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Tax & Business Alert

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UNLOCK BIGGER DEDUCTIONS ON RENTAL REAL ESTATE

Many rental property owners are surprised to learn that federal tax law often restricts their ability to deduct losses, treating most rental activities as passive unless specific requirements are met. But if you can qualify for the real estate professional exception, you may be able to turn otherwise suspended losses into immediate tax savings.

THE REAL ESTATE PROFESSIONAL ADVANTAGE

For federal tax purposes, rental real estate losses are usually treated as passive, meaning they can be deducted only against passive income, such as profits from other rental properties. If you don't have enough passive income, your unused losses are suspended and carried forward. Those suspended losses can be deducted later, once you have sufficient passive income or when you sell the property that generated them.

However, there's a big exception for real estate professionals. If you qualify, a rental real estate loss potentially can be classified as a nonpassive loss.

To be eligible for the real estate professional exception:

- You must spend more than 750 hours during the year delivering personal services in real estate activities in which you materially participate, and
- Those hours must be more than half the time you spend delivering personal services (in other words, working) during the year.

The next step to being able to claim a nonpassive loss is determining if you have one or more rental properties

in which you materially participate. Generally, you need to pass one of the following to meet the material participation test for a rental real estate activity:

1. Spend more than 500 hours on the activity during the year.
2. Spend more than 100 hours on the activity during the year and make sure no other individual spends more time than you.
3. Make sure the time you spend on the activity during the year constitutes substantially all the time spent by all individuals.

DON'T MEET THE REQUIREMENTS?

If you don't meet the real estate professional rules, you may still deduct certain rental losses currently through limited exceptions:

Small landlord exception. If you own at least 10% of the property and actively participate, you may be able to treat up to $25,000 of losses as nonpassive. (Properties owned via limited partnerships don't qualify.) This exception begins to phase out when adjusted gross income (AGI) exceeds $100,000. It's eliminated when AGI reaches $150,000.

Seven-day rental rule. If the average rental period is seven days or less, the activity is treated as a business, not real estate. Passing a material participation test makes losses nonpassive.

30-day rental with services. If the average rental period is 30 days or less and significant personal services are provided, the activity is also considered to be a business. Losses may be treated as nonpassive if a material participation test is met.

There are other ways to meet the material participation test, but these three are typically the easiest. Note, also, that participation by your spouse is included for material participation purposes, although it's not included for the real estate professional test.

If you qualify as a real estate professional and meet the material participation test for a property, losses from the property are treated as nonpassive losses that you can generally deduct in the current year.

MAKE THE MOST OF YOUR TAX BENEFITS

With proper documentation and knowledge of available exceptions, you can better position yourself to reduce your tax liability. Professional guidance can assist. Contact us today. ■

ESTATE PLANNING FOR 2026 AND BEYOND

Until recently, much tax uncertainty surrounded estate planning. The Tax Cuts and Jobs Act doubled the federal gift and estate tax exemption to an inflation-adjusted $10 million, but only for 2018 through 2025. Fortunately for those with larger estates, in 2025, legislation was signed into law that increases the exemption to $15 million for 2026, with annual inflation adjustments going forward — and no expiration date. This provides more estate planning certainty, but not complete certainty. Lawmakers could still reduce the exemption in the future.

If your estate is large, transferring assets to loved ones or trusts sooner rather than later may be beneficial. It can lock in tax savings should the exemption be reduced in the future.

BUILDING IN FLEXIBILITY

What if you're not currently ready to transfer significant amounts of wealth to the next generation? There are techniques you can use to take advantage of the higher exemption amount while retaining some flexibility to access your wealth. Here are two ways to build flexibility into your estate plan:

Spousal lifetime access trust (SLAT). If you're married, a SLAT can be an effective tool for removing wealth from your estate while retaining access to it. A SLAT is an irrevocable trust, established for the benefit of your children or other heirs, that permits the trustee to make distributions to your spouse if needed, indirectly benefiting you as well.

So long as you don't serve as trustee, the assets will be excluded from your estate and, if the trust is designed properly, from your spouse's estate as well. For this technique to work, you must fund the trust with your separate property, not marital or community property.

Keep in mind that if your spouse dies, you'll lose the safety net provided by a SLAT. To reduce that risk, many couples create two SLATs and name each other as beneficiaries. The arrangement must be planned carefully to avoid running afoul of the "reciprocal trust doctrine," which could cause the arrangement to be unwound and the tax benefits erased.

Special power of appointment trust (SPAT). A SPAT is an irrevocable trust in which you grant a special power of appointment to a spouse or trusted friend. This person has the power to direct the trustee to make distributions to you.

