

2025 employment tax year in review

Chicago Chapter PayrollOrg

December 5, 2025

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Agenda

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Rates and limits and W-2/1099 reporting changes	Taxation and reporting of state paid family and medical leave insurance (PFML)	One Big Beautiful Bill Act (OBBBA)	Catch-up contributions under the Secure 2.0 Act	Federal and state unemployment insurance	State and local income tax	Payroll year-end checklist highlights
Federal rates & limits	IRS 2025 state guidance	Fringe benefits	Changes to rules governing catch-up contributions			Additional payday
State paid family and medical leave insurance	Family leave benefits	Employer-provided meals	Correcting excess pretax contributions			Top three year-end checklist items
	Taxation and reporting of contributions	Moving expenses				
	Taxation and reporting of medical leave benefits	Bicycle commuting benefits				
	State PFML plans	Dependent care assistance				
	Next steps	Educational assistance				
		Health Savings Accounts				
		Overtime and tip deductions				
		Employer tax credits				

Resources

- [Ernst & Young LLP special reports](#)
- [Federal Form W-2 resources](#)
- [Acronyms](#)



Rates and limits and W-2/1099 reporting changes

Agenda

Rates and limits and W-2/
1099 reporting changes

Taxation and reporting of state paid
family and medical leave insurance

One Big Beautiful Bill Act
(OBBBA)

Catch-up contributions under the
Secure 2.0 Act

Federal/ and State
unemployment
insurance

State and local income
tax

Payroll year-end checklist
highlights

Federal rates and limits



2025 and 2026 federal rates and limits

Category	Measure	2025 limit	2026 limit	Compared to 2025
Social Security wage base	Year	\$176,100	\$184,500	UP
Salary reduction to a qualified 401(k) or 403(b) retirement plan (See Tax Alert 2025-2287)	Year	\$23,500	\$24,500	UP
Qualified parking	Month	\$325	\$340	UP
Commuter highway vehicle/transit pass	Month	\$325	\$340	UP
Adoption assistance	Per adoption	\$17,280	\$17,670	UP
Health flexible spending account (FSA) employee pretax contribution	Year	\$3,300	\$3,400	UP
Business cents per mile	Mile	\$0.70	Pending	
Foreign earned income exclusion for 2026	Year	\$130,000	\$132,900	UP
Federal unemployment insurance wage base	Year	\$7,000	\$7,000	No change

2025 and 2026 health savings account

Limit type	2025	2026
Contribution*		
Self	\$4,300	\$4,400
Family	\$8,550	\$8,750
Out-of-pocket		
Self	\$8,300	\$8,500
Family	\$16,600	\$17,000
High-deductible health plan (HDHP)		
Self	\$1,650	\$1,700
Family	\$3,300	\$3,400

Keep in mind

The combined total of annual employer contributions plus employee pretax contributions must be reported on Form W-2, box 12, code W

Errors in box 12, code W may create tax return filing issues for employees

*An additional contribution of \$1,000 is permitted for individuals aged 55 and older. An individual enrolled in Medicare may not contribute to an HSA. For plan years beginning in 2026, the maximum amount that may be made newly available for the plan year for an excepted Health Reimbursement Arrangement under Treas. Reg. § 54.9831-1(c)(3)(viii)(B)(1) is \$2,200 (up from \$2,150 in 2025)

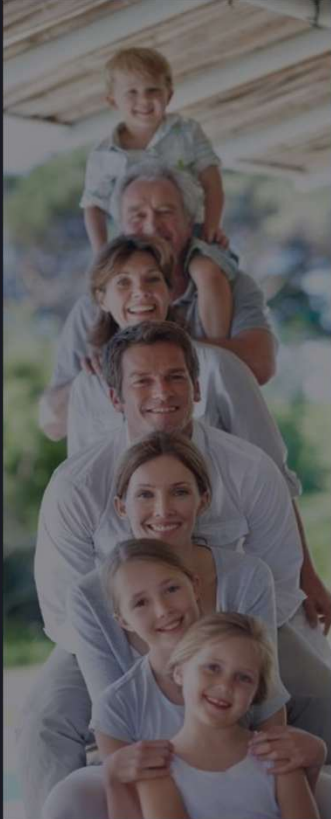
Information reporting penalties (Forms W-2/1099)



Section 6721: Failure to timely file an accurate information return with IRS/SSA (for returns required to be filed in 2027)				
Filed/corrected on or after	On or before	Penalty	Maximum	Maximum small employer
1/1	2/1	\$0	N/A	N/A
Day after deadline (in 2027, 2/2)	30 days after required filing date (in 2027, 3/2)	\$60	\$698,500	\$244,500
31 days after deadline (in 2027, 3/2)	8/1	\$130	\$2,095,500	\$698,500
8/2		\$340	\$4,191,500	\$1,397,000
	Intentional disregard	\$690	No limit	No limit
Section 6722: Failure to furnish correct payee statements (for statements required to be furnished in 2027)				
Filed/corrected on or after	On or before	Penalty	Maximum	Maximum small employer
1/1	2/1	\$0	N/A	N/A
Day after deadline (in 2027, 2/2)	30 days after required filing date (in 2027, 3/2)	\$60	\$698,500	\$244,500
31 days after deadline (in 2027, 3/2)	8/1	\$130	\$2,095,500	\$698,500
8/2		\$340	\$4,191,500	\$1,397,000
	Intentional disregard	\$690	No limit	No limit

State paid family and medical leave insurance

State disability and paid family/medical leave insurance for 2026



State/jurisdiction	Employee contribution (% of taxable wages)	Employer contribution (% of taxable wages)	Taxable wage limit if applicable
California Disability Paid family medical leave insurance	1.1%	None	None
	Included in disability contribution	N/A	Included in disability contribution
Connecticut Paid family medical leave insurance	0.5%	None	\$184,500 (2026 Social Security wage limit)
Colorado Paid family medical leave insurance	50% of 0.9% (if employer has 10 or more employees; if fewer than 10 employees, employees pay 100%)	50% of 0.9% (if employer has 10 or more employees; if fewer than 10 employees, employers pay 0%)	\$184,500 (2026 Social Security wage limit)
Delaware Paid family medical leave insurance Contributions started in 2025	Employers may deduct up to 50% of premium from employees' wages	Medical: 0.40%; family leave: 0.08%; parental leave: 0.32% (employers with 10 to 24 employees are subject only to parental leave and employers with nine or fewer employees are completely exempt) *	\$176,100 (2025 Social Security wage limit)
District of Columbia Paid family medical leave insurance	None	0.75%	None, payroll tax is on total wages

*2026 rates not yet available

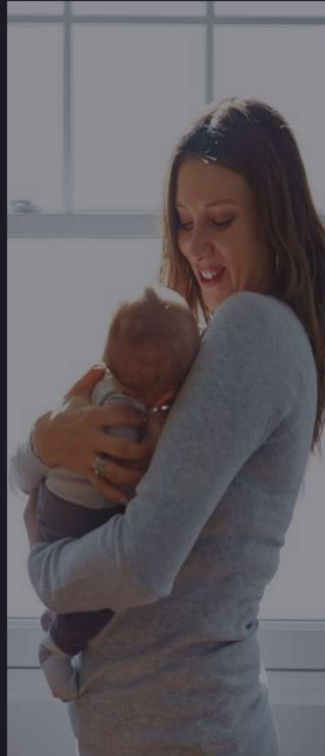
State disability and paid family/medical leave insurance for 2026



State/jurisdiction	Employee contribution (% of taxable wages)	Employer contribution (% of taxable wages)	Taxable wage limit if applicable
Hawaii Disability	50% of cost but not more than 0.5% of covered weekly wages up to a maximum weekly contribution of \$7.21) *	Difference between cost and worker's contribution	For 2025, \$1,441.72 (weekly)
Maryland Paid family medical leave insurance Effective January 1, 2027	50% of rate to be set by May 1, 2026 (rate cannot exceed 1.2%)	50% of rate to be set by May 1, 2026 (rate cannot exceed 1.2%)	\$184,500 (2026 Social Security wage limit)
Maine Paid family medical leave insurance Effective January 1, 2025	50% of 1.0% (100% if employer has fewer than 5 employees)	50% of 1.0% (0% contribution if employer has fewer than 15 employees)	\$184,500 (2026 Social Security wage limit)
Massachusetts Paid family medical leave insurance	25 or more employees: medical 0.28%, family 0.18% Fewer than 25 employees: medical 0.28%, family 0.18%	25 or more employees: medical 0.42%, family 0% Fewer than 25 employees: 0%	\$184,500 (2026 Social Security wage limit)
Minnesota Paid family medical leave insurance Contributions start January 1, 2026	50% of 0.88% (0.66% for employers with 30 or fewer employees and an average employee wage less than 150% of the statewide average)	50% of 0.88% (0.66% for employers with 30 or fewer employees and an average employee wage less than 150% of the statewide average)	\$184,500 for 2026 (a lower wage base applies to employers with fewer than 30 employees with the lowest premium available to those with 1 to 9 employees)

