Archer MSA distributions are includible in income and subject to a 20% income tax penalty when they are used for other than qualified medical expenses and fail to meet specific exceptions.

D. Your answer is incorrect. Although Archer MSA distributions are tax-free when used to pay qualified medical expenses, they are subject to a tax penalty when taken in excess of such expenses unless a specific exception applies. Please try again.

Chapter 5

Question 1 Feedback

A. Your answer is incorrect. Although the SECURE Act 2.0 modified the age at which RMDs must begin, it did not eliminate them.

B. Your answer is incorrect. If Harry had become age 72 in 2022, his RMD would have been required by April 1, 2023. However, Harry became age 72 in 2023.

C. Your answer is correct. The SECURE Act 2.0 increased the age at which RMDs must begin for individuals who attain age 72 after 2022 to age 73. Harry became age 72 in 2023 and is required to take an RMD at age 73 that he may defer until April 1, 2025.

D. Your answer is incorrect. The SECURE Act 2.0 moved the commencement of RMDs to age 73 only for individuals who become age 72 after 2022. Harry became age 72 in 2023.

Question 2 Feedback

A. Your answer is incorrect. Although the SECURE Act 2.0 modified the tax penalty imposed for an RMD insufficiency, it did not eliminate the penalty.

B. Your answer is incorrect. A 10% tax penalty for an insufficiency is imposed in the case of an IRA insufficiency that was timely corrected; however, no timely correction is noted.

C. Your answer is correct. The SECURE Act 2.0 reduced the applicable tax penalty for a failure to take an RMD from 50% of the insufficiency to 25% of the insufficiency. Accordingly, Susan will be liable for a $2,500 tax penalty unless her insufficient distribution is timely corrected.

D. Your answer is incorrect. While the former tax law imposed a draconian 50% tax penalty on any RMD insufficiency, it was modified by the SECURE Act 2.0.

Index

Appendix A

Form 8815 Department of the Treasury Internal Revenue Service (99)	**Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989** (For Filers With Qualified Higher Education Expenses) ➢ Attach to Form 1040	OMB. No. 1545-0074 20XX Attachment Sequence No. 167

Name(s) shown on return	Your social security number

1 (a) Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible education institution	**(b)** Name and address of eligible educational institution

If you need more space, attach a statement.

2	Enter the total qualified higher education expenses you paid in 20XX for the person(s) listed in column (a) of line 1. See the instructions to find out which expenses qualify.	2	
3	Enter the total of any nontaxable educational benefits (such as nontaxable scholarship or fellowship grants) received for 201X for the person(s) listed in column (a) of line 1 (see instructions)	3	
4	Subtract line 3 from line 2. If zero or less, **stop**. You **cannot** take the exclusion.	4	
5	Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds **issued after 1989** that you **cashed during 20XX**	5	
6	Enter the interest included on line 5 (see instructions).	6	
7	If line 4 is equal to or more than line 5, enter "1.000." If line 4 is less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places).	7	
8	Multiply line 6 by line 7	8	
9	Enter your modified adjusted gross income (see instructions). . . 9 **Note:** *If line 9 is $XXX,XXX or more if single or head of household, or $XXX,XXX or more if married filing jointly or qualifying surviving spouse with dependent child,* ***stop.*** *You* ***cannot*** *take the exclusion.*		
10	Enter: $XX,XXX if single or head of household; $XXX,XXX if married filing jointly 10		
11	Subtract line 10 from line 9. If zero or less, skip line 12, enter -0- on line 13, and go to line 14 11		
12	Divide line 11 by: $15,000 if single or head of household; $30,000 if married filing jointly or qualifying surviving spouse with dependent child. Enter the result as a decimal (rounded to at least three places)	12	
13	Multiply line 8 by line 12	13	
14	**Excludable savings bond interest.** Subtract line 13 from line 8. Enter the result here and on Form 1040 . . . .>	14	

Final Exam

Federal Income Tax Changes - 2025

The following exam is attached only for your convenience. To access the official exam for this self-study course, please log into your account online and take the Final Exam from the course details page. A passing score of 70 percent or better will receive course credit and a Certificate of Completion.

