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TAX ALPHA
THE RETURN YOU ENGINEER

Seven provisions of the Internal Revenue Code that reward advance planning

The difference between filing a return and planning for one is measured in years, not weeks.

ABSTRACT

Most of what determines an owner's tax bill is settled before the return is opened. This paper examines seven provisions of the Internal Revenue Code that reward advance planning: cost segregation paired with restored full expensing, intangible drilling costs, the rebuilt Opportunity Zone program, installment sales and their trust-based variants, defined benefit and cash balance plans, Roth conversion at a discounted valuation, and the research and development credit.

The organizing idea is tax alpha: the return produced by tax treatment rather than by market performance. Two identical investments held by two owners can deliver different after-tax results because of when the gain is recognized, which entity holds the asset, and what deduction was created alongside it. Unlike market return, that difference can be engineered in advance.

Every dollar not paid in tax is a dollar still available to deploy, so the work runs in one sequence: model the tax consequence before a dollar is deployed, quantify the alpha the decision produces, then implement through the appropriate licensed professionals against that analysis. Affiliated and third-party professionals are separately engaged and compensated.

Each section states the mechanism, the conditions that govern it, and the risk it carries. Figures reflect the One Big Beautiful Bill Act of 2025 and IRS Notice 2025-67. Three client case studies show how the provisions interact across a single tax year.

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Preparation Looks Backward. Planning Looks Forward.

By the time a return is prepared, nearly every number on it is fixed. The entity was chosen years ago. The building was placed in service in March. The business sold in August. A preparer's job at that point is accuracy, and accuracy is worth paying for — but it is not the same thing as savings.

Planning happens upstream, while the facts are still moveable. It asks a different set of questions. In what year should this gain land? Which entity should hold the asset? What deduction can be created in the same year as the income it offsets? Should the note be paid over five years or one? These decisions are usually available for a window of months, and then they close permanently.

The seven strategies below share that character. None of them are secrets, and none of them are loopholes — each one is an explicit provision of the Internal Revenue Code, several of them written specifically to encourage the behavior they reward. What they have in common is that they must be put in place before the taxable event, not after it. That is the whole argument for planning.

They also carry real conditions and real risk. We have tried to state both plainly. A strategy that only works when described in a brochure is not a strategy.

A decision that is available for a window of months is worth more than a deduction found in April. Planning is the practice of acting while the facts are still moveable.

THE ARGUMENT



01 Cost Segregation and Full Expensing

A commercial building depreciates over thirty-nine years; residential rental property over twenty-seven and a half. Those schedules apply to the structure. They do not apply to everything inside it.

A cost segregation study is an engineering analysis that separates a property into its components and assigns each one the recovery period the tax code actually gives it. Carpet, cabinetry, dedicated electrical, specialty plumbing, and decorative finishes commonly land in five- or seven-year classes. Paving, landscaping, fencing, and site lighting land in fifteen-year classes. The shell of the building stays where it was.

That reclassification has always accelerated deductions. What changed is what happens to the accelerated portion. The One Big Beautiful Bill Act, signed in July 2025, permanently restored 100% bonus depreciation for qualifying property with a recovery period of twenty years or less, acquired and placed in service after January 19, 2025. Every component a study moves into a five-, seven-, or fifteen-year class is squarely in that category.

The practical effect is that a study no longer just front-loads a deduction over several years. It converts a portion of the purchase price into a first-year write-off.

Owners who skipped a study during the phase-down years, when bonus depreciation had fallen to 60% and then 40%, are not out of time. A look-back study paired with a Form 3115 change in accounting method allows the missed depreciation to be caught up in a single year, without amending prior returns.

Conditions Worth Knowing

The deduction is timing, not forgiveness. Accelerated components are recaptured on sale, generally as ordinary income under section 1245, so the benefit is the time value of money and the ability to place the deduction in a high-bracket year. And the study itself has to be defensible: the IRS publishes an Audit Techniques Guide for exactly this area, and an engineering-based study from a qualified firm is the standard it expects.