*2026 rates not yet available

State disability and paid family/medical leave insurance for 2026



State/jurisdiction	Employee contribution (% of taxable wages)	Employer contribution (% of taxable wages)	Taxable wage limit if applicable
New Hampshire Paid family medical leave insurance	Employees may opt into the state's Granite State Paid Family Leave Fund (FMLI)	Employers that choose to participate in the FMLI program will be entitled to a tax credit, allowed against FMLI premiums due, of 50% of the premium that the employer paid for FMLI coverage for the tax period at issue	N/A
New Jersey Disability	0.19%	New employers pay 0.5% of taxable wages if in state plan; otherwise, experience rating applies; for other employers, experience rates range from 0.1% to 0.75%	\$44,800 (employers) \$171,100 (employees)
Paid family medical leave insurance	0.23%	None	\$171,100 (employees only)
New York Disability	0.5% up to: \$0.14 daily \$0.60 weekly \$1.20 biweekly \$1.30 semi-monthly \$2.60 monthly	Balance of costs over employee contributions necessary to provide benefits	None
Paid family medical leave insurance	0.432% (annual maximum of \$411.91)	None	\$95,347.22

*2026 rates not yet available

State disability and paid family/medical leave insurance for 2026



State/jurisdiction	Employee contribution (% of taxable wages)	Employer contribution (% of taxable wages)	Taxable wage limit if applicable
Oregon Paid family medical leave insurance	60% of 1.0% if employer has 25 or more employees; otherwise, employee pays 100% *	40% of 1.0% if employer has 25 or more employee; otherwise, employer pays 0% *	\$176,100*
Puerto Rico Disability	0.3%	0.3%	\$9,000
Rhode Island Disability Paid family medical leave insurance	1.3%* Included in disability contribution	None N/A	\$89,200 Included in disability contribution
Vermont Paid family medical leave insurance	Employees may opt into the voluntary plan	Employers with two or more employees may participate in the voluntary plan	N/A
Washington Paid family medical leave insurance Long term care insurance	71.43% of 0.1.13% if employer has more than 50 employees in 2025; otherwise, 100% 0.58% of gross wages	28.57% of 1.13% if employer has 50 or more employees in 2025; otherwise, 0% None	\$184,500 (2026 Social Security wage limit) None

*2026 rates not yet available

W-2/1099 reporting changes

INTERNAL
REVENUE
SERVICE

Form 1099 reporting and withholding threshold

- Currently, the base threshold under IRC § 6041(a) that triggers the requirement to issue and file Forms 1099 (e.g., Form 1099-MISC and Form 1099-NEC) and backup withholding under IRC § 3406(b)(6) is \$600 for the year
- Under the OBBBA ([H.R. 1](#)), and effective for payments made after December 31, 2025, this threshold is increased to \$2,000
- This threshold is indexed for inflation for returns starting with those required to be filed in calendar year 2027 ([Rev. Proc. 2025-32](#))

Reminder about Form W-2c corrections

A safe harbor is available to protect an employer from penalties for the failure to issue Form W-2c for de minimis errors, unless the employee elects for the safe harbor not to apply and does not revoke that election ([TD 9984](#))

De minimis errors:

- Dollar error no more than \$100
- Withholding tax error no more than \$25

Employee election must include:

- Clear statement of employee's election
- Employee name, address, SSN
- If desired, tax year the election applies
- If desired, type of statement (e.g., W-2)
- The employer can prescribe any reasonable manner for making the election (for example, in writing, on-line, by phone) but on-line cannot be the exclusive manner

Other information:

- Employers are not required to notify employees about the safe harbor or the employees' right to make the election
- Employer must retain records of employee elections and revocations for as long as they may be relevant

Polling question

What is the size of your workforce?

- a. Less than 1,000 employees
- b. 1,001 to 5,000 employees
- c. More than 5,000 employees
- d. Don't know
- e. Not applicable (EY, faculty, other)

Taxation and reporting of state paid family and medical leave insurance (PFML)

2025 IRS guidance for state PFML plans

- [Revenue Ruling 2025-4](#)* addresses the federal income tax treatment of taxes paid to, and benefits paid from, state-paid family and medical leave programs and the related Form W-2 and 1099 reporting responsibilities
- The Revenue Ruling is effective for PFML benefits paid by a state on or after January 1, 2025, and except for the requirement that the state report family leave benefits on Form 1099-G, treats 2025 as a transition period
- The guidance applies only to state PFML plans. State disability insurance (SDI) plans, which provide medical leave, have long been subject to the third-party sick pay requirements under [Notice 2015-6](#)
- The guidance does not address PFML provided under private, non-state plans

* See also [Tax Alert 2025-0297](#)

“

Before Revenue Ruling 2025-4, no published guidance addressed the taxation of, or reporting requirements for, state-paid PFML benefits. As a result, practitioners relied heavily on interpretations of IRC §§ 104, 105 and 106, which govern the taxation of accident or health insurance coverage and benefits, although it was unclear whether or to what extent PFML might constitute accident or health insurance.

Christa Haas Bierma

A Touch of Grey in the Silver Lining: Taxing Family Leave
Daily Tax Report, December 19, 2024

Family leave under state PFML

✓ Taxable (reported on 1099-G, box 10)

Family leave provides paid time off for the illness or qualifying circumstances of the employee's family members. For example:

- Bonding with a child after birth, adoption, foster care placement
- Caring for a family member with a serious health condition, as certified by a health care provider
- Military exigency when a family member is on active duty or has been notified of an impending call to active duty in the Armed Forces
- Military caregiver leave for the care of a family member who is a covered service member with a serious injury or illness (related to their service)
- Safe leave that employees can use to address domestic violence, stalking or other forms of abuse

Because this paid leave pertains to other than the employee's own illness or disability, it is included in federal taxable income even if the employee pays the PFML contribution



Medical leave under state PFML

- ✓ Not taxable to extent insurance (PFML tax) paid by employee (If taxable, reported on W-2)

Medical leave provides paid time off to employees for their own covered health condition. For example:

- A serious health condition, as certified by a healthcare provider, that keeps the employee from working
- Illness, injury (nonwork related) or conditions related to pregnancy or childbirth
- Recovery from miscarriage, stillbirth or perinatal depression if certified as a serious health condition
- Other chronic or long-term conditions requiring multiple treatments

Because this paid leave pertains to the employee's own illness or nonwork-related injury, it is treated the same as a state DI benefit and covered by the rules governing third-party sick pay paid by an agent of the employer under [Notice 2015-6](#)



Taxation and reporting of state PFML taxes (EE and ER contributions)

