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Tax & Business Alert

NOVEMBER 2026

TIME COLLEGE EXPENSES FOR TAX SAVINGS

Higher education can be hard on your wallet. Fortunately, federal tax breaks may ease the burden. As year end approaches, carefully timing qualified expenses and coordinating education tax credits, scholarships and Section 529 plan withdrawals may help your family maximize these tax-saving opportunities.

CONSIDER YEAR-END PAYMENTS

For education credits, timing is critical because expenses generally count in the year they're paid. Qualified expenses paid in 2026 can support a 2026 American Opportunity Tax Credit (AOTC) or Lifetime Learning Credit (LLC) if they're for an academic period beginning in 2026 or during the first three months of 2027.

That rule may create a year-end planning opportunity. Suppose a college's spring semester begins in January 2027, and tuition is due in January. Paying the bill in December 2026 could make the eligible expense available for a 2026 credit rather than a 2027 credit.

The AOTC equals 100% of the first $2,000 of qualified tuition and related expenses and 25% of the next $2,000, for a maximum credit of $2,500 *per eligible student* per year. The LLC equals 20% of up to $10,000 of qualified expenses, for a maximum $2,000 credit *per tax return* per year. Additional eligibility requirements apply, and the credits begin to phase out when modified adjusted gross income (MAGI) exceeds $80,000 and are eliminated at MAGI of $90,000 (twice these amounts for married couples filing jointly). Married taxpayers filing separately aren't eligible.

If an income spike in 2026 will cause your credit to be eliminated this year but you expect to be fully eligible next year, consider the opposite approach: Hold off on paying the spring semester tuition until January 2027.



COORDINATE EDUCATION BENEFITS

Because the same education expense generally can't support more than one federal tax benefit, careful coordination is important. For example, you can't use the same $4,000 of tuition both to claim the AOTC and to support a tax-free 529 plan distribution.

If a student has enough eligible expenses, consider reserving tuition and other credit-eligible costs for an education credit and using 529 plan funds for other

THE TAX-SAVING POWER OF 529 PLANS

Section 529 plans provide a valuable tax-advantaged way to fund education expenses. Although contributions aren't deductible for federal purposes, any growth is tax-deferred. Distributions used to pay qualified expenses are income-tax-free for federal purposes and potentially also for state purposes.

A 529 plan can cover a broader range of college costs than education tax credits can. Qualified 529 plan expenses generally include tuition, required fees, books, supplies and equipment, as well as room-and-board costs for students enrolled at least half time. Education credits generally don't cover room and board.

qualified expenses that don't support the credit. Before taking a 529 plan distribution, also account for scholarships and grants, and make sure you have sufficient qualified expenses in the same tax year as the withdrawal. If distributions exceed adjusted qualified expenses, part of the earnings portion will be taxable and may also be subject to a 10% penalty.

SEEKING GUIDANCE

Before making a year-end tuition payment or 529 plan withdrawal, total the student's expected expenses, scholarships and other educational assistance. Then determine which expenses should be assigned to each available tax benefit. Contact us to discuss how the rules apply to your family. ■

NAVIGATING THE EXCESS BUSINESS LOSS LIMIT

If your business is anticipating a loss in 2026, you may expect to use that loss to offset income from other sources on your individual tax return. But if you operate as a sole proprietor or a pass-through entity, the excess business loss limitation could prevent you from deducting the full amount currently. The limit has been reduced for 2026, making year-end tax planning especially important this year.



HOW THE LIMIT WORKS

A loss occurs when a business's expenses and other deductions for the year exceed its revenue. Such losses generally can offset a sole proprietor's or pass-through business owner's income from other sources — such as salary, self-employment income, interest, dividends and capital gains — only up to the annual excess business loss limit.

Before applying that limit, you must factor in any other restrictions that may reduce your deductible business loss. These include basis, at-risk and passive activity loss rules.

If you still have a deductible loss after those rules have been applied, the excess business loss limit kicks in. For 2026, the current deduction limit for eligible business losses is $256,000, or $512,000 for married couples filing jointly — *down* from $313,000 and $626,000, respectively, for 2025. The 2026 amounts will be adjusted for inflation starting in 2027. (If you own multiple businesses, the calculation considers your combined business activities rather than applying a separate limit to each business.)

Any loss disallowed under this rule isn't lost. Instead, it's treated as a net operating loss (NOL) carryover to the following tax year. NOLs generally can be carried forward indefinitely, though the NOL deduction generally can't exceed 80% of taxable income for the year, subject to various exceptions and transition rules.

