

Chapter 6: New Developments

Protecting Americans from Tax Hikes Act of 2015.....	A247
Bipartisan Budget Act of 2015	A269
Fixing America's Surface Transportation Act ...	A273

Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 ..	A276
Omnibus of 2015.....	A278
Identity Theft Issues.....	A280
The ACA and Tax Return Preparation	A293

Please note. Corrections were made to this workbook through January of 2017. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

6

PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015¹

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), which permanently extends several key provisions and temporarily extends others. The tax extenders legislation was combined with an omnibus spending package, which funds the government through September 2016. A summary of the tax extenders follows.

Note. The omnibus spending package is discussed later in this chapter.

INDIVIDUAL EXTENDERS

The PATH Act permanently extends several tax provisions and extends others through either 2016 or 2019.

Additional Child Tax Credit²

Old Law. A taxpayer can claim a tax credit of \$1,000 for each qualifying child under the age of 17. The aggregate amount of the child tax credit (CTC) is reduced by \$50 for each \$1,000 of modified adjusted gross income (MAGI) over the following threshold amounts.

Filing Status	MAGI Threshold
Single or head of household (HoH)	\$ 75,000
Married filing jointly (MFJ)	110,000
Married filing separately (MFS)	55,000

¹. Joint Committee on Taxation. *Technical Explanation of the Protecting Americans From Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029*. JCX-144-15. (Dec. 17, 2015).

². IRC §24.

To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit, or ACTC), which is 15% of earned income in excess of a threshold amount (the "earned income formula"). This threshold amount is \$10,000, indexed for inflation starting in 2001. However, for tax years 2009 through 2017, the threshold amount was reduced to \$3,000.

A taxpayer with three or more qualifying children can calculate the ACTC using an alternative formula if this results in a larger credit than is calculated using the earned income formula. Under the alternative formula, the ACTC is the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit.

New Law. The PATH Act makes the reduced earned income threshold of \$3,000 for the ACTC **permanent**.

American Opportunity Credit³

Old Law. The American opportunity credit (AOC) modified and enhanced the Hope credit for tax years 2009 through 2017. The maximum AOC is \$2,500 per eligible student for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a qualified program. The credit is 100% of the first \$2,000 of qualified tuition and related expenses and 25% of the next \$2,000 of qualified expenses. Forty percent of the AOC is refundable.

New Law. The PATH Act makes the modifications to the Hope credit, known as the AOC, **permanent**.

Note. For more information about the AOC, see the 2015 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: Education.

Earned Income Credit⁴

Old Law. The American Taxpayer Relief Act of 2012⁵ (ATRA) extended a provision that allows taxpayers with three or more qualifying children to claim an earned income credit (EIC) of 45% of qualified earnings. Previously, such taxpayers were allowed to claim an EIC of 40%.

Additionally, ATRA increased the phaseout threshold for MFJ taxpayers to \$5,000 (indexed for inflation after 2009) above that for other filers. Previously, the phaseout threshold for MFJ taxpayers was \$3,000 above that for other filers.

These ATRA provisions were scheduled to expire after December 31, 2017.

New Law. The PATH Act makes **permanent** the EIC rate of 45% for taxpayers with three or more qualifying children. In addition, the higher phaseout threshold for MFJ taxpayers is now **permanent**.

Deduction for Teachers' Expenses⁶

Old Law. Certain expenses of eligible elementary and secondary school teachers are allowed as an above-the-line deduction. For tax years beginning prior to January 1, 2015, the deduction was capped at \$250 of expenses paid or incurred annually for equipment and materials used by the eligible teacher in the classroom. This deduction was scheduled to expire after December 31, 2014.

New Law. For tax years beginning after December 31, 2014, the PATH Act makes **permanent** the above-the-line deduction for eligible teachers' expenses. For tax years beginning after December 31, 2015, the \$250 maximum amount is indexed for inflation. For the 2016 tax year, the maximum deduction remains at \$250.⁷

³ IRC §25A.

⁴ IRC §32.

⁵ PL 112-240.

⁶ IRC §62(a)(2)(D).

⁷ Rev. Proc. 2016-14, 2016-9 IRB 365.

The PATH Act also provides that teachers' expenses for professional development are considered eligible expenses for purposes of the deduction.

Note. For further details on the deduction for teachers' expenses, including the types of expenses that qualify and how to claim qualifying expenses on a tax return, see **uofi.tax/16a6x22** [www.irs.gov/taxtopics/tc458.html].

Parity for Employer-Provided Transit and Parking Benefits⁸

Old Law. Qualified employer-provided transportation fringe benefits are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes. Qualified transportation fringe benefits include transit passes, parking, vanpool benefits, and qualified reimbursements for bicycle commuting.

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was subject to one monthly limit for combined vanpool and transit pass benefits and a higher monthly limit for qualified parking benefits. For months beginning on or after February 17, 2009, and before January 1, 2015, parity in qualified transportation fringe benefits was provided by increasing the monthly exclusion for combined transit pass and vanpool benefits to the same level as the exclusion for parking. As of January 1, 2015, a lower monthly limit was scheduled to apply to the exclusion for combined transit pass and vanpool benefits.