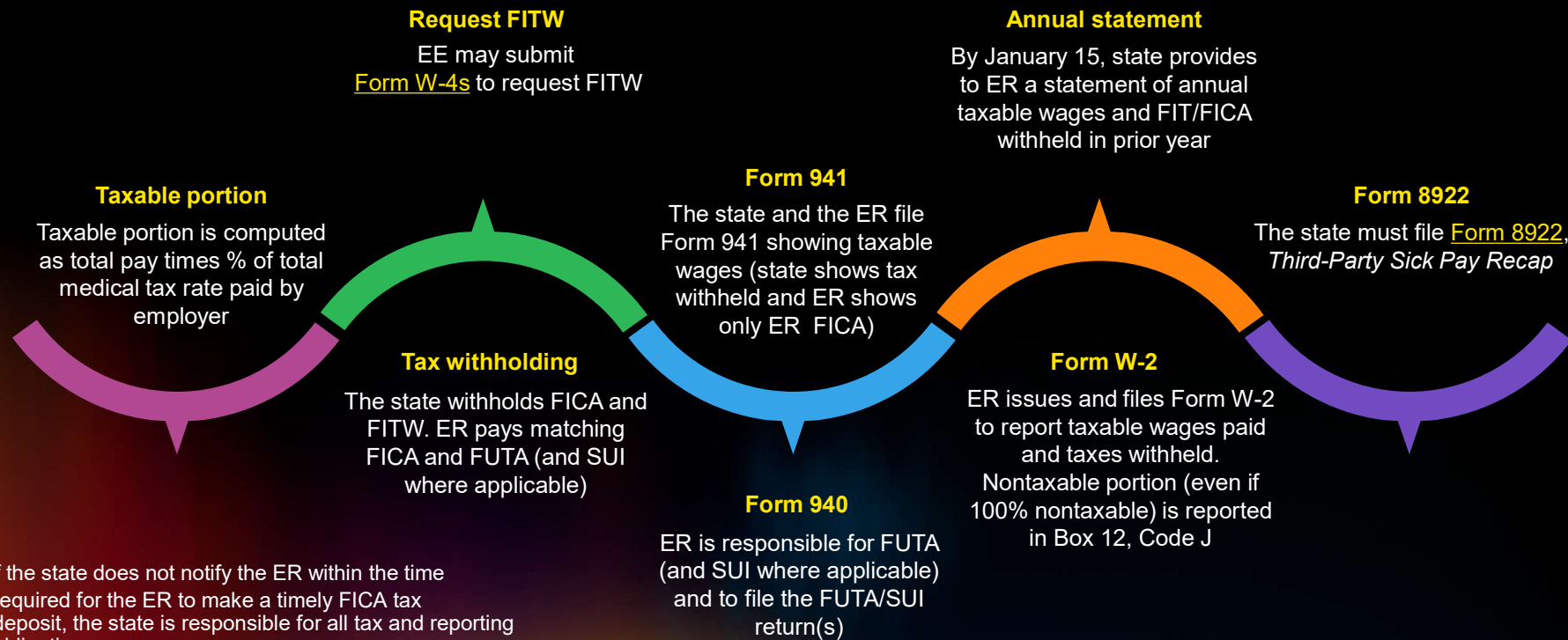
Type of contribution	Consequences to employer*	Consequences to employee*
Employer contribution	Employers may deduct the employer contribution as an excise tax under IRC § 164	The employer contribution is excluded from wages on Form W-2
Employee contribution	Employers must include the employee contribution as wages on Form W-2 subject to FIT, FITW, FICA and FUTA (i.e., cannot be a pretax contribution)	The employee's contribution is included in wages on Form W-2 subject to FIT, FITW, FICA and FUTA. Employees may deduct the employee contribution as state income tax under IRC § 164 if the employee itemizes deductions on employee's federal income tax return, but only to the extent the deduction for State tax paid does not exceed the SALT deduction limitation provided under IRC § 164(b)(6)
Employer pickup of employee contributions (employee portion of tax is paid by employer)	Employers may deduct the employer pickup payment it pays from its funds as an ordinary and necessary business expense under IRC § 162 Employers must include this voluntary payment as wages on Form W-2 subject to FIT, FITW, FICA and FUTA	The employer pickup is additional compensation to employees and is included in wages on Form W-2 subject to FIT, FITW, FICA and FUTA. Employees may deduct the employer pickup of the employee contribution as state income tax under § 164, if the employee itemizes deductions on the employee's federal income tax return, but only to the extent the deduction for state tax paid does not exceed the SALT deduction limitation provided under IRC § 164(b)(6)

* FIT and FICA withholding is required at the time the PFML contributions are required to be withheld from employees' wages and at the time employer contributions are paid to the state



Tax and reporting of state-paid medical leave benefits*

IRS Notice 2015-6



* If the state does not notify the ER within the time required for the ER to make a timely FICA tax deposit, the state is responsible for all tax and reporting obligations

States with PFML plans

Employers and employees both contribute unless otherwise noted

- **California.** *Covers family leave only.* Included as part SDI program. **100% paid by employee**
- **Connecticut.** Covers medical and family leave. **100% paid by employee**
- **Colorado.** Covers medical and family leave*
- **Delaware.** Covers medical and family leave*
- **District of Columbia.** Covers medical and family leave. **100% paid by employer**
- **Maine.** Covers medical and family leave*
- **Maryland** (starting in 2027). Covers medical and family leave*
- **Massachusetts.** Covers medical and family leave*
- **Oregon.** Covers medical and family leave*
- **Minnesota.** Covers medical and family leave
- **New Hampshire.** Voluntary non-state plan
- **New Jersey.** *Covers family leave only.* A separate SDI program provides Medical leave benefits
- **New York.** *Covers family leave only.* A separate SDI program provides Medical leave benefits. **100% paid by employee**
- **Rhode Island.** Included as part of SDI program. **100% paid by employee**
- **Vermont.** Voluntary non-state plan
- **Washington.** Covers medical and family leave*

*Employees pay 100% of tax if employed by a small employer

Observations

- Employers will have no federal tax or reporting obligations for PFML benefits paid in **New Jersey and New York** because these programs cover only family leave which is reported by the state on Form 1099-G
- Assuming employers do not pay any portion of the contribution required to be paid by employees, they will have no FITW, FICA or FUTA obligations for PFML medical benefits paid in **California, Connecticut and Rhode Island** because, under the law, employees pay 100% of the contribution resulting in no taxable third-party sick pay for medical leave benefits

State PFML: Next steps for 2026

1

Taxable PFML contributions

Identify employees where all or a portion of the employee's PFML tax is paid by the employer, and for 2026, set up the payroll system to include this amount in federal taxable wages (check state and local tax rules)

2

Taxable PFML medical benefits

Identify states in which the employer pays all or some of the medical portion of the PFML tax and monitor regularly to determine if medical leave benefits have been paid to employees in those states. Contact state(s) if notice of FICA/FITW withholding has not been provided

3

State SIT and SUI conformity

In those states in which PFML is paid, confirm the extent to which, for SITW and SUI purposes, they conform with the federal guidance in Rev Proc. 2025-4

4

Monitor state developments

Most states with PFML have yet to post guidance in response to Rev. Proc. 2025-4. Employers will need to monitor developments

5

Evaluate private plan compliance

If privately-paid PFML is both income and wages, but is not third-party sick pay, it is unclear what rules govern responsibility for employment tax obligations, other than the statutory employer rules under IRC § 3401(d). Consult your employment tax advisor for guidance

6

Private plan vs. state plan

Considering this recent IRS guidance, employers might consider which is most administratively/financially practical—state or private PFML. Contact your employment tax advisor for assistance

Polling question

Do you have employees in state(s) that require contributions to a state paid family and medical leave insurance plan?

- a. Yes
- b. No
- c. Don't know
- d. Not applicable (EY, faculty, other)

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1099 reporting changes

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(OBBBA)

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One Big Beautiful Bill Act (OBBBA)

Fringe benefits

Employer-provided meals

Current law



- IRC § 274(o), added by the Tax Cuts and Jobs Act (TCJA) and effective for amounts paid or incurred after December 31, 2025, disallowed deductions for:
 - Any expense for the operation of a facility described in IRC § 132(e)(2), and any expense for food or beverages, including under IRC § 132(e)(1), associated with such facility
 - Any expense for meals described in IRC § 119(a)

OBBBA



- The OBBBA adds two exceptions to the disallowance:
 - IRC § 274(e)(8), which excepts expenses for goods or services sold by the taxpayer in a bona fide transaction for adequate and full consideration
 - IRC § 274(n)(2)(C), which excepts the expense of food or beverages provided on certain fishing vessels, fish processing facilities and oil rigs

Effective date

- Amounts paid or incurred on or after 1-1-2026

Insights

- Employers will need to decide if they will impute income for disallowed meal expenses or pay the federal, state and local taxes on behalf of their employees (gross up)
- Employers may wish to consider notifying employees of the decision made concerning the future treatment of the disallowed meal expenses

Moving expenses

- OBBBA permanently repeals the deduction for moving expenses under IRC § 217 (except for members of the Armed Forces, or their spouse or child, to whom IRC § 217(g) applies, and permanently repeals the qualified moving expense reimbursement exclusion under IRC § 132 (except for members of the Armed Forces on active duty who move under a military order and incident to a permanent change of station)
- A new exception is added to the repeal, preserving the deduction and exclusion for employees or new appointees of the intelligence community moving pursuant to a change in assignment
- The deduction and the exclusion have been temporarily suspended since 2018



