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Tax Talk

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Dear Clients and Friends,

The pendulum swings back and forth in American politics, and on November 3 it swung hard back to the left. From a tax perspective, at the Federal level (where we will still have divided control) this probably means very little meaningful tax legislation will be enacted in the near-term, but, depending on the outcome of the 2028 elections, may portend higher taxes and greater funding for the IRS in 2029. At the state level, the "tax the rich" movement continues to gain momentum (e.g. Colorado just voted to increase its rate on higher incomes from 4.4% to 8.4%), but constitutional issues and the relative ease with which individuals and companies can relocate within the U.S. likely will somewhat limit these proposals (e.g. Florida and Texas, with no individual income tax, continue to be very attractive to high income and high net worth individuals).

Those who took advantage of the Qualified Opportunity Zone tax deferral included in late 2017 tax legislation face a day of reckoning soon, as 85% - 90% of the gain deferred must be recognized on December 31, 2026. We will discuss that in this issue, along with an update on the IRS' pursuit of conservation easements, charitable gifting strategies, taxation of carried interest, estate planning to take advantage of the income tax basis step-up rule, a change in California sales taxation of electronically-delivered software, a profile of one of our members, and our usual annual roundup of changes in amounts indexed to inflation.



Kent Bridges, Managing Partner

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges

Deferred QOZ Gain Must be Recognized in 2026

Included in *The Tax Cuts and Jobs Act* legislation enacted in late 2017 was new Internal Revenue Code Section 1400Z-2, "Special Rules for Capital Gains Invested in Opportunity Zones". These rules, often referred to as the "Qualified Opportunity Fund", "QOF", "Opportunity Zone", or "OZ" rules provided taxpayers who had recognized a capital gain the opportunity to defer tax on the gain for up to 8 years, the opportunity to have up to 15% of that gain permanently escape tax, and the opportunity to permanently avoid any tax on the appreciation in the value of the reinvested gain; provided the gain was invested in a "qualified opportunity zone" and you met the other requirements of the statute. The purpose of this tax incentive was to encourage investment in economically depressed areas.

The potential tax benefits of reinvesting gain into a QOF were: (1) you could elect to defer tax on the gain until the earlier of the date you dispose of your ownership in the QOF or 2026; (2) if you hold your ownership in the QOF for at least 5 years you can permanently exclude 10% of the deferred gain or if you hold for at least 7 years 15% of the gain; and (3) if you hold your ownership for at least 10 years, then you can exclude from tax 100% of the appreciation in value of your investment in the QOF.

The QOF program was scheduled to expire for investments made after 2026, but the One Big Beautiful Bill Act (OBBBA) enacted in 2025 made it permanent. However, the OBBBA did not change the rule that 85% or 90% (depending on whether held at least 7 years or 5 years, respectively, as of December 31, 2026) of the original gain deferred must be recognized in taxable income on December 31, 2026. If the value of the QOF investment has decreased, you can base the gain recognition on the current value rather than the amount of gain originally deferred.

Taxpayers who have taken advantage of the QOF deferral and still hold the QOF investment should factor this required gain recognition into their 2026 tax planning and 4th quarter 2026 estimated tax payments.

Charitable Gifting Strategies

Many of our clients are quite philanthropic. Fortunately, the tax law greatly rewards philanthropy. Here is a brief synopsis of the general rules and suggested strategies.

Cash donations – The most common and straightforward type of charitable gift is a gift of cash to a public charity (e.g. your church, alma mater, Red Cross, etc.). A cash donation can offset up to 60% of your income for the year, with any excess carrying forward for up to 5 years.

Noncash donations – You can also claim a tax deduction for the fair market value of property other than cash which you donate to charity. This can include for example clothing and furniture. However, the greatest tax benefit typically comes from donating appreciated property like stocks or real estate. Let's assume that you have some highly appreciated stock which you are about to sell. If instead you make a donation of the stock to charity, you avoid paying tax on the gain and you get a tax

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Member in the Spotlight — Laura Niklasson

This month represents Laura Niklasson's 32nd year with Bridges & Dunn-Rankin. Laura joined the firm in 1994 as the first administrative employee of the firm. She was the perfect person to take on the challenge of a fledgling start-up, bringing order to the chaos of a new firm with few administrative policies and procedures. In her role as Office Manager, Laura handles the firm's internal accounting, human resources, vendor relations, network and information technology, office automation and equipment, and various other duties, while also assisting many of our clients with their accounting and payroll-related needs.