02 Intangible Drilling Costs

Domestic oil and gas is one of the few places in the code where Congress deliberately left a large, current, above-the-line deduction in place. It has survived every major rewrite since 1913.

Drilling a well produces two kinds of cost. Tangible costs — casing, wellhead equipment, tanks — are capitalized and depreciated. Intangible drilling costs are everything consumed in the process and left with no salvage value: labor, fuel, drilling fluids, site preparation, rig time. On a typical domestic well, intangible costs run roughly 60% to 80% of the total, and an investor holding a working interest may elect to deduct them in the year they are incurred.

The second feature matters as much as the first. Passive losses ordinarily cannot offset wages, business income, or capital gains. Section 469(c)(3) carves out an exception: a working interest in an oil or gas property held in a form that does not limit the investor's liability is not treated as a passive activity. The deduction is therefore available against active and portfolio income, which is what makes it useful in the year a business sells or a large bonus lands.

Conditions Worth Knowing

This is the highest-risk item in the paper, and the deduction is not the investment thesis. Wells come in dry. Commodity prices move against operators. The general-partner structure that unlocks the active treatment also exposes the investor to liability that a limited interest would not, and many programs convert to limited interests after the drilling phase. Sponsor quality, geology, and program economics deserve more diligence than the tax result does.

STATUTE

§469(c)(3)

A working interest sits outside the passive activity rules, so the deduction reaches wages, business income, and capital gains — the reason it matters in the year a business sells.



03 Qualified Opportunity Zones, Second Edition

The Opportunity Zone program was written in 2017 with an expiration date attached. It no longer has one. The 2025 legislation made the program permanent and rebuilt its mechanics, and the rebuilt version takes effect on January 1, 2027.

The core bargain is unchanged. An investor who realizes a capital gain and reinvests it into a Qualified Opportunity Fund within 180 days defers tax on that gain, and — if the fund investment is held for at least ten years — pays no federal tax on the fund's own appreciation.

What changed is the timing architecture. Under the original rules, every investor's deferral ended on the same date, December 31, 2026, regardless of when they invested. The new rules replace that with a rolling five-year deferral measured from the date of each investment, which makes the benefit consistent whether an owner sells in 2027 or 2034.

Rural Funds

The most significant addition is a rural sleeve. A Qualified Rural Opportunity Fund, invested entirely in rural zones, receives a 30% basis step-up at five years rather than the standard 10% — triple the standard reduction in deferred gain. Rural projects also face a 50% substantial improvement threshold instead of 100%, meaning the developer must invest half the property's basis in improvements rather than matching it.

Conditions Worth Knowing

Ten years is a genuine lock-up in an illiquid asset, and the exclusion is now capped: on the thirtieth anniversary of an investment, basis freezes at that day's fair market value. The seven-year step-up is gone. And an Opportunity Zone investment is still a real estate or operating investment first — the tax benefit does not rescue a project that should not have been built.

WHAT THE 2025 REWRITE CHANGED

Deferral now runs five years from each investment rather than ending on one fixed date, and a rural fund receives a 30% basis step-up in place of the standard 10%.



04 Installment Sales and Sale Trusts

When a business or a property sells in a single closing, the entire gain lands in one tax year, usually at the top of every applicable rate and often carrying the net investment income tax with it. Spreading that recognition across years is the oldest deferral tool in the code.

Section 453 permits a seller who receives at least one payment after the year of sale to report gain proportionally as payments arrive. This is settled law, used routinely, and requires no exotic structure.

Trust-based variants extend the idea. In the common form, the seller conveys the asset to an irrevocable trust with an independent trustee in exchange for an installment note; the trust then sells the asset to the buyer and invests the proceeds, paying the seller over a defined term. Done properly, the seller has not received the money, and gain is reported as the note is paid.