THE LIMIT IN ACTION

Suppose you're single and the sole owner of a pass-through business that generates a $600,000 loss in 2026, and you have no income or gains from other businesses. Assume the entire loss is otherwise

deductible after applying the relevant basis, at-risk and passive activity loss rules.

Under the excess business loss limitation, you can deduct only $256,000 of the business loss currently. The remaining $344,000 is an excess business loss and is treated as an NOL carryover. So even if you have enough nonbusiness income in 2026 to absorb the entire $600,000 loss, you can't use all of it to reduce your 2026 taxable income. But you'll have an NOL you can deduct from your income in future years until the NOL is used up (subject to the various applicable rules and limits).

PLANNING BEFORE YEAR END

If your business is expecting a substantial loss, consider estimating the impact before December 31. The timing of business income, gains and deductible expenses could affect the amount subject to the limitation. Other tax provisions also may affect your business loss deduction. Contact us to determine how the rules apply to your situation and discuss year-end planning opportunities. ■

SHOULD YOUR BUSINESS DONATE EXCESS INVENTORY?

If your business has inventory that's unlikely to sell, donating the goods to charity before year end could help you clear space, support a charitable cause and potentially generate a tax deduction. But inventory contributions are subject to special rules, so consider the tax consequences before donating.

THE BASICS

Inventory is generally considered ordinary-income property. If donated inventory was included in your opening inventory for the year, your charitable deduction generally is limited to the *lesser* of its tax basis or fair market value (FMV). You generally must adjust your inventory and cost-of-goods-sold calculations so you don't deduct the donated inventory twice.

If you donate items in the same year you bought them and their cost has already been reflected in cost of goods sold or otherwise recovered under your accounting method, you generally can't also claim a charitable deduction for donating the inventory itself.

Keep in mind that slow-moving, obsolete or damaged goods may be worth less than their original cost, potentially reducing the deduction because it's generally limited to the lesser of basis or FMV. So consider the goods' current FMV when deciding whether donating them makes financial sense.

ENHANCED DEDUCTIONS

Certain donations may qualify for an enhanced deduction. For example, in some cases C corporations may be eligible to deduct the lesser of 1) the inventory's basis plus one-half of its appreciation or 2) twice its basis. These higher limits may apply when qualifying inventory is donated to certain charitable organizations for the care of the ill, needy



or infants. Specific requirements apply, including rules governing how the charity uses the property and a written statement from the charity. Special enhanced-deduction rules also apply to donations of apparently wholesome food inventory and can benefit businesses other than C corporations.

DOCUMENTATION AND FILING

Proper documentation is essential. Generally, you'll need a contemporaneous written acknowledgment from the charity.

You also may need to file Form 8283, "Noncash Charitable Contributions," and obtain a qualified appraisal. Form 8283 filing requirements can vary for donated inventory, and certain inventory is exempt from the qualified appraisal requirement.

YEAR-END CONSIDERATIONS

Before donating excess inventory, determine its basis and FMV and confirm that the recipient and intended use satisfy applicable requirements. We're available to help you evaluate the potential deduction and documentation requirements and determine whether a year-end donation fits your business's tax strategy. ■

REVIEW YOUR HEALTH CARE FSA BEFORE YEAR END

If you have an employer-sponsored Flexible Spending Account (FSA), now is a good time to check your balance. FSAs allow you to pay eligible health care expenses with pretax dollars, but they're generally subject to a "use-it-or-lose-it" rule. Here's what you need to know.

AVOID FORFEITING UNUSED FUNDS

Before rushing to spend your balance, review your employer's plan. For plan years beginning in 2026, the plan may allow you to carry over up to $680 of unused funds to the 2027 plan year. Alternatively, it may provide a grace period of up to 2½ months after the plan year ends to incur eligible expenses. For a 2026 calendar-year plan that has a grace period, that period ends March 15, 2027. A plan can't offer both a carryover and a grace period — only one or neither.



If you have a calendar-year plan and expect to forfeit funds, consider using the funds for eligible expenses before December 31, 2026. These may include deductibles and co-payments, dental and vision care, medications, and certain medical supplies. Consult your plan for eligible expenses and reimbursement requirements.

PREPARE FOR 2027

Year end is also a good time to review your FSA election. Compare how much you contributed for 2026 with what you spent on eligible expenses. Then consider your anticipated health care needs for 2027. Using your spending as a guide can help you maximize the FSA's pretax benefits while reducing the risk of setting aside more than you can use. ■

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