While Laura's official title has long been Office Manager, over the years her role has really evolved more to be IT Manager, as she has primary responsibility for our network reliability and security and all computer hardware and software. Given the extreme importance of IT in our business, this makes Laura the most mission-critical person in the firm.

Laura, a native of Florida, holds a B.A. in International Relations from Agnes Scott College. She is a black belt in Aikido and she and husband Rob are the proud parents of three young adult children and are members of First Presbyterian Church of Douglasville.

Bridges & Dunn-Rankin is proud to have Laura Niklasson as a member of our firm.



Laura E. Niklasson

Charitable Gifting Strategies — continued

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deduction for the value of the property; a double benefit. The potential tax savings in this case can be up to 60% or more of the value of the property. In other words, your favorite charity can get a dollar at an after-tax cost to you of potentially 40 cents or less. In order to get a tax deduction for the full value of the property, you must have held the property for at least one year and the nature of the property must be of the sort that if you sold it you would have a long-term capital gain. Also, unless the property is publicly-traded stock, you will have to get a qualified appraisal. The amount of your deduction for a donation of appreciated property is limited to 30% of your income, with any excess carrying forward for up to 5 years.

Conservation easements – Let's assume you have a tract of land which could potentially be developed into a residential subdivision, but you don't want to ever see the land developed, desiring for it to forever remain in its beautiful natural state. If you are willing to grant a perpetual conservation easement to a qualified organization (effectively giving up your rights to develop the property), then the tax law will reward you with a tax deduction. The amount of the deduction is the difference between the appraised value of the land assuming its highest and best use value before the granting of the conservation easement and its value after granting the conservation easement. Be careful here, however. The IRS perceives that there has been a lot of abuse in this area and carefully scrutinizes deductions for conservation easements.

Strategies where carryforwards may expire unused – As noted above, the deduction for cash donations is limited to 60% of your income and the deduction for appreciated property is limited to 30% of your income. In each case, these amounts carry forward for up to 5 years, subject each year to these same percentage limitations. Tax rules provide that you must utilize current year donations before dipping into your carryforwards. Accordingly, for taxpayers who regularly make donations that are very significant compared to their taxable income, there can be a risk of carryforwards expiring unused. In these situations, we sometimes suggest that a client consider bunching significant donations into one tax year, then skip a year in order to be able to dip back into the carryforwards (on a FIFO basis) before they expire. In other cases, it may make sense to accelerate income into the final year of a carryforward. In situations where there is concern that the IRS might challenge the value placed on a gift of appreciated property, having a carryforward can actually be comforting as it can provide some potential cushion against such a challenge.

Private foundations – For those who wish to get a tax deduction today (e.g. potentially matching the deduction against a large gain), but wish to effectively control the money for a long period of time (perhaps even leaving a legacy for future generations to manage), a private foundation can work well. With a private foundation, you get a tax deduction when the money goes into the foundation, but are typically only required to gift 5% of the value of the foundation's assets to charities each year. One should be aware that the annual return filed by a private foundation (Form 990-PF) is a publicly-available document, so the assets, income, expenses and annual giving of your private foundation can be seen by anyone.

Donor-advised funds – Private foundations are subject to a number of limitations, require some upfront set-up cost and on-going administrative effort, and (as noted above) must file an annual return that becomes a publicly-available document. For those who want to get their tax deduction now and have some time to decide which charities will benefit, but don't want the cost, hassle, limitations or public disclosure of a private foundation, a "donor-advised fund" can be the answer. These organizations are technically public charities, and with a gift to them you are relinquishing control over the funds. However, these organizations have a long history of following the advisement of their donors. When you make a gift to a donor-advised fund, they set up an account in your name with the assets. Whenever you want to make a gift to charity, you provide them with the name of the organization and amount and they send a gift of that amount to the charity with a letter indicating that the gift is from you. You can continue this process so long as a balance remains in your account.

Charitable remainder trust – Plan to leave assets to charity at your death, but need an income stream from such during your life? A "charitable remainder trust" (CRT) can be the answer for you; particularly if you have highly appreciated property you are about to sell. Instead of selling the property yourself, you gift it to your CRT and the CRT sells it and avoids paying tax on the capital gain. Also, you get a tax deduction for the net present value that will go to charity at your death. The CRT makes

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Charitable Gifting Strategies — continued

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distribution to you each year, which are generally subject to tax (often at capital gains rates, depending on the income of the CRT).