Where This Gets Serious

The IRS has never issued a revenue ruling or regulation approving the trust-based version. Its silence is not endorsement — each transaction stands or falls on its own facts. Treasury has proposed regulations designating monetized installment sales as listed transactions requiring disclosure on Form 8886. Monetized structures have appeared repeatedly on the IRS Dirty Dozen list.

Several rules are absolute. Under section 453A(d), pledging the note as loan collateral triggers immediate gain on the borrowed amount. Above roughly $5 million in deferred obligations, section 453A imposes an interest charge on the deferred tax — a real cost that has to be modeled, not ignored.

What separates a defensible structure from a challenged one is usually sequence and independence: the trust is funded before a binding purchase agreement is signed, the trustee is genuinely unrelated to the promoter, the note bears a market rate, and the seller cannot direct investments or demand prepayment. If any of those is missing, the arrangement is unlikely to survive examination — and the seller, not the promoter, bears the assessment.



05 Defined Benefit and Cash Balance Plans

A 401(k) is a contribution-limited plan: the code caps what goes in. A defined benefit plan is a benefit-limited plan: the code caps what comes out, and the contribution is whatever an actuary says is required to fund it. For an owner in their fifties with high, stable income and few employees, the difference is an order of magnitude.

A cash balance plan is the version most closely held businesses use. It presents each participant with a hypothetical account credited annually with a pay credit and a stated interest crediting rate — readable like a 401(k) statement, funded like a pension. Contributions are deductible to the business and rise with the participant's age, because there are fewer years left to fund the promised benefit.

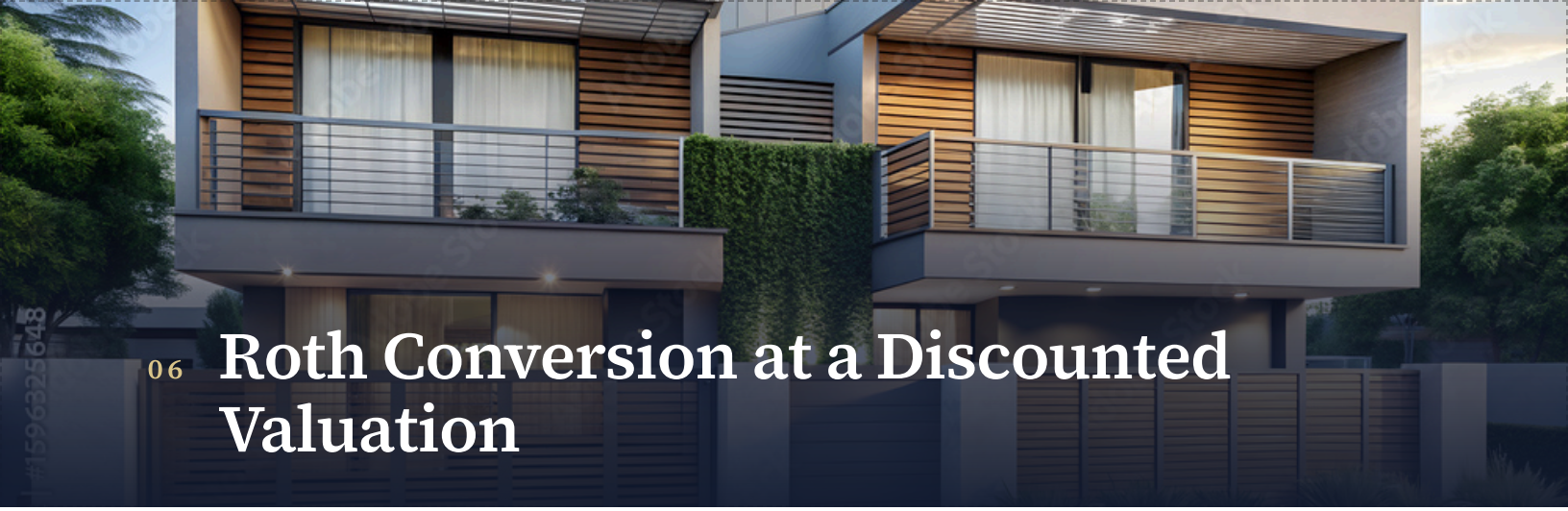
Conditions Worth Knowing

Funding is a legal obligation, not an election. Once the plan is adopted, the required contribution is due whether the year was strong or weak, which makes income stability a prerequisite. Employees must be covered, and the staff cost is a real number that cross-testing reduces but does not eliminate.