New Law. The PATH Act reinstates parity in the exclusion for combined employer-provided transit pass and vanpool benefits and for employer-provided parking benefits. This parity is made **permanent**.

For 2015, the monthly limit on the exclusion for combined transit pass and vanpool benefits is \$250, which is the same as the monthly limit on the exclusion for qualified parking benefits. The monthly exclusion limit is \$255 for 2016.⁹

Deduction for State and Local Sales Taxes¹⁰

Old Law. For tax years beginning before January 1, 2015, a taxpayer who itemizes deductions can elect to take a deduction for state and local general sales taxes in lieu of the deduction for state and local income taxes. This option was scheduled to expire after December 31, 2014.

New Law. A provision in the PATH Act makes **permanent** the taxpayer's option to claim an itemized deduction for sales and local sales taxes in lieu of state and local income taxes.

Observation. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming have not implemented a state income tax.¹¹ The ability to take a deduction for state and local general sales taxes instead of income taxes allows taxpayers in these states to claim a deduction for state-level tax liability incurred for the year. For further information, including an online sales tax calculator, see **uofi.tax/16a6x23** [www.irs.gov/individuals/sales-tax-deduction-calculator].

⁸ IRC §132(f).

⁹ Ibid.

¹⁰ IRC §164.

¹¹ *State Individual Income Tax Rates and Brackets for 2016*. Kaeding, Nicole. Feb. 8, 2016. Tax Foundation. [taxfoundation.org/article/state-individual-income-tax-rates-and-brackets-2016] Accessed on Jun. 2, 2016.

Qualified Conservation Contributions¹²

Old Law. Under a special rule, an individual taxpayer can deduct the fair market value (FMV) of capital gain property contributions made for conservation purposes to the extent of the excess of 50% of the contribution base over the amount of all other allowable charitable contributions. Individuals can carry over any qualified conservation contributions that exceed the 50% limit for up to 15 years.

An individual who is a qualified farmer or rancher in the year in which the contribution is made can deduct the FMV of any qualified conservation contribution up to 100% of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

The temporary rules regarding contributions of capital gain property for conservation purposes were scheduled to expire for tax years beginning after December 31, 2014. Contributions made after that date were to be subject to the 30% limit that otherwise applies to capital gain property.

New Law. Under the PATH Act, the special rule for qualified conservation contributions is **permanently extended**.

Distributions from IRAs for Charitable Purposes¹³

Old Law. Otherwise taxable distributions from an individual retirement arrangement (IRA) are excluded from the taxpayer's gross income to the extent they are qualified charitable distributions. The exclusion cannot exceed \$100,000 per taxpayer per year. A **qualified charitable distribution** is any distribution from an IRA that is made directly by the IRA trustee to an organization described in IRC §170(b)(1)(A) (generally, public charities) other than a supporting organization¹⁴ or a donor-advised fund.¹⁵ A taxpayer's distributions are eligible for the exclusion from gross income only if made on or after the date the IRA owner reaches age 70½.

This exclusion was scheduled to expire for tax years beginning after December 31, 2014.

New Law. A provision in the PATH Act makes the exclusion from gross income for qualified charitable distributions from an IRA **permanent**.

Note. For further information about qualified charitable distributions, see IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*.

¹² IRC §170(b)(1)(E).

¹³ IRC §408(d)(8).

¹⁴ See IRC §509(a)(3).

¹⁵ See IRC §4966(d)(2).

Discharges of Acquisition Debt on Principal Residences¹⁶

Old Law. An exclusion from gross income is provided for any discharge of qualified principal residence debt. **Qualified principal residence debt** is defined as acquisition debt¹⁷ relating to the taxpayer's principal residence.¹⁸ The maximum amount of the exclusion is \$2 million (\$1 million for MFS taxpayers).

The exclusion for qualified principal residence debt was scheduled to expire after December 31, 2014.

New Law. The PATH Act extends for **two years** the exclusion from the taxpayer's gross income for discharges of qualified principal residence debt. Therefore, the **exclusion ends on December 31, 2016**. The provision also allows an exclusion from gross income for a taxpayer whose qualified principal residence debt was discharged on or after January 1, 2017, if the discharge was made under a binding written agreement entered into prior to January 1, 2017.

Mortgage Insurance Premiums¹⁹

Old Law. Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer in connection with acquisition debt on a qualified residence are treated as qualified residence interest; thus, qualified mortgage insurance is deductible. The deduction phases out by 10% for each \$1,000 by which the taxpayer's AGI exceeds \$100,000 (\$50,000 for MFS taxpayers). This provision was scheduled to expire on December 31, 2014.

New Law. A provision in the PATH Act extends the deduction for mortgage insurance premiums for **two years**. Therefore, a **deduction for qualified mortgage insurance is allowed for amounts paid or accrued in 2015 and 2016**.

Tuition and Fees Deduction²⁰

Old Law. An individual is allowed an above-the-line deduction for qualified tuition and related higher-education expenses paid by the individual during the tax year. The amount of the tuition and fees deduction varies based on the taxpayer's MAGI, as shown in the following table.