Estate tax benefits – The Federal estate tax can potentially consume a substantial percentage of your estate. However, any amounts gifted to charity during your lifetime or at your death escape the estate tax.

Substantiation requirements – Under present law, you must have in hand at the time you file your income tax return a "donee acknowledgement statement" for any gift of $250 or more. Your cancelled check alone is insufficient documentation.

Qualified charitable distribution from IRA – Individuals age 70 ½ and older can make a "qualified charitable distribution" (QCD) direct from their IRA to a charitable organization, without such amount being included in their income. The advantages of such donations (versus taking a distribution from your IRA then making the charitable gift) include: (a) you avoid increasing your adjusted gross income, which can cause social security benefits to become taxable and also result in limitations on itemized deductions and cause Medicare premiums to be higher; (b) you avoid the percentage limitations on charitable donation deductions; and (c) if you do not otherwise have sufficient deductions to itemize you avoid wasting your standard deduction. The amount is limited to $111,000 per year (2026 amount and likely to increase for 2027) and the IRA distribution cannot be to a private foundation or donor-advised fund. Each spouse age 70 ½ or older with sufficient IRA funds can take advantage of this, such that the combined amount for a married couple can potentially be as high as $222,000 per year.

IRS Ends Uniform Settlement Offer for Conservation Easements

In the May issue of our newsletter, we reported that on May 13 the IRS announced that it was going to try and settle its backlog of conservation easement cases en masse with a global settlement offer. A little over 3 months later (on August 19), the IRS announced that it was concluding the uniform settlement offer effective immediately and "will not issue any additional uniform settlement letters under the May 13 program". The IRS further stated that "Any deadlines for accepting previously issued offers are withdrawn. Prior elections to participate in the May 13 settlement framework will remain in effect and will be processed in accordance with their terms."

The IRS explained its decision as follows: "Experience administering the initiative, together with engagement with taxpayers, has shown that standardized, unsolicited settlement letters on a rolling basis, each with a fixed response period, are not well suited to the full range of conservation easement cases. Partnership agreements, insurance arrangements, procedural posture, and other circumstances may differ materially and affect when and how taxpayers evaluate settlement."

The IRS also announced that it has established an Office of Conservation Easements stating "The Office will centralize technical expertise and coordinate policy, enforcement, and case-resolution strategy across the IRS and with the Office of Chief Counsel. It will support engagement with taxpayers, practitioners, conservation and historic preservation organizations, and other stakeholders. The Office will also work with Treasury to evaluate administrative and legislative options that advance Congress's conservation and historic preservation objectives, promote consistent tax administration, and strengthen valuation integrity."

Taxation of Carried Interest

For almost 20 years there has been talk of "shutting down the carried interest loophole". So, what is "carried interest" and what are the tax rules today?

"Carried interest", also referred to as a "future profits interest" (mostly by tax professionals) or a "promote" (mostly by real estate developers), generally refers to an agreement whereby a service provider receives a share of the future profits of a partnership and/or share of the future appreciation in value of its business or assets in exchange for the performance of services. So long as what the service provider is receiving is only future profits and appreciation (and none of the existing capital value), tax law going back to the *Campbell* case in 1990 (and later endorsed by the IRS in Rev. Proc. 93-27 and Rev. Proc. 2001-43) provided that the service provider did not have any compensation income from the receipt of the profits interest and could get his or her holding period running for possible long-term capital gain treatment.

Stories of billionaire hedge fund managers on Wall Street having most of their compensation taxed as long-term capital gain (rather than ordinary income) led to an outcry to "shut down the loophole". After a decade of proposals to address this, IRC 1061 was enacted in late 2017.



Brock W. Bullard, CPA

IRC 1061 provides that an "applicable partnership interest" (API) must be held at least three years (rather than the usual one year) in order to qualify for long-term capital gain treatment. If the API is held for less than 3 years, then any gain which would otherwise be long-term capital gain is treated as short-term capital gain.

An "applicable partnership interest" is a partnership interest transferred in connection with the performance of substantial services in a business the activity of which is raising or returning capital and investing in or disposing of securities, commodities, options, derivative contracts, cash or cash equivalents and real estate held for investment.

The rules apply only to portfolio investment on behalf of third-party investors, and do not apply to a partnership interest where one's return is commensurate with the capital they have invested or the amount included in their income under IRC 83.