1. What is the 2025 standard deduction for a 50 year-old married couple filing jointly, neither of whom is blind?

   A. $9,600

   B. $15,000

   C. 30,000

   D. $22,500

2. Julian is age 60 and paid $1,950 in premiums for qualified long-term care insurance in 2025, how much of the premium can he include in his medical expenses?

   A. $0

   B. $1,095

   C. $1,800

   D. $1,950

3. What is the unified estate tax credit applicable to a taxable estate of $13,990,000 of a decedent dying in 2025?

   A. $1,000,000

   B. $5,541,800

   C. $6,625,800

   D. $13,990,000

4. Gail and Bob are married and file a joint tax return in 2025. They had a $34,000 adjusted gross income and each deferred $2,000 into their employer's 401(k) plan. If they have a $500 income tax liability, what is the amount of their retirement contribution savings credit?

   A. $0

   B. $500

   C. $1,000

   D. $2,000

5. In 2025 Jose and his spouse adopted a 7 year-old child and his 22 year-old special needs brother. If Jose's employer provided $35,000 under its adoption assistance program, what is the maximum amount of the adoption assistance they can exclude from income assuming their combined modified adjusted gross income does not exceed the applicable amount?

   A. $0

   B. $17,280

   C. $34,560

   D. $35,000

6. A qualifying child in 2025, for purposes of the child tax credit, is one who, in addition to meeting other existing requirements, is under the age ___ by the end of the year.
   A. 6
   B. 17
   C. 18
   D. 21

7. The premium for the second-lowest-cost health insurance plan that would cover the family at the silver level of coverage is referred to as _____________and is used to determine any health insurance premium tax credit.
   A. the benchmark plan premium
   B. the bronze plan premium
   C. the qualified plan premium
   D. the essential health plan premium

8. What is the maximum percentage of the paid health insurance premium for which an otherwise eligible non-profit small employer could be eligible as a tax credit in 2025?
   A. 0%
   B. 25%
   C. 35%
   D. 50%

9. At what percentage of the federal poverty level does a taxpayer who is otherwise eligible for a health insurance premium credit under the Affordable Care Act in 2025 lose eligibility because of income?
   A. 150% of the federal poverty level
   B. 200% of the federal poverty level
   C. 400% of the federal poverty level
   D. A taxpayer does not lose eligibility for a health insurance premium credit based on income in 2025

10. How frequently may an Archer MSA be rolled over?
   A. Every 6 months
   B. Every 12 months
   C. Every 24 months
   D. An Archer MSA cannot be rolled over

11. What is the maximum additional health savings account (HSA) contribution that may be made by a 60 year-old participant because of age?
   A. $0
   B. $500
   C. $1,000
   D. $2,500

12. Linda, age 58, contributed $3,500 to her traditional IRA in 2025. If her permitted Roth IRA contribution is not reduced because of her income, what is the maximum amount she can contribute to it in 2025?
    A. $8,000
    B. $7,000
    C. $4,500
    D. $3,000

13. At what age does the SECURE Act 2.0 require a traditional IRA owner to begin receiving required minimum distributions before 2033?
    A. 65
    B. 70 ½
    C. 72
    D. 73

14. Under the SECURE Act 2.0, an eligible retirement plan may provide for annuity payments that increase by a constant percentage, applied annually or more frequently, at a rate less than _______ per year.
    A. 3%
    B. 5%
    C. 7%
    D. 9%

15. Helen was required to take a $20,000 RMD from her 401(k) plan in 2025 but took only $10,000. For what tax penalty, if any, is she liable?
    A. $1,000
    B. $2,500
    C. $5,000
    D. No tax penalty applies to a failure to take an RMD in years beginning in 2023