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JANUARY 2026

NEW FEDERAL TAX RULES ON TIPS

Recent federal tax legislation created a temporary deduction for certain tip income beginning with the 2025 tax year. While often described as "no tax on tips," the change is more technical than that phrase suggests. Tips must still be reported as income, but qualifying individuals may deduct some or all of those tips when calculating federal income tax. The new rules apply to tax years 2025 through 2028.

The IRS has recently proposed a detailed list of nearly 70 occupations grouped into eight categories that qualify for this deduction and clarified that tips must be voluntary and cash or charge-based to qualify (i.e., not mandatory service charges). The eight categories are: (1) beverage and food service; (2) entertainment and events; (3) hospitality and guest services; (4) home services; (5) personal services; (6) personal appearance and wellness; (7) recreation and instruction; and (8) transportation and delivery.

The deduction generally does not apply to tips earned in a specified service trade or business (SSTB), such as professional services (e.g., health care, law, performing arts, etc.). However, the IRS has provided temporary relief for 2025 under which tipped employees are treated as working in a non-SSTB for purposes of this deduction.

Employers – The new law does not eliminate employer reporting obligations. In general, the employer's role does not change

significantly. Employers remain responsible for reporting tip income.

- Form W-2 will not be modified for 2025. Tip income remains included in wages and subject to Social Security and Medicare taxes. Employees will claim the deduction on their own tax return using the tip amounts already reported and their own records.
- Continue normal tip reporting procedures:
 - Employees must report tips of \$20 or more per month to the employer.
 - These tips are included in taxable wages and reflected on Form W-2.
 - Tip pooling and allocation rules still apply.
- The IRS has published guidance identifying jobs considered "customarily tipped." Employers should review any industry guidance to understand which employee roles may qualify.
- There is no change in payroll tax withholding requirements. Employers still withhold and remit federal income tax, Social Security, and Medicare on tip income as before.

Employee and Non-employee Individuals – Eligible individuals may claim a new federal income tax deduction for "qualified tips." This does not make tips tax-free, but it can reduce taxable income. The deduction generally applies only to employees. However, the deduction may also be available to certain non-employee individuals (such as independent contractors and self-employed persons) who receive qualified tips

(Continued on reverse)

reported on Form 1099, provided they meet detailed documentation requirements and benefit from the same temporary SSTB relief as employees.

- Employees and eligible non-employees will claim the deduction on their individual federal income tax returns, using tip amounts reported on Form W-2 or Form 1099 and their own records.
- Tips must still be reported as income first, then any qualifying tips are deducted.
- The maximum deduction is generally \$25,000 per year. This deduction applies only to federal income tax, not Social Security or Medicare taxes.
- Only certain workers qualify. The deduction applies to people in jobs where tipping is customary, such as restaurant servers, bartenders, hotel staff, salon workers, and similar positions.
- There are income limits. The deduction phases out for higher-income taxpayers as follows:
 - Single filers: phaseout begins when modified adjusted gross income is above

- \$150,000
- Married filing jointly: phaseout begins when modified adjusted gross income is above \$300,000
- Proper records matter. It is important to have good documentation of tips received and tips reported to your employer. Use employer summaries, payroll records, and tip reports.
- State taxes may still apply. This is a federal rule only.
- The deduction is temporary and currently set to expire after 2028.

For individuals, this change might result in meaningful federal tax savings for those who work in a tipped occupation and meet the income limits. For employers, accurate and timely reporting of tip income is important, as it now directly affects employee deductions.

If you have questions about eligibility, estimated tax savings, or how these rules may affect payroll or tax planning, please contact our office.

NEW FEDERAL TAX RULES ON OVERTIME PAY

Starting in 2025, federal law allows certain employees to deduct a portion of their pay for federal income tax purposes if specific requirements are met. These rules currently apply through 2028 unless Congress extends them.

What qualifies – Only the “overtime premium” qualifies. For example, if an employee earns “time-and-a-half,” the extra half-time portion is the amount that may be deductible, not the entire overtime paycheck.

How much can be deducted:

- Up to \$12,500 per year (single filers)
- Up to \$25,000 per year (married filing jointly)

The deduction is reduced or eliminated if modified adjusted gross income exceeds:

- \$150,000 (single)

- \$300,000 (married filing jointly)

What does not change – Social Security and Medicare taxes

For 2025, the IRS has provided transitional reporting rules. Employers are encouraged (but not required) to separately identify qualified overtime compensation on Form W-2 or a separate statement. If, however, the employer fails to report that amount to the employee, the employee may still calculate the amount using the employee’s records.

Beginning in 2026, Form W-2 is expected to include a specific reporting field for qualified overtime compensation.

If you have questions about how this applies to you, please let us know.

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Tax & Business Alert

JANUARY 2026

CAN YOU CLAIM A TAX DEDUCTION FOR TIPS OR OVERTIME INCOME?