Not only are the trust assets removed from your estate (and shielded from gift taxes by the current exemption), but so long as you're neither a trustee nor a beneficiary, the assets will enjoy protection against creditors' claims.

BALANCING TAX SAVINGS WITH CONTROL

Many other estate planning strategies are available to minimize gift and estate taxes as well as other taxes, such as income taxes, while maintaining your own financial security. Contact us to discuss what's appropriate for your particular situation and goals. ■

TAKING CONTROL WITH SELF-DIRECTED IRAS

You have until April 15, 2026, the tax filing deadline, to make 2025 contributions to an IRA. If you're seeking more than the traditional mix of stocks, bonds and mutual funds, a self-directed IRA offers greater autonomy and diversification. But it also introduces added complexity.

PUT INVESTMENT DECISIONS IN YOUR HANDS

A self-directed IRA is simply an IRA that provides greater control over investment decisions. Traditional and Roth IRAs typically offer a selection of stocks, bonds and mutual funds. Self-directed IRAs (available at certain financial institutions) offer greater diversification and potentially higher returns by permitting you to select virtually any type of investment, including real estate, closely held stock, precious metals and commodities (such as lumber, oil and gas).

A self-directed IRA can be a traditional or Roth IRA, a Simplified Employee Pension (SEP), or a Savings Incentive Match Plan for Employees (SIMPLE). But be aware that additional rules and different deadlines apply to SEP and SIMPLE IRAs.

STEER CLEAR OF TAX MISTAKES

To avoid pitfalls that can lead to unwanted tax consequences, exercise caution with self-directed IRAs. The most dangerous traps are the prohibited transaction rules. They're designed to limit dealings between an IRA and "disqualified persons," including account holders, certain members of their families, businesses controlled by account holders or their families, and certain IRA advisors or service providers.

Among other things, disqualified persons can't sell property or lend money to the IRA, buy property from the IRA, provide goods or services to the IRA, guarantee a loan to the IRA, pledge IRA assets as security for a loan, receive compensation from the IRA, or personally use IRA assets. This makes it nearly impossible for an IRA owner to actively manage a business or real estate held in a self-directed IRA.

The penalty for engaging in a prohibited transaction is severe: The IRA is disqualified, and its assets are deemed to have been distributed on the first day of the year in which the transaction took place, subject to income taxes and potentially penalties.

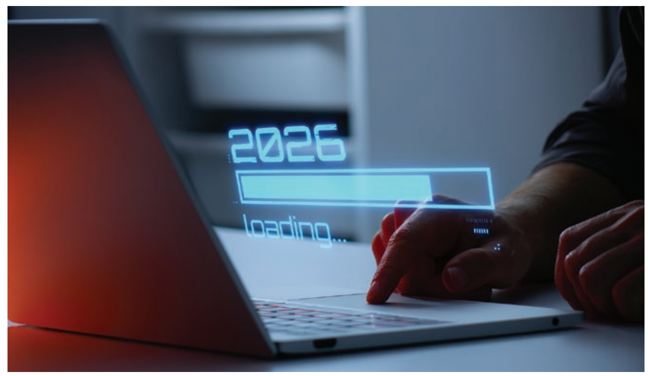
IS IT THE RIGHT FIT?

A self-directed IRA can be a powerful tool if you're looking to diversify beyond traditional markets. But it's not a strategy to adopt lightly. Knowing the rules, risks and responsibilities is crucial before moving retirement assets into alternative investments. Have questions? Contact us. ■

2026 TAX LAW CHANGES FOR BUSINESSES

Here's a sampling of some significant tax law changes going into effect this year:

- Increase of the Section 179 expensing limit to \$2.56 million and the phaseout threshold to \$4.09 million (up from \$2.5 million and \$4 million, respectively, for 2025).
- Expansion of the income ranges over which the Section 199A qualified business income deduction limitations phase in, generally to \$201,750 – \$276,750 (up from \$197,300 – \$247,300 for 2025), double those amounts for married couples filing jointly.
- Reduction of the threshold for the excess business loss limitation to \$256,000 (down from \$313,000 for 2025), double those amounts for joint filers.
- Increase of the limitation on the use of the cash method of accounting to \$32 million (up from \$31 million for 2025).
- New option to claim the family and medical leave credit for up to 25% of insurance premiums paid or incurred during the tax year for active family and medical leave coverage instead of claiming the credit for up to 25% of eligible family and medical leave compensation paid.



- Elimination of certain clean energy incentives, such as the Section 179D deduction for energy-efficient commercial buildings and the alternative fuel vehicle refueling property credit (both after June 30, 2026).

Contact us to discuss how these or other changes might affect your business. ■