Bicycle commuting benefits

- OBBBA terminates the exclusion from employee income for qualified bicycle commuting reimbursement under IRC §132(a)(5) for tax years beginning after December 31, 2025
- This exclusion has been temporarily suspended since 2018

Dependent care assistance programs

Current law



- Under IRC § 129, employees can exclude from gross income certain amounts provided to them by their employer for dependent care assistance, provided certain requirements were met
- The maximum amount excludible during a tax year under a dependent care program was \$5,000

OBBBA



- The maximum amount excludible during a tax year under a dependent care assistance program is increased to \$7,500

Effective date

- 1-1-2026

Insights

- This exclusion applies to both employee contributions to an employer's dependent care assistance plan and to backup daycare employers provide when employees work outside of normal business hours
- The combined total of contributions to the dependent care assistance plan and employer-provided backup day care are subject to the annual maximum (\$7,500 effective 1-1-2026)

Educational assistance

Current law



- Under IRC § 127, an employee could exclude from gross income up to \$5,250 annually of educational assistance provided by the employer to the employee if certain requirements were met
- The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) added payments on student loans as a permitted category of educational assistance, subject to a December 31, 2020 sunset, which was later extended to December 31, 2025, by the Consolidated Appropriations Act of 2021

OBBBA



- The exclusion for employer payments of qualified education loans is made permanent

Effective date

1-1-2026

- The maximum exclusion will be adjusted for inflation

Effective date

1-1-2027

Insights

- IRC § 127 applies to nonjob-related education, whereas; under IRC § 162 (working condition fringe), there is no tax-free maximum on education expenses related to the employee's current job
- See [IRS FS-2024-22](#) for more information on educational assistance programs

Health savings account enhancements

Current law



- IRC § 223 allows eligible individuals to contribute to a tax-advantaged HSA
- Among other requirements, an individual must be covered by a high-deductible health plan and maintain other coverage to be eligible



OBBBBA



- Makes permanent a previously expired temporary provision that allowed pre-deductible coverage of telehealth services without disqualifying an otherwise eligible individual from making HSA contributions
- Clarifies that an individual covered by a direct primary care service arrangement costing no more than \$150 per month (doubled for family coverage) will not be disqualified from contributing to an HSA as a result of the direct primary care service coverage
- Treats any bronze or catastrophic plan offered in the individual market on a health care exchange as a high-deductible health plan

Effective date

- 1-1-2026

Overtime and tip deductions

Overtime deduction (new IRC § 225)

Individual

- Allows individuals to deduct up to \$12,500 (\$25,000 joint) for qualified overtime (OT)
- Phases out for AGI over \$150,000 (\$300,000 joint)
- Available to itemizers and non-itemizers
- Defines qualified OT compensation as the premium portion of overtime that is required by Section 7 of the Fair Labor Standards Act of 1938 (FLSA)
- Qualified OT does not include more generous provisions under state law, employer policy or union contract (e.g., double time, overtime for work holidays)

Employer

- OT pay eligible for the federal deduction is included in wages subject to FIT, FITW, FICA and FUTA
- Starting in 2026, employees can reduce their FITW in anticipation of the OT pay deduction on Form W-4
- Employers must report qualified OT pay on Form W-2 in Box 12, Code TT ([Tax Alert 2025-1745](#))
- This Form W-2 reporting requirement is delayed until 2026

Effective date

- 1-1-2025 to 12-31-2028

Premium portion of overtime

- The federal deduction is limited to the portion of OT pay that exceeds the regular rate of pay (regular pay x .5)
- For example, under the FLSA, an employee earning \$10 per hour must be paid \$15 (\$10 x 1.5) for hours worked over 40 in the week. The premium portion is \$5

Overtime deduction—2025 transition rules

Individual*



- To calculate qualified OT compensation, FLSA-eligible individuals may base the qualified OT on employer documents (e.g., earnings statements)
- The Notice lists seven methods, depending on how pay is reported, that are considered reasonable, for example:
 - Employee is paid OT at 2 times the regular rate of pay and the earnings statement shows “overtime premium” of \$10,000. The OT deduction is $\$10,000 \div 2$, or \$5,000
 - Same as above but the employee earnings statement shows “total overtime” of \$20,000 (regular rate + premium pay). The OT deduction is $\$20,000 \div 4$, or \$5,000

*See IRS [Notice 2025-69](#) for more information

Employer*



- Employers will not face penalties for the 2025 tax year for failing to separately account for qualified OT on Forms W-2 and 1099 information statements and returns
- To qualify for this relief, employers must comply with longstanding requirements to timely and correctly furnish a complete and correct Form W-2, including proper reporting of OT and tips
- Employers are encouraged, but not required, to provide detailed information on qualified OT compensation to employees, which can be communicated through various secure methods, including online portals and written statements
- Employers may also report qualified OT in Form W-2, box 14

*See IRS [Notice 2025-62](#) for more information

Overtime deduction—2025 voluntary statements



Although employer information reporting is optional for 2025 and employees may rely on paystubs and similar employer documents, employees may still not have sufficient information to calculate their OT deduction in the manner described by the IRS. For instance, the employee may not know whether total OT pay reported on the paystub reflects total OT pay or premium pay, or if OT is paid at 1.5 times or 2.0 times the regular rate of pay. To avoid a flood of employee inquiries during the 2025 tax filing season, employers might consider providing voluntary statements

Sample 2025 voluntary OT statements* (*depending on employer's circumstance*)

How to use your earnings statement to compute the federal overtime deduction

Refer to your final 2025 earnings statement dated ____ to compute overtime earnings eligible for the federal tax deduction.

Note that amount reported as “overtime pay” represents your regular pay plus overtime computed at 1.5 times your regular rate of pay. [Employers insert here the employer information that describes these relevant facts.]

Refer to IRS [Notice 2025-69](#) for information on how to compute your overtime pay deduction based on your earnings statement.

Your 2025 qualified overtime compensation

Below is the amount of qualified overtime paid to you in 2025. This is the total amount eligible for claiming the federal overtime deduction on your 2025 Form 1040 (subject to the deduction limit and income phase out).

[Insert qualified overtime pay for 2025. Employers can refer to the U.S. Department of Labor’s [Handy Reference Guide to the Fair Labor Standards Act](#) for information on required OT under the Fair Labor Standards Act.]

This amount represents the premium portion of your 2025 overtime pay as adjusted to include only the premium pay required under the Fair Labor Standards Act.

*Consult with your tax advisor on the wording applicable to your facts and circumstances

Tip deduction (new IRC § 224)

Individual



- Allows individuals to deduct up to \$25,000 for qualified tips paid in 2025 through 2028 and phases out for adjusted gross income (AGI) over \$150,000 (\$300,000 joint)
- Is available to itemizers and non-itemizers and to both employees and independent contractors but not to employees of a specified service trade or business (SSTB) as defined in IRC § 199A(d)(2)
- Qualified tips are those:
 - Paid in cash or charged, as well as pooled tips
 - Paid voluntarily, not subject to negotiation, and determined by the payor
 - Paid to those in one of the covered occupations (Treasury Tipped Occupation Code, or TTOC) published by the Treasury (See [REG-110032-25](#) for the preliminary list of TTOCs)

Employer



- Tips eligible for the federal deduction is included in wages subject to FIT, FITW, FICA and FUTA
- Employers must report qualified tips on Form W-2 in Box 12, code TP and the TTOC in Box 14b ([Tax Alert 2025-1745](#); [Tax Alert 2025-1907](#))
- This Form W-2 reporting requirement is delayed until 2026

Effective date

- 1-1-2025 through 12-31-2028



Tip deduction—2025 transition rules

Individual*



- Individuals may report as their qualified tips any of the following amounts:
 - The Social Security tips reported in Form W-2, box 7
 - The tips reported by the employee on Form 4070, *Employee's Report of Tips to Employer* (or any similar substitute form)
 - The amount an employer voluntarily reports in Form W-2, bx 14 (or on a separate statement)
 - The amount listed on line 4 of Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, filed with the employee's 2025 income tax return
- Until final regulations take effect, the IRS will consider tips received by employees in occupations that regularly received tips as of December 31, 2024, to be from a business that is not an SSTB
- Employees and non-employees may only include an amount in qualified tips if it was correctly reported on Forms W-2 or 1099

*See IRS [Notice 2025-69](#) for more information

Employer*



- Employers will not face penalties for the 2025 tax year for failing to separately account for qualified tips on Forms W-2 and 1099 information statements and returns
- To qualify for this relief, employers must comply with longstanding requirements to timely and correctly furnish a complete and correct Form W-2/1099, including proper reporting of OT and tips
- Employers are encouraged, but not required, to provide detailed information on qualified tips to employees, which can be communicated through various secure methods, including online portals and written statements
- Employers may also report qualified tips in Form W-2, box 14

*See IRS [Notice 2025-69](#) for more information

Polling question

Do you plan to provide employees with a voluntary statement concerning qualified OT and/or tip wages for 2025?