2026 LIMITS

PROVISION	2026 LIMIT
Maximum annual defined benefit — §415(b)	$290,000
Defined contribution annual additions — §415(c)	$72,000
Elective deferrals — §402(g)	$24,500
Catch-up contributions, age 50 and over	$8,000
Compensation cap — §401(a)(17)	$360,000

Source: IRS Notice 2025-67. A cash balance contribution is actuarially determined and is not itself a fixed dollar limit; the §415(b) benefit cap governs the maximum the plan may promise.



06 Roth Conversion at a Discounted Valuation

A conversion is a purchase. The owner pays tax today on the amount converted, and everything after that grows and distributes free of federal income tax. The variable worth planning around is not whether to convert, but what the converted asset is worth on the day it moves.

Publicly traded securities leave no room here — value is the closing price. Closely held assets are different. Where a self-directed IRA holds a minority, non-managing membership interest in an LLC that owns real estate, the value of that interest is not the same as its share of the underlying property. A holder who cannot force a sale, compel distributions, or readily find a buyer owns something worth less than pro-rata net asset value.

A qualified independent appraisal quantifies that gap as discounts for lack of control and lack of marketability. Where they apply, the amount reported as taxable on conversion is the appraised value of the interest rather than the property's equity. Everything the property does afterward — recovery, appreciation, rent — happens inside the Roth, where it is not taxed at all, and Roth IRAs carry no required minimum distributions during the owner's lifetime.

Timing compounds the effect. A conversion placed in a year already carrying a large deduction, from a cost segregation study or a drilling program, lets that deduction absorb the conversion income rather than leaving it exposed at the top rate.

Conditions Worth Knowing

The discount has to be earned rather than assumed. It requires an independent qualified appraiser, restrictions that genuinely exist in the operating agreement, and annual fair market value reporting on Form 5498. Aggressive discounts have been litigated and reduced.

The prohibited transaction rules under section 4975 are strict liability and unforgiving. The owner cannot use the property, guarantee its debt, or transact with it; a violation disqualifies the entire account as of the first day of that year. The conversion tax should be paid from funds outside the account, and since 2018 a conversion cannot be undone.



07 The Research and Development Credit

A deduction reduces income. A credit reduces tax. The research credit under section 41 is one of the few dollar-for-dollar offsets available to an operating business, and a fraction of the companies that qualify for it claim it.

The obstacle is usually the word research. The statute's four-part test asks whether the work aimed to improve the function, performance, reliability, or quality of a product or process; whether it relied on hard science or engineering; whether technical uncertainty existed at the outset; and whether it proceeded through experimentation. None of that requires a laboratory. Software development, process improvement, tooling design, formulation work, and prototyping routinely qualify.

Qualified expenses are wages for those performing or supervising the work, supplies consumed in it, cloud computing, and 65% of contract research. Most companies compute under the alternative simplified credit: 14% of qualified spending above half the prior three-year average.

A company with no tax liability is not excluded. A qualified small business — under $5 million in gross receipts and within five years of its first receipts — may apply up to $500,000 of credit each year against employer payroll taxes, converting it into cash for a business still operating at a loss.

The 2025 legislation also repaired a distortion: since 2022, domestic research costs had to be capitalized and amortized over five years, taxing companies on money already spent. Section 174A restores immediate expensing of domestic research expenditures for tax years beginning after December 31, 2024, with small businesses permitted to apply it retroactively to 2022.

Conditions Worth Knowing

Documentation decides these claims. Contemporaneous project records, time allocation, and technical evidence survive examination, and Form 6765 now requires detail at the business-component level. Promoter studies that qualify everything have drawn IRS attention and appear on the Dirty Dozen list. A study that cannot be defended line by line is worse than no study at all.