If you received tips or overtime pay in 2025, you may be eligible for a new deduction when you file your income tax return. Last year's One Big Beautiful Bill Act (OBBA) created both deductions, which can be claimed whether or not you itemize deductions. But various rules and limits apply. Also be aware that such income may still be fully taxable for state and local income tax purposes. And federal *payroll* taxes still apply to tips and overtime income you deduct for federal *income* tax purposes.

DEDUCTING TIPS

Eligible taxpayers can deduct up to \$25,000 of annual qualified tips income. The deduction begins to phase out when modified adjusted gross income (MAGI) exceeds \$150,000 (\$300,000 for married couples filing jointly). It's completely phased out when MAGI reaches \$400,000 (\$550,000 for joint filers).

Qualified tips can be paid by customers in cash or with credit cards or given to workers through tip-sharing arrangements. The tips deduction is available if you receive qualified tips in an occupation that's designated by the IRS as one where tips are customary. Some examples of eligible occupation categories are beverage and food service, hospitality and guest services, personal appearance and wellness, and transportation and delivery.

The tips deduction is allowed for both employees and self-employed individuals. However, those who work in certain trades or businesses — such as health, law, accounting, financial services, investment management — are ineligible.



DEDUCTING OVERTIME

Eligible taxpayers can deduct up to \$12,500 of qualified overtime income (\$25,000 for joint filers). The deduction begins to phase out when MAGI exceeds \$150,000 (\$300,000 for joint filers). It's completely phased out when MAGI reaches \$275,000 (\$550,000 for joint filers).

Qualified overtime income is overtime compensation mandated under Section 7 of the Fair Labor Standards Act. It requires time-and-a-half overtime pay except for certain exempt workers. Only the extra "half" constitutes qualified overtime income and thus is deductible.

Qualified overtime income doesn't include overtime premiums that aren't required by Sec. 7, such as those required under state laws or pursuant to union-negotiated collective bargaining agreements.

REPORTING REQUIREMENTS

Under the OBBBA, qualified tips income must be reported on Form W-2, Form 1099-NEC or another specified information return or statement furnished to both the worker and the IRS. And qualified overtime income must be reported to workers on Form W-2 or another specified information return or statement furnished to both the worker and the IRS.

However, the IRS announced that for the 2025 tax year, there will be no OBBBA-related changes to

federal information returns such as Form W-2, Forms 1099 and Form 941. The IRS is providing transition relief for the 2025 tax year and will update forms for the 2026 tax year.

We can help you determine your eligibility for one or both of these deductions. We'd also be pleased to answer any other questions you may have about the impact of the OBBBA on your 2025 return and 2026 tax planning. ■

BUSINESSES: ACT SOON TO TAKE ADVANTAGE OF CLEAN ENERGY TAX INCENTIVES

While the One Big Beautiful Bill Act (OBBBA) extends or enhances many tax breaks for businesses, it ends some clean energy tax incentives. Fortunately, your business may still benefit from certain clean energy breaks if it acts in the first half of 2026.

MAKE BUILDING IMPROVEMENTS

The Section 179D deduction allows owners of new or existing commercial buildings to immediately deduct the cost of certain energy-efficient improvements rather than depreciate them over the 39-year period that typically applies. The deduction is available as long as the property begins construction by June 30, 2026.



The Sec. 179D deduction is available for new construction as well as additions to or renovations of commercial buildings of any size. (Multifamily residential rental buildings that are at least four stories above grade also qualify.) Eligible improvements include depreciable property installed as part of a building's interior lighting system, HVAC and hot water systems, or the building envelope.

To be eligible, an improvement must be part of a plan designed to reduce annual energy and power costs by at least 25% relative to applicable industry standards, as certified by an independent contractor or licensed

engineer. The base deduction is calculated using a sliding scale, ranging for 2026 from 59 cents per square foot for improvements that achieve 25% energy savings to \$1.19 per square foot for improvements that achieve 50% energy savings.

Projects that meet specific prevailing wage and apprenticeship requirements are eligible for bonus deductions. Such deductions for 2026 range from \$2.97 per square foot for improvements that achieve 25% energy savings to \$5.94 per square foot for improvements that achieve 50% energy savings.

LOOK AT VEHICLE-RELATED BREAKS

The Section 45W Qualified Commercial Clean Vehicle Credit had been scheduled to expire after 2032. Under the OBBBA, it's available only for vehicles that were acquired on or before September 30, 2025. If your business acquired one or more eligible vehicles before that date, you may be able to claim the credit on your 2025 tax return.

And you still have time to install alternative fuel vehicle refueling property and claim a Section 30C tax credit for 2026. The OBBBA eliminates the credit for property placed in service after June 30, 2026. (The credit had been scheduled to sunset after 2032.) Property that stores or dispenses clean-burning fuel or recharges electric vehicles is eligible. The credit is worth up to \$100,000 per item (each charging port, fuel dispenser or storage property).