- a. Yes
- b. No
- c. We're considering it
- d. Don't know
- e. Not applicable (EY, faculty, other)

Employer tax credits

Employer-provided childcare credit

Effective January 1, 2026, the OBBBA:

- Amends IRC §45F(a) by increasing the employer-provided childcare credit from 25% to 40% of qualified childcare expenditures (and from 25% to 50% for eligible small businesses)
- Increases total credit limit from \$150,000 to \$500,000 (\$600,000 for small businesses) per year

Paid family and medical leave tax credit

Current law



- The credit is effective for wages paid in taxable years beginning after December 31, 2017, and before January 1, 2026 ([see the IRS website for more information on IRC § 45S](#))
- Leave mandated by state or local law is deducted from the employer's offered leave when determining eligibility for the credit, disqualifying many employers
- The tax credit is available only on wages paid for family and medical leave and not on a percentage of premiums paid for PFML insurance policies

* See [Tax alert 2025-1476](#) for more information

OBBBA*



- Permanently extends the paid family and medical leave credit, with some modifications:
 - The law will allow employers that were previously disqualified by the statute's disregard of leave required by state or local law to qualify by counting the required leave for eligibility purposes
 - The tax credit may be claimed on a percentage of premiums paid for PFML insurance policies or leave wages, but not both
 - To be eligible for the tax credit, employers are permitted to restrict paid leave benefits to employees who work at least 20 hours per week

Effective date

- 1-1-2026

Insights

If an employer provides paid vacation leave, personal leave, or medical or sick leave (other than leave specifically identified in IRC § 45S) that paid leave is not considered family and medical leave

The OBBBA modifications make the tax credit available to more employers and should be evaluated for feasibility under these new rules

Employee retention tax credit

Current law



- In 2020, the CARES Act created a refundable federal employment tax credit, which was available for qualified wages paid by eligible employer during the COVID-19 emergency from March 13, 2020, through September 30, 2021 (December 31, 2021 for recovery startup businesses)
- The statute of limitations expired on April 15, 2024, for claiming the 2020 credit, and on April 15, 2025, for the claiming the 2021 credit

OBBBA*



- As of July 4, 2025, the law disallows refunds for the third and fourth quarters of 2021 if the claim was filed after January 31, 2024
- The law extends the statute of limitations for IRS assessment for third and fourth quarter 2021 claims to six years after the later of:
 - Date the original return was filed
 - Date credit was claimed
 - April 15, 2022

* See [IR-2025-106](#) for more information



Catch-up contributions under the SECURE 2.0 Act

Changes to rules governing catch-up contributions

Increase in catch-up contribution



- Beginning in 2024, the catch-up contribution limit for SIMPLE plans increased to 110% of the normal limit. This higher limit applies automatically for employers with up to 25 employees. Employers with more than 25 employees can elect to have the higher contribution limits apply, but only if they make additional matching or nonelective contributions to the plan
- Beginning in 2025, the limit on catch-up contributions increased to 150% of the otherwise applicable limit for eligible participants aged 60 through 63. These higher limits are not just for SIMPLE plans — they apply to IRC §§401(k), 403(b) and 457(b) plans as well

FICA wage limit for making pre-tax catch-up contributions*



- Pretax catch-up contributions for participants earning over \$145,000 (\$150,000 for 2026) in FICA wages (as reported on Form W-2, box 3) in the preceding year must be designated as after-tax Roth catch-up contributions
- If the employer's plan does not allow for Roth contributions, participants exceeding the FICA wage threshold are not allowed to make catch-up contributions in the year they are disqualified
- A plan cannot require all catch-up contributions to be Roth catch-up contributions regardless of the employee's prior-year FICA wages
- The statutory deadline was extended for two years, until 2026 in [IRS Notice 2023-62](#). For 2026, a reasonable, good-faith interpretation of the statutory text is required. Stated differently, the more nuanced interpretations of the statute reflected in the final regulations are not mandatory until 2027; unlike 2024 and 2025, however, taxpayers cannot simply ignore the Roth catch-up requirement in 2026

*For more information see [T.D. 10033](#)

Correcting excess pretax contributions

Form W-2 corrections



- A contribution that must be treated as a Roth catch-up contribution but was mistakenly treated as a pretax contribution can be corrected in two ways (in addition to the normal methods for correction):
 - If the Form W-2 has not yet been filed or furnished, the catch-up contribution (adjusted for allocable gains or losses) can be transferred into the participant's Roth account and the contribution (not adjusted for allocable gains or losses) reported as a Roth contribution on the Form W-2
 - Whether or not the Form W-2 has been filed or furnished, the contribution can be corrected by in-plan Roth rollover, resulting in Form 1099-R reporting of the amount transferred (adjusted for allocable gains or losses)
- These correction methods are only available, however, if certain conditions are met. For example, practices and procedures must be in place that are designed to comply with the rules at the time an elective deferral is made
- Corrections are not required if the elective deferral that was required to be a designated Roth contribution is \$250 or less or is attributable to an amended Form W-2. [T.D. 10033](#) gives several examples

Insights

- There is likely to be even more interplay between payroll and benefits than historically required for retirement plans
- Retirement plan administrators will need prior-year FICA wage information to determine if pretax catch-up contributions are allowed
- Payroll and plan administrators will need to collaborate to confirm payroll tax configurations are accurately modified for correct income tax withholding and Form W-2 reporting
- Reach out to your compensation & benefits advisor to confirm the plan changes necessary (e.g., adding a Roth option if one is not yet available)
- Consider notifying plan participants of the plan updates made and why they are necessary

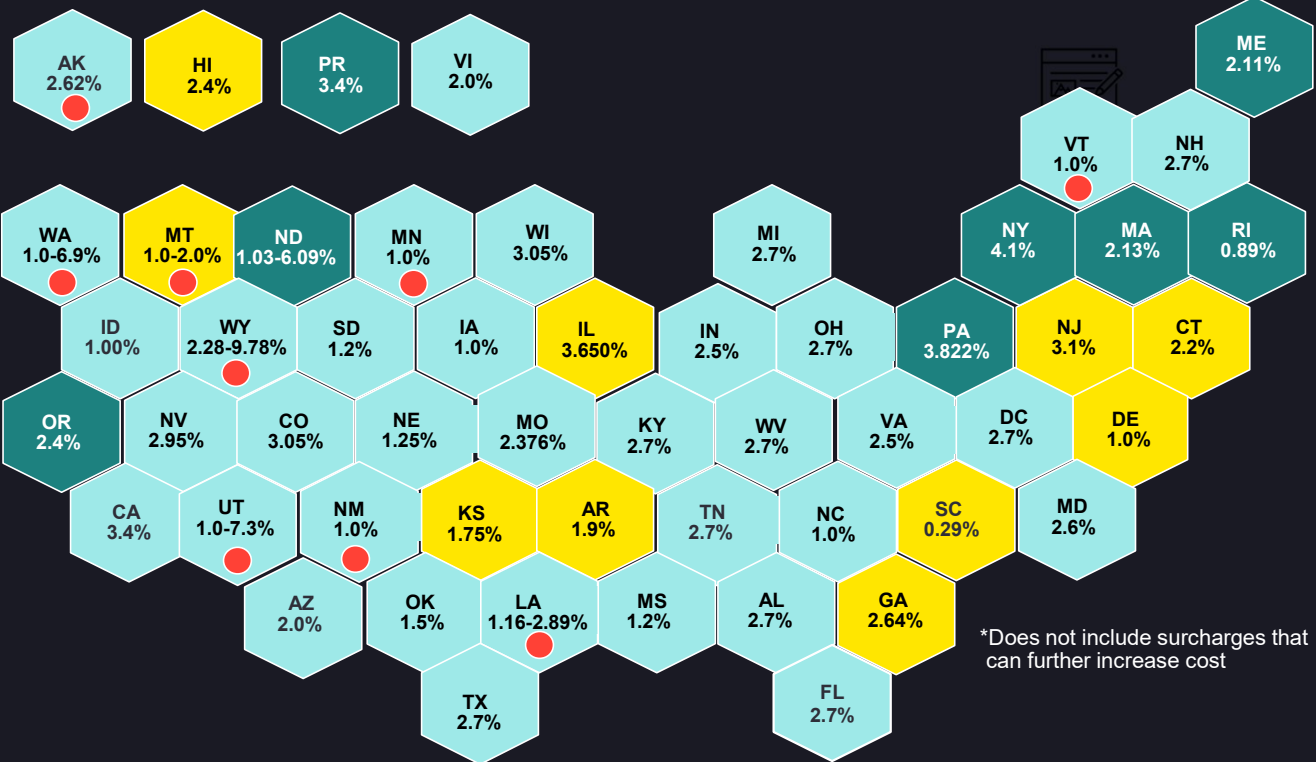
Polling question

Does your qualified retirement plan offer a Roth contribution option?