SpaceX Pre-IPO Equity

They came to us with 16,665 vested shares across 30 tax lots, a $422,000 AMT preference from a Q1 ISO exercise already on the books, $527,000 of W-2 income, and a goal of $500,000 in liquid cash by year end.

AT A GLANCE

VESTED SHARES	16,665
TAX LOTS	30
SHARES SAFE TO SELL	8,310
AMT PREFERENCE	$422,000
ISO SHARES AT RISK	4,700
W-2 INCOME	$527,000
LIQUIDITY TARGET	$500,000
FEDERAL TAX ELIMINATED	$259,297

HERE'S WHAT WE FOUND

Only 8,310 of those shares were safe to sell. Another 4,700 were Q1 2026 ISO shares that, if sold on the wrong side of the holding period, would convert $422,000 of AMT preference into ordinary income taxed at 37%. No one had looked at the position lot by lot. Share sales carry no withholding, so a $230,000 tax bill was building with nothing reserved against it. And the proceeds had nowhere tax efficient to land, which is where most concentrated positions quietly leak value on the way out.

HERE'S WHAT WE DID

Sold exclusively out of the long term eligible lots. Sized a $128,000 bonus depreciation deployment to produce exactly $512,000 of loss, the precise §461(l) ceiling for joint filers, confirming first that §168(k) is not an AMT addback so the deduction would reduce regular tax and AMT together. Sized the 2027 carryforward to $736,000, the largest amount §172's 80% cap allows the year to fully absorb. Closed a $5,157 safe harbor gap with one estimated payment.

WHERE THE PROCEEDS WENT

Then we put the proceeds into direct indexing with an options overlay. We use this to get the client out of the concentrated position over time while generating losses along the way that offset the tax on the shares still to be sold. The overlay matters because a plain index sleeve stops producing those losses once the market runs. We declined the competing long/short SMA pitch, which delays the tax rather than reducing it.

HERE'S THE OUTCOME

	WITHOUT PLANNING	WITH PLANNING
2026 federal tax	$302,679	$234,742
2027 federal tax	$261,721	$70,361
April 2028 position	Balance due	$20,679 refund

$259,297

of federal tax eliminated across two years

$422,000 of ordinary income exposure avoided entirely. The client hit his liquidity target without selling a single share that shouldn't have been sold, and the remaining position is being unwound with a tax offset running against it instead of a bill waiting on it.

Practice Exit and Multi-Entity Restructure

They came to us with a $1.58 million liquidity event and no plan for it. A dental practice sold for $783,000, the commercial building it operated in sold for $800,000, and behind both sat a two-tier Texas structure: a limited partnership holding the real estate, an LLC serving as general partner, owned 50/50 by a married couple. Their existing preparer had filed the returns. No one had planned the exit.

AT A GLANCE

LIQUIDITY EVENT
$1,580,000

PRACTICE SALE
$783,000

BUILDING SALE
$800,000

PARTNERS' CAPITAL
−$81,000

TAX DEFERRED OR OFFSET
≈ $377,000

HERE'S WHAT WE FOUND

Three years of Form 1065 returns nobody had read back to them. Roughly $36,700 per year running through an undifferentiated "other deductions" block in 2022 and 2023, then disappearing entirely in 2024 with no corresponding change in operations. Both of those returns had been amended because the originals were filed without figures. Partners' capital sat at negative $81,000, which directly affects outside basis under §705 and gain recognition on disposition. A forward projection they had never seen: the partnership was on track to generate $107,349 of net income in 2025, roughly $50,000 of K-1 income per partner, landing in the same tax year as the sale and carrying the 3.8% net investment income tax under §1411. And one item the sale had nothing to do with: a prior Qualified Opportunity Fund position whose deferred gain was reaching its statutory recognition date under §1400Z-2(b), with the tax payable that April.