DON'T WAIT

Other clean energy breaks that might still be available to you if you act soon include the clean energy investment and production credits and the advanced manufacturing production credit. Contact us for more information about clean-energy tax breaks and how your business might benefit. ■

MAKE SMART CHOICES WITH A SUDDEN WINDFALL

An unexpected influx of money — such as from an inheritance, bonus, legal settlement or lottery win — can feel exciting and full of possibility. But without a clear plan, that financial good fortune might not last as long as you'd hoped.

AVOID COMMON PITFALLS

It can be tempting to immediately buy your dream car or home, which could turn out to be an unwise purchase. Or you might be feeling generous when charities come knocking, only to find out later that they were fraudulent.

You can avoid these potential pitfalls by stashing your windfall in a bank or money market account as soon as you receive it. Waiting at least a month before you touch the money can help prevent impulse buys and other mistakes.

Also, you may owe taxes. Some windfalls, such as lottery winnings and certain legal settlements, are subject to federal tax — at a rate as high as 37% if your windfall pushes you into the top income tax bracket. State and local taxes may apply as well. A tax professional can help you determine what you owe.

USE YOUR WINDFALL WISELY

What you eventually decide to do with your windfall will depend on many factors. If you have debt, you'll

probably want to pay it off — especially if it carries a high interest rate and the interest isn't deductible. Also, establishing or boosting your emergency savings can minimize the need to incur future debt.



Next, consider where you'd like to be five, 10 or 20 years into the future. Develop a budget that will help you move toward your goals — whether that means retiring early, starting a business or something else.

You probably shouldn't quit your job without having thought it through carefully. Few windfalls are large enough to see you all the way through retirement (depending on your age).

PLAN FOR THE LONG TERM

Be cautious about requests for money. Friends and family members may expect to share in your good fortune or may pitch "can't-miss" investment ideas. Before making any commitments, seek professional advice. We can help you evaluate the tax impact, prioritize goals and create a personalized plan to make your windfall last — and grow — for years to come. ■

TAX CALENDAR

January 15

Individuals must pay their final 2025 estimated tax payment.

February 2

Employers generally must file:

- 2025 Forms W-2, "Wage and Tax Statement," with the Social Security Administration and provide copies to their employees.
- 2025 Forms 1099-NEC, "Nonemployee Compensation," and related Form 1096, "Annual Summary and Transmittal of U.S. Information Returns," and provide copies to the nonemployees.
- 2025 Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Return." If an employer's undeposited tax is \$500 or less, he or she can either pay it with the return or deposit it. If it is more than \$500, he or she must deposit it.
- Form 941, "Employer's Quarterly Federal Tax Return," to report Medicare, Social Security and income taxes withheld in the fourth quarter of 2025.*

- 2025 Form 943, "Employer's Annual Federal Tax Return for Agricultural Employees," to report Social Security, Medicare and withheld income taxes.*

- 2025 Form 945, "Annual Return of Withheld Federal Income Tax," to report income tax withheld on all nonpayroll items, including backup withholding and withholding on pensions, annuities, IRAs, etc.*

March 2

Employers must file 2025 Form 1099-MISC, "Miscellaneous Income," reporting certain payments to certain persons, along with the related Form 1096, "Annual Summary and Transmittal of U.S. Information Returns," and provide copies to payment recipients.

March 16

Calendar-year partnerships and S corporations must file or extend 2025 tax returns. If the return isn't extended, this is also the last day for those types of entities to make 2025 contributions to pension and profit-sharing plans.

* If an employer's tax liability is less than \$2,500, he or she can pay it in full with a timely filed return.

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2026 TAX LAW CHANGES FOR INDIVIDUALS

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

- New charitable contribution deduction for nonitemizers for cash contributions up to \$1,000 (\$2,000 for married couples filing jointly)
- New 0.5% of adjusted gross income floor on charitable deduction for itemizers
- New 35% benefit limit on itemized deductions for taxpayers in the 37% tax bracket
- Reduced income thresholds at which the alternative minimum tax exemption begins to phase out (and a phaseout rate that's twice as fast as 2025's)
- New tax-advantaged Trump accounts to benefit children under age 18
- Increase in tax-free 529 plan withdrawal limit for qualified elementary and secondary school expenses to \$20,000 (from \$10,000 for 2025)
- New requirement that higher-income taxpayers' catch-up contributions to employer-sponsored retirement plans must be treated as post-tax Roth contributions



- Elimination of certain energy-efficiency credits for homeowners
- Wider income ranges over which the Section 199A qualified business income (QBI) deduction limitations phase in, potentially allowing larger deductions for some pass-through entity owners.
- New minimum QBI deduction of \$400 for taxpayers who materially participate in an active trade or business if they have at least \$1,000 of QBI from it

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