- a. Yes
- b. No
- c. We're considering it
- d. Don't know
- e. Not applicable (EY, faculty, other)

Federal (FUTA) and state unemployment insurance (SUI)

2025 new employer SUI base tax rates*



Legend

- New employer rate decreased from 2024
- New employer rate unchanged from 2024
- New employer rate increased from 2024
- New employer rates are based on an industry average

*Does not include surcharges that can further increase cost

Rev. 9/2/2025
Source: Ernst & Young LLP survey



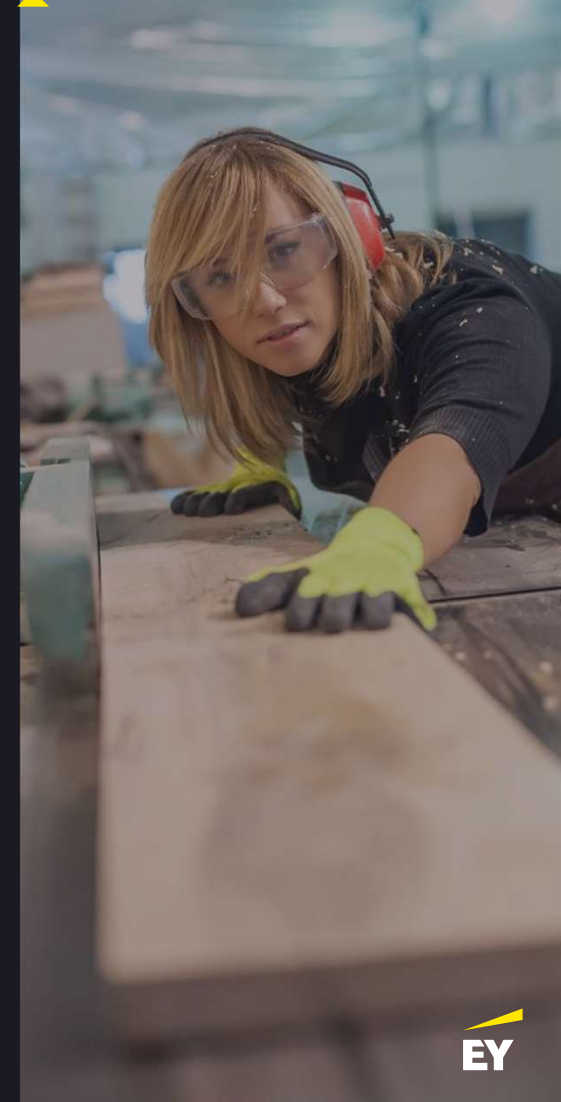
FUTA credit reduction states for 2025*



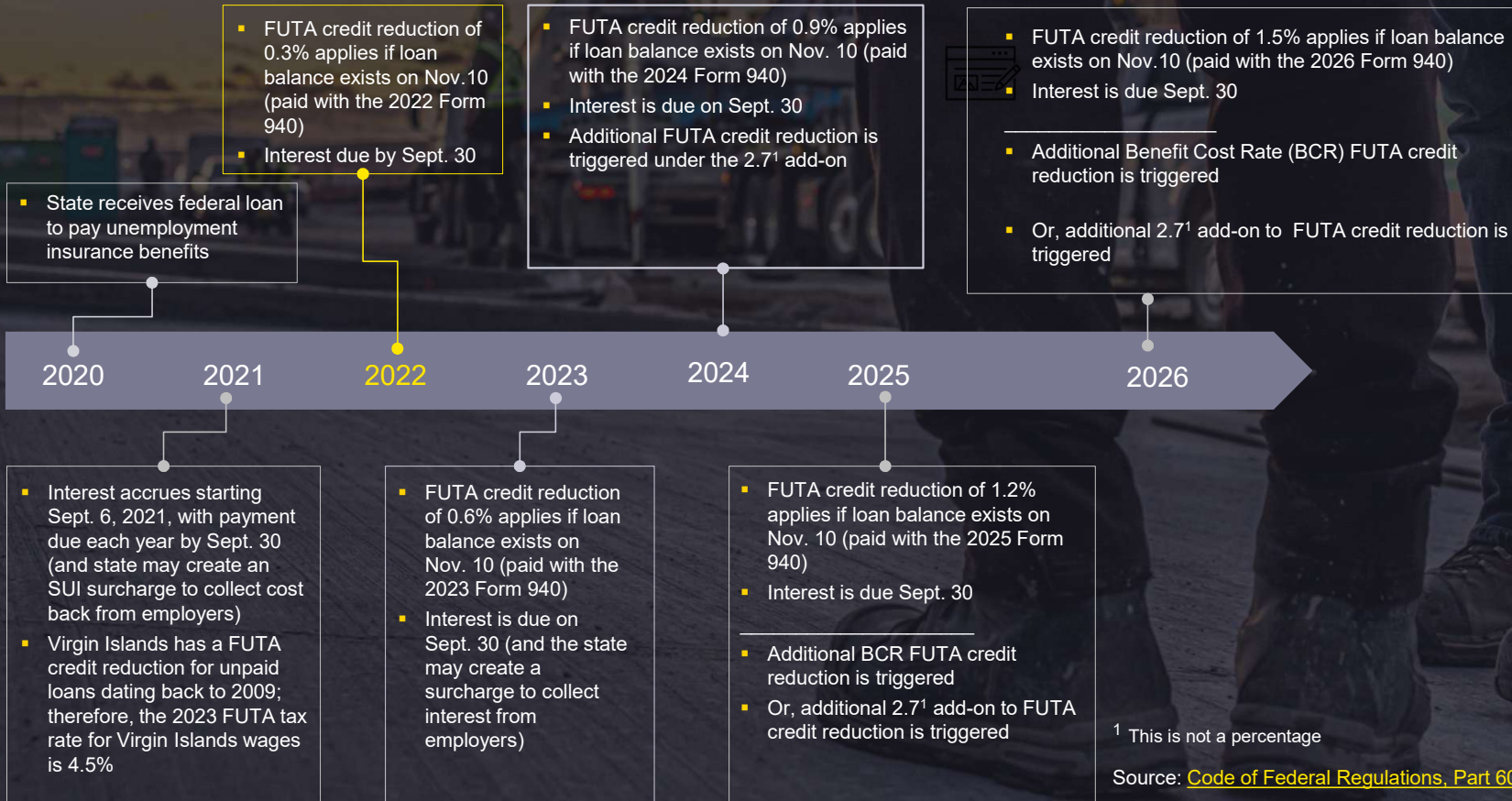
State	First year of federal UI loan	Federal UI loan balance as of 11-6-2025	2025 FUTA credit	2025 2.7 add-on	Net 2025 FUTA rate (0.6% credit reduction + 1.2%)	Is there an employer surtax to repay interest on the federal UI loan?
California	2020	\$20,929,482,418	1.2%	0.0%	1.8%	No
Virgin Islands	2009	\$29,920,863	4.5%	0.0%	5.1%	Yes \$25 per employee applies

Note that California and the Virgin Islands requested and received approval for a waiver of BCR add-on for 2025

*U.S. Department of Labor, [FUTA Credit Reductions](#)



FUTA credit reduction for unpaid federal loans



State unemployment insurance developments

Arkansas



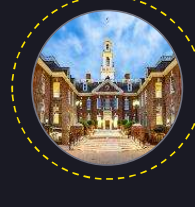
- Effective January 1, 2026, legislation enacted in 2025 decreases the minimum base SUI tax rate from 1.9% to 1.8%. The law also allows employers that have been in business in other states to elect a lower contribution rate based on their previous experience, provided they meet certain criteria.
- Finally, the law establishes penalties for employers that provide false information concerning employment to avoid UI benefit claim charges.