HERE'S WHAT WE DID

We modeled the exit by gain character rather than by sale price, which is the analysis most sellers never receive. Ordinary income was isolated to cash-basis receivables, supplies, and work in progress. §1245 recapture was identified on fully depreciated dental equipment, where the entire allocation converts to ordinary rates. Unrecaptured §1250 gain on the building was separated from the land, which carries no recapture. Goodwill was allocated and defended as the highest-value line in the Form 8594 negotiation, taxed at long-term capital gain rates with no recapture exposure. Each resulting bucket was then matched to the vehicle that could actually reach it, and the recognition event already on the calendar was planned for rather than absorbed.

HERE'S THE OUTCOME

The real estate proceeds were exchanged under §1031 into Delaware Statutory Trusts, deferring both the long-term capital gain and the unrecaptured §1250 gain while converting one illiquid building into diversified, professionally managed, income-producing real estate with no landlord obligations. The capital gain component of the practice sale was reinvested into a Qualified Opportunity Fund under §1400Z-2, deferring recognition and starting the holding period toward permanent exclusion of future appreciation. The maturing QOF inclusion was offset with ordinary deductions sourced through a permanent-crop agricultural investment in which the clients materially participate under §469, so a tax bill already scheduled for April never landed.

≈ $377,000

total federal tax deferred or offset across the engagement

The clients replaced the rental income they gave up with a passive distribution stream, held deferral on the capital gain and §1250 components, neutralized a recognition event on the calendar, and paid current tax only on the ordinary income items no deferral vehicle reaches.

WHAT DEFERRAL IS NOT

Deferral is not forgiveness. §1031 carries basis forward and §1400Z-2 has a statutory recognition date. Ordinary income and §1245 recapture are not deferrable under either structure and were paid in the year of sale. Results are specific to this household and are not indicative of any other outcome. DSTs, Qualified Opportunity Funds, and direct agricultural offerings are illiquid, speculative, and available only to accredited investors.

Concentrated Position Exit and Same-Year Offset

They came to us with a $3.91 million liquidity event and no plan for it. 20,775 shares of a concentrated employer-stock position sold for $3,909,796 against a cost basis of $434,091, and behind the sale sat a California household structure: a joint account owned by a married couple, two irrevocable life insurance trusts, and a premium-financed policy requiring $2.4 million of pledged collateral the employer's own stock could not secure. Their existing advisor had placed the trades. No one had planned the sale.

AT A GLANCE

SHARES SOLD
20,775

PROCEEDS
$3,909,796

LONG-TERM GAIN
$3,475,705

TAX OFFSET
≈ $957,000

COLLATERAL REQUIRED
$2,400,000

HERE'S WHAT WE FOUND

No cost basis from the firm managing the account, so we reconstructed it by hand, FIFO, off the April statement: $3,475,705 of realized long-term capital gain on a single trade date. Roughly $1.2 million of combined federal and California tax on that one event, carrying the 3.8% net investment income tax under §1411 and taxed by California as ordinary income, because the state grants no preferential capital gain rate. A proposed remedy of “some losses through December” and a line of credit for the balance, with no dollar amount, no positions, and no timeline. A forward projection they had never seen: just under $800,000 of additional 2026 tax absent any action. And one item the sale had nothing to do with: RSUs, ESPP, NSOs, and ISOs vesting into the same years, planned by no one.

HERE'S WHAT WE DID

We modeled the year by what was still moveable rather than by what had already been realized, which is the analysis most sellers never receive. The April gain was isolated as closed, because character and §1411 exposure fix at settlement. Charitable capacity under §170 was sized against the realized gain itself, since the deduction is the only lever that still reaches a completed sale.

Bonus depreciation under §168(k) was screened out of current-year offset because California does not conform. The concentration itself was separated from the tax problem and routed into direct indexing, where the unwind produces §1091-compliant harvestable losses on a schedule instead of in one event.