Estate Planning to Take Advantage of the Income Tax Basis Step-Up

Traditional estate planning has historically been focused on moving assets out of the taxable estate in order to avoid the Federal estate tax which can be as high as 40% of the value of one's assets at death. The downside to this is that appreciated assets outside of one's estate do not qualify for the income tax basis step-up to date of death value provided by IRC Section 1014. Is this a necessary trade-off? Or can one have their cake and eat it too? Well, sometimes yes and possibly yes, respectively.

Over the past 30 years, the estate tax exemption equivalent has increased from $600,000 to $15,000,000. The rules have also been changed to permit portability of the exemption between spouses, such that a married couple now has an effective combined exemption of $30,000,000. This (combined with the fact that amounts left to charity are not subject to the estate tax and the fact that life insurance in an irrevocable life insurance trust is generally outside of the taxable estate) means that the overwhelming vast majority of Americans (more than 99%) will not be subject to the estate tax, and the focus of estate planning from a tax perspective for them should probably be on their heirs enjoying the step-up in income tax basis to fair market value at date of death (rules which apply regardless of whether or not any estate tax is actually incurred).

For individuals whose net worth will likely exceed the estate tax exemption, good planning may mean keeping in their taxable estate those assets which have value substantially in excess of income tax basis, while moving outside of the taxable estate assets with little appreciation.

Many of our clients have formed an Intentionally Defective Grantor Trust (IDGT), which is a trust that is respected for purposes of creditor protection and estate tax minimization, but which is ignored for income tax purposes (until the death of the grantor). Typically, the intentional "defect" which causes the irrevocable trust to be a grantor trust is the right of substitution, whereby the grantor has retained the right to substitute assets of equal value (e.g. give the trust cash or a promissory note in exchange for an asset held by the trust). This provision can be very beneficial from the perspective of enabling the grantor to move back into his or her estate a low-basis/high-value asset that will likely be held until death and achieve step-up in tax basis to the value on date of death (enabling the grantor's heirs to sell the asset without incurring any income tax on the appreciation in value), without increasing the amount of the taxable estate or triggering any income tax on the transfer.

California to Subject Software Delivered Electronically to its Sales Tax

Historically, California has not subjected to its sales tax (which can be 10% or higher with local add-ons) the sale of software which is delivered electronically. Effective January 1, 2027, this will change with all sales of pre-written software (including that delivered electronically or access remotely on-line such as cloud-hosted and SaaS) treated as tangible personal property subject to sales tax.

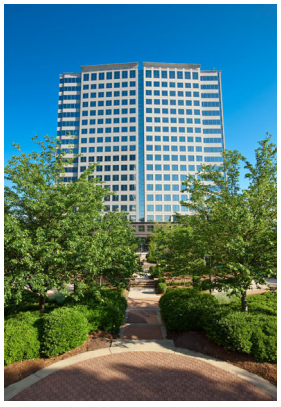
Custom-developed software will remain exempt, as will specified digital assets, audio and audiovisual works, digital books, video games, visual artwork and digital infrastructure.

Quick Notes

- For 2027, the Social Security wage base increases to $192,300, the maximum wage base for computing retirement plan contributions increases to $375,000, the maximum benefit amount for a defined benefit plan increases to $300,000, the maximum amount which may be contributed to a defined contribution plan increases to $75,000, the maximum permissible elective 401(k) deferral increases to $25,500 ($34,000 for those age 50 and older and potentially $37,250 for those 60 - 63), and the maximum permissible contribution to an IRA is projected to remain at $7,500 ($8,600 for those age 50 and older). Also, for 2027, the maximum amount which can be contributed to an HSA plan increases to $4,500 for individual coverage and $9,000 for family coverage. Those over age 55 can contribute an additional $1,000 (for each spouse over 55). Note that some of the above amounts are PROJECTED, as IRS has not released all final amounts.
- The annual gift tax exclusion increases to $20,000 for 2027, and the lifetime estate and gift tax exclusion amount will increase to $15,458,000 (per spouse).
- The IRS has not yet announced the business mileage rate for 2027, but it will likely be in the range of 72 - 79 cents per mile.
- If you have opted into the IRS Identity Protection PIN program at any time in the past, the IRS should mail to you in December or January a new IP PIN for your 2026 income tax return. There is a separate IP PIN for each spouse who made the election. You must provide this number(s) to your tax return preparer. Otherwise, your returns will not go through electronically.

Bridges & Dunn-Rankin, LLP
CERTIFIED PUBLIC ACCOUNTANTS

400 Galleria Parkway, Suite 1050
Atlanta, GA 30339
Phone: 770-563-8888
Fax: 770-563-8885
www.bridgesdunnrankin.com



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