Connecticut



- Effective October 1, 2025, legislation enacted in 2025 lowers from 60 days to 40 days to contends that benefits have been improperly charged due to fraud or error.

Delaware



- The law phases in a permanent taxable wage base over three years- \$12,500 for calendar year 2025, \$14,500 for calendar year 2026, and \$16,500 for calendar year 2027 and thereafter.
- Effective in 2027, the current benefit wage ratio methodology will be replaced with the benefit ratio methodology. The law provides temporary relief to experience-rated employers in calendar years 2025 and 2026 by reducing new employer tax rates, simplifying tax rate schedules, reducing or holding constant overall employer tax rates, and lowering the maximum SUI tax rate.

State unemployment insurance developments

Iowa



- Under [S.F. 607](#), the SUI taxable wage base for 2026 will decrease to \$20,400, down from \$39,500 in 2025.
- The Iowa Workforce Development announced that the state's UI tax rates for calendar year 2026 will remain at the lowest schedule permitted under law.

Maryland



- Beginning January 1, 2026, legislation (1) imposes an unemployment insurance administrative fee of 0.15% on all taxable employers, (2) requires that all associated revenue be deposited into the Special Administrative Expense Fund to be used for specified administrative expenses, and (3) reduces the unemployment insurance tax rate assigned to each taxable employer by 0.15%, subject to a minimum overall tax rate of 1.0% for new employers.

Montana



- Effective January 1, 2026, the law adds a lower contribution tax rate schedule and changes the tax schedule rate trigger, lowering the average SUI tax rate from 1.12% to 0.95% on new Schedule I.

State unemployment insurance developments

Ohio



- Earlier this year, Ohio Governor Mike DeWine approved the 2026-2027 biennial budget (H.B. 96), which implements a new employer state unemployment insurance (SUI) surcharge (TCSF) of 0.15% on taxable wages up to \$9,000 per employee, per year.
- Because the TCSF will not be placed in trust for the payment of SUI benefits, it is not considered a SUI contribution for Form 940 reporting purposes.

Oklahoma



- Effective in 2026, the law lowers the state's top unemployment tax rate from 9.2% to 6.5%. It also raises the state's unemployment trust fund threshold for triggering employer surcharges from \$25 million to \$50 million. Additionally, SB 911 makes two key changes to how unemployment tax rates are calculated. It lowers the percentage of the state's average annual wage used to determine the conditional factor rate for unemployment taxable wages and creates a quarterly table for this rate.

Oregon



- The law provides certain Oregon employers with a nonrefundable tax credit against their state unemployment insurance (SUI) tax liability for calendar year 2025. The credit amount is the lesser of \$5,000 or the employer's total SUI taxes due for 2025. Tax credits less than \$100 in any calendar year are not allowed.

State unemployment insurance developments

South Dakota



- Effective January 1, 2026, the law decreases contribution rates for all three Schedules (A, B, and C), beginning January 1, 2026. Rates will range from 0.00% to 9.39%, down from 0.00% to 9.45% previously. Additionally, effective January 1, 2026, employers must pay a 0.08% administrative fee and an investment fee ranging from 0.00% to 0.53%, depending on reserve ratio

Washington



- Effective January 1, 2026, the law modifies the deadline for submitting voluntary unemployment contributions, moving it from March 31 to March 1.


Polling question

Do you anticipate a reduction in force next year?

- a. Yes
- b. No
- c. We're considering it
- d. Don't know
- e. Not applicable (EY, faculty, other)

State and local income tax

Alabama law enacts de minimis nonresident income tax exemption

- Under [H.B. 379](#), and effective January 1, 2026, compensation paid to nonresident employees for services performed within the state for 30 or fewer days is exempt from Alabama state and local income tax and withholding if the following conditions are met:
- The employee performed employment duties in more than one state during the calendar year
- The compensation was not paid to employees working in their capacity as a professional athlete, professional entertainer or public figure 
- The nonresident employee's state of residence provides a substantially similar exclusion, does not impose an individual income tax or the employee's income is tax exempt under the US Constitution or federal statute

If the nonresident employee performs services within Alabama for more than 30 days in the calendar year, all compensation paid to the employee for the calendar year is subject to Alabama state and local income tax and withholding

Insights

- In response to COVID-era tax return filings, the Department's rulemakings, upheld by the Alabama Tax Tribunal, revealed it had adopted an administrative policy of imposing Alabama income tax on the wages employees earn while working from home outside of Alabama (i.e., convenience of the employer rule) See Tax Alert [2023-0609](#)
- H.B. 379 does not specifically preclude the state from imposing nonresident income tax under the convenience of the employer rule
- Employers should consult their employment tax advisor about the Alabama income tax implications of wages paid to remote workers

Louisiana expands de minimis nonresident income tax exemption

- Louisiana [H.B. 567](#), signed into law by Governor Jeff Landry, increases the threshold for nonresident employee income tax and withholding from 25 to 30 days, effective January 1, 2026. This change allows nonresident employees to work in Louisiana for up to 30 days without triggering state income tax or employer withholding obligations
- Under legislation enacted in 2021 and effective January 1, 2022, [SB 157](#) exempted employees from the state's nonresident income tax when they worked within the state for fewer than 25 days in the calendar year

State income tax rate changes

Retroactive to January 1, 2025

The following states changed their personal income tax rates retroactive to January 1, 2025, and income tax withholding tables were updated to reflect those changes in 2025 unless otherwise noted

- [Georgia](#)
- [Idaho](#)
- [Maryland](#)
- [Ohio](#)
- [South Carolina](#) (withholding update deferred to 2026)
- [Utah](#)
- [Virginia](#)
- [Wisconsin](#) (no 2025 withholding update)

Effective January 1, 2026

The following states have enacted legislation to reduce their personal income tax rates in 2026 unless otherwise noted

- [Indiana](#) (rate cuts effective 2030 through 2042 if revenue goals are met)
- [Kentucky](#) (2026 withholding formula is [here](#))
- [Mississippi](#)

Local income tax changes

Proposed Chicago head tax

- Chicago Mayor Brandon Johnson included in his FY2026 city budget proposal a "Community Safety Surcharge," which would be paid by corporations in the form of a \$21 per employee head tax ([City of Chicago, 2026 Budget Overview, p. 190](#))
- The City Council must approve a final balanced budget by December 31, 2025, and the budget is effective January 1, 2026 ([City of Chicago Office of Budget and Management](#))

Seattle Social Housing Tax

- Under [Proposition 1A](#), and effective January 1, 2025, a new employer-paid Social Housing Tax is created to fund the Seattle Social Developer, a voter-approved agency created in February 2023 to support mixed-income social housing
- Employers are taxed 5% of the excess compensation (over \$1 million) paid to an employee in the prior calendar year. ([Seattle Municipal Code Section 537](#))
- For 2025, the Social Housing Tax return and payment are due January 31, 2026. Thereafter, the return and payment are due quarterly on the last day of the month following the close of the calendar quarter

Polling question

Are you a Certified Payroll Professional (CPP) or Fundamental Payroll Certification (FPC) through PayrollOrg? (CPAs, please do not respond to this question)