HERE'S THE OUTCOME

$470,000 was allocated into a medical charitable device fund under §170, producing a deduction at a 5 to 1 income offset ratio and absorbing nearly $900,000 of liability in the same year the gain was recognized. The agricultural and real estate allocation was repositioned into Roth conversion efficiency under §408A, where California nonconformity carries no penalty. The remaining concentration moves into direct indexing, and the equity compensation schedule is now planned in advance of each vest.

≈ $957,000

total federal and state tax offset across the engagement

The clients kept the collateral their trusts require, replaced an unmanaged concentration with a portfolio that produces its own offsets, and paid current tax only on the components no deduction reaches.

WHAT A DEDUCTION IS NOT

A deduction is not a deferral. §170 contributions are permanent and irrevocable, require qualified appraisal and substantiation, and are limited by AGI percentage ceilings. The April gain itself was not reduced or recharacterized, because a closed sale cannot be. California does not conform to federal bonus depreciation, so strategies that work federally may produce no state benefit. Results are specific to this household and are not indicative of any other outcome. Charitable device funds, agricultural offerings, and direct private placements are illiquid, speculative, and available only to accredited investors.

Sequence Is the Strategy

Read individually, these are seven deductions and deferrals. Used well, they are a calendar.

A deduction is worth the most in the year of the highest marginal rate, which for most owners is the year they sell — also the year with the least flexibility, because by then the letter of intent is signed. The retirement plan had to be adopted before the plan year closed; the drilling program funded before December 31; the Opportunity Zone clock started at the closing, not at the wire.

Three questions open the window early enough to matter. When will the largest taxable event of the next decade occur? Which deductions can be created in that same year? And what is the owner willing to hold illiquid in exchange for the tax result?

An exit plan drafted five years out will be revised more than once. That is not a failure of the plan; it is the point of having one early enough to revise.

Aggressive Is Not the Same as Effective

Every provision here was enacted deliberately: full expensing to encourage capital investment, the drilling deduction to encourage domestic production, Opportunity Zones to move capital into specific census tracts, the pension rules to encourage funded retirements. Using them as written is not avoidance — it is the response the statute was designed to produce.

The line worth holding runs between a provision used for its purpose and a structure built to look like one. The first compounds quietly for decades. The second produces a Form 8886, a penalty, and a bill the promoter does not pay. We work on the first side of that line, with your CPA and attorney.

> *Nearly every strategy here exchanges liquidity for savings. The question is not whether the deduction is real, but whether the owner wants the asset that produces it.*
>
> THE PRACTICAL TEST

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To discuss how any of these apply to a specific situation, contact Trinity Tax Strategies.

AUTHORITIES CITED

Internal Revenue Code §168(k) — bonus depreciation
§263(c) — intangible drilling and development costs
§453 and §453A — installment method; interest charge and pledging rules
§469(c)(3) — working-interest exception to the passive loss rules
§401(a), §402(g), §415(b), §415(c), §401(a)(17) — qualified plan limits
§1245 and §1250 — depreciation recapture
§1400Z-2 — qualified opportunity zones
One Big Beautiful Bill Act of 2025, Pub. L. 119-21
IRS Notice 2025-50 — rural opportunity fund improvement threshold
IRS Notice 2025-67 — 2026 retirement plan limitations
Chief Counsel Memorandum AM 2023-006
IRS Cost Segregation Audit Techniques Guide
Form 3115, change in accounting method; Form 8886, reportable transaction disclosure

DISCLOSURES

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Statutory references and dollar limits are current as of September 2026 and reflect the One Big Beautiful Bill Act of 2025 and IRS Notice 2025-67. Provisions described as effective in 2027 remain subject to Treasury guidance and regulation.

Alternative investments, including oil and gas programs, Qualified Opportunity Funds, and private real estate, involve substantial risk, are illiquid, may use leverage, and may be suitable only for accredited investors. Loss of principal is possible. The case study describes an actual engagement; identifying details are withheld and figures are as modeled in the client's returns. No result described is a promise of any outcome in another matter. Past performance does not guarantee future results.