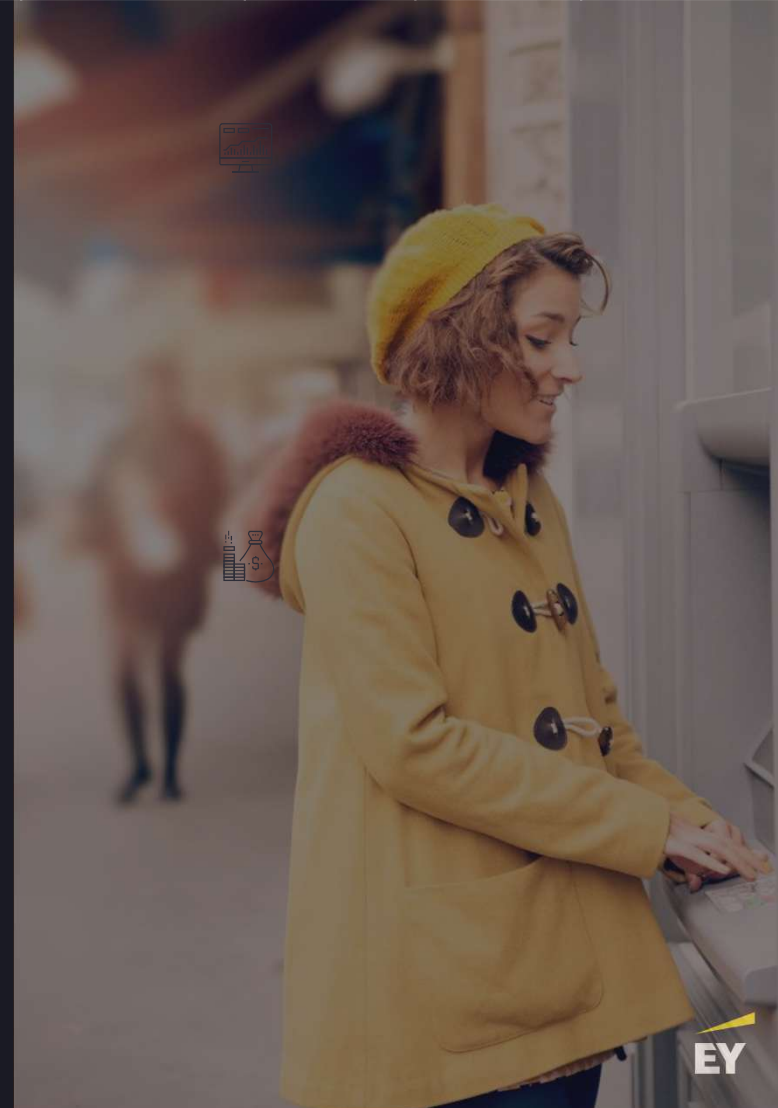
- a. Yes
- b. No

Payroll year-end checklist highlights

The additional pay day

Why the additional pay day?

- Because the the calendar year is actually divisible by 52.1786 weekly pay period (and not 52) and 26.0893 (and not 26), every 5 or 6 years there are 53 weekly periods, and every 11 or 12 years there are 27 biweekly periods
- The extra pay day is the accumulative result of receiving weekly-based pay in the course of the employer's full calendar-year life cycle



The additional pay day: Salaried employees

The additional payroll period will generally always result in higher-than-normal annual wages for nonexempt employees; however, whether the same is true of exempt-salaried employees depends on how their payroll period salaries are determined. There are three approaches for computing the weekly/biweekly pay of salaried employees, each with a different budgetary result

01

Recompute the annual salary in the year of an additional payroll period

- The agreed-upon annual regular salary of exempt employees is divided by the actual number of payroll periods in the year

Budgetary result. In all years, including the year of the additional payroll period, the annual compensation is close the agreed upon regular salary

02

*

Do not recompute the annual salary in the year of an additional payroll period

- The agreed-upon annual regular salary of exempt employees is divided by 26, or 52 payroll periods, and is not adjusted in those years with an additional payroll period

Budgetary result. The result is a windfall in pay in the year of an additional payroll period

03

Use the exact calendar-year divisor of 26,0893 or 52.1786

- The agreed-upon annual regular salary is divided by 26.0893 for those paid biweekly and 52.1786 for those paid weekly

Budgetary result. In most years, salaried employees are paid slightly less than the agreed upon salary which is captured in the year of the additional pay period when the salaried employee receives the additional pay period wages

* Most employers that pay their salaried employees on a weekly or biweekly basis choose this method despite the windfall for salaried employees (EY unofficial survey of employers)

Additional pay period considerations

1 Income tax withholding

In the year in which there is an additional payroll period, weekly and biweekly payers should consider if an adjustment is needed to their federal, state and local income tax withholding formulas to avoid underwithholding for the year

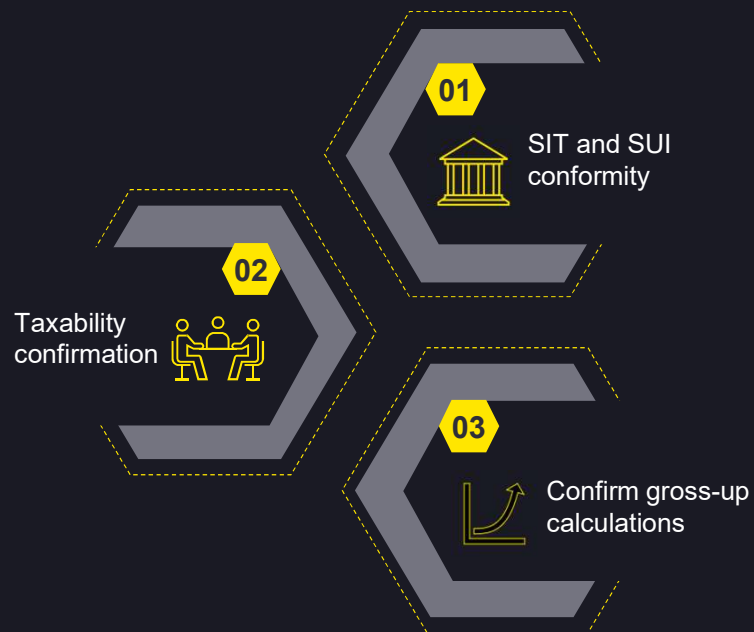
2 Payroll deductions and special wage payments

Payroll deductions and special wage payments that occur on a pay period basis may need to be adjusted in the year of the additional pay period. For instance, a health insurance deduction may need to be suppressed in the final pay period of the year

Insights

- To eliminate complications in paying the correct annual salary to exempt employees, it is not uncommon for businesses to pay their salaried exempt on a semimonthly basis (where allowed by state and local law) while paying hourly and salaried nonexempt employees on a weekly or biweekly basis
- Always consult with a labor law advisor before making a change in the amount or frequency at which you pay salaried employees

Top three year-end checklist items for 2025



01

FIT, FITW, FICA and Form W-2 reporting requirements were affected by the SECURE 2.0 Act, the OBBA and IRS guidance governing state PFML. States and locals may not conform to these federal changes and employers will need to monitor state/local tax rules

02

Before releasing 2025 Forms W-2, review payroll system tax configurations for the correct tax treatment and reporting of fringe benefits. Also review to confirm that benefit limits have not been exceeded

03

The Form 941-X instructions clarify that prior-year adjustments to federal income tax withholding and the Additional Medicare Tax are not allowed merely because these taxes were paid by the employer in connection with a gross-up. Businesses will need to carefully review their 2024 gross-up calculations prior to December 31, 2024, to avoid federal income tax and Additional Medicare Tax overpayments they cannot recover after the close of the year. (See [Form 941-X instructions, page 4](#))

Resources

Ernst & Young LLP special reports



- [2025 payroll year-end checklist](#)
- [The additional payday: considerations for weekly and biweekly payers](#)
- [Fringe benefits reporting: frequently asked questions for 2025](#)
- [Federal reporting chart for fringe benefits chart for 2025](#)
- [US employment tax rates and limits for 2025](#)
- [Federal and state Form W-4 compliance for 2025](#)
- [State unemployment insurance requirements for employee notices and workplace posters](#)
- [Taking the stress out of Affordable Care Act reporting](#)

Federal Form W-2 resources

- [2025 Form W-2](#)
- [2025 Form W-2 and W-3 instructions](#)
- [SSA specifications for filing electronically](#)
- [SSA AccuWage \(testing files\)](#)
- [IRS specifications for substitute forms \(Pub. 1141\)](#)

Acronyms



Acronym	Definition
EE	Employee
ER	Employer
FICA	Social Security and Medicare tax
FIT	Federal income tax
FITW	Federal income tax withholding
FUTA	Federal unemployment insurance
HSA	Health Savings Account
LIT	Local income tax
LITW	Local income tax withholding
PFML	Paid family and medical leave insurance
SALT	State and local tax
SDI	State disability insurance
SIT	State income tax
SITW	State income tax withholding
SSA	Social Security Administration
SSN	Social Security Number
SUI	State unemployment insurance
UI	Unemployment insurance

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