Tuition and Fees Deduction		
Filing Status	MAGI Phaseout Range	Maximum Deduction
Single, HoH, QW	\$ 0– 65,000	\$4,000
MFJ	0–130,000	4,000
Single, HoH, QW	65,001– 80,000	2,000
MFJ	130,001–160,000	2,000
MFS	Not applicable	Deduction not available

This deduction was scheduled to expire on December 31, 2014.

New Law. The PATH Act extends the qualified tuition deduction for **two years**; thus, it is available through December 31, 2016.

Note. For more information about the tuition and fees deduction, see the 2015 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: Education.

¹⁶ IRC §108.

¹⁷ See IRC §163(h)(3)(B).

¹⁸ See IRC §121.

¹⁹ IRC §163.

²⁰ IRC §222.

BUSINESS EXTENDERS

The PATH Act includes many business tax incentives. Several of these provisions are now permanent, some are extended through 2016, and others are extended through 2019.

Research Credit²¹

Old Law. A taxpayer can claim a research credit of 20% of the amount by which the taxpayer's qualified research expenses for a tax year exceed its base amount for that year. Therefore, the research credit is generally available for incremental increases in qualified research. An alternative simplified credit may be claimed in lieu of this credit. The alternative credit is calculated using a 14% rate and a different base amount. The research credit was scheduled to expire after December 31, 2014.

New Law. The PATH Act makes the research credit **permanent** for tax years beginning after December 31, 2015. It also expanded the credit to allow it to offset:

1. Alternative minimum tax (AMT) in addition to regular tax for **eligible small businesses**, or
2. The 6.2% payroll tax on social security wages in lieu of the credit against income tax liability for **qualified small businesses**

An **eligible small business** is defined as a nonpublicly traded corporation, a partnership, or a sole proprietorship with average annual gross receipts for the 3-tax-year period preceding the tax year that do not exceed \$50 million.²²

A **qualified small business** is defined as a corporation, partnership, or individual who:

1. Has gross receipts of less than \$5 million for the tax year, and
2. Did not have any gross receipts for any tax year prior to the five tax year period ending with the tax year. (Essentially, this provision limits the payroll tax credit to start-up businesses less than five years old.)

For individuals, the preceding tests are based on the aggregate gross receipts received from all of their trades or businesses.

A qualified small business makes the election to apply some or all of the research credit against payroll taxes with its timely filed income tax return (including extensions). The election may only be revoked with IRS consent.

After the election is filed with the income tax return, the taxpayer may claim the credit on line 11 of Form 941, *Employer's Quarterly Federal Tax Return*. Form 8974, *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, must be attached to Form 941. IRS drafts of these forms follow.

Note. The credit is still based on eligible research expenses, but the new offsets apply only to those costs incurred beginning in 2016. The payroll tax credit is intended to help start-up companies that have only a small amount or no income taxes to offset.

²¹ IRC §§38, 41, and 3111(f).

²² IRC §38(c)(5)(C).

Form 941 for 2017: Employer's QUARTERLY Federal Tax Return

(Rev. January 2017) Department of the Treasury — Internal Revenue Service

950117
OMB No. 1545-0029

Employer identification number (EIN) -

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

Foreign country name Foreign province/county Foreign postal code

Report for this Quarter of 2017 (Check one.)

- ☐ 1: January, February, March
☐ 2: April, May, June
☐ 3: July, August, September
☐ 4: October, November, December
- Instructions and prior year forms are available at www.irs.gov/form941.

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

1	Number of employees who received wages, tips, or other compensation for the pay period including: Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), or Dec. 12 (Quarter 4)	1	<input type="text"/>																				
2	Wages, tips, and other compensation	2	<input type="text"/>																				
3	Federal income tax withheld from wages, tips, and other compensation	3	<input type="text"/>																				
4	If no wages, tips, and other compensation are subject to social security or Medicare tax	<input type="checkbox"/> Check and go to line 6.																					
<table border="0"> <thead> <tr> <th></th> <th>Column 1</th> <th></th> <th>Column 2</th> </tr> </thead> <tbody> <tr> <td>5a</td> <td>Taxable social security wages</td> <td><input type="text"/> × 0.124 =</td> <td><input type="text"/></td> </tr> <tr> <td>5b</td> <td>Taxable social security tips</td> <td><input type="text"/> × 0.124 =</td> <td><input type="text"/></td> </tr> <tr> <td>5c</td> <td>Taxable Medicare wages & tips</td> <td><input type="text"/> × 0.029 =</td> <td><input type="text"/></td> </tr> <tr> <td>5d</td> <td>Taxable wages & tips subject to Additional Medicare Tax withholding</td> <td><input type="text"/> × 0.009 =</td> <td><input type="text"/></td> </tr> </tbody> </table>					Column 1		Column 2	5a	Taxable social security wages	<input type="text"/> × 0.124 =	<input type="text"/>	5b	Taxable social security tips	<input type="text"/> × 0.124 =	<input type="text"/>	5c	Taxable Medicare wages & tips	<input type="text"/> × 0.029 =	<input type="text"/>	5d	Taxable wages & tips subject to Additional Medicare Tax withholding	<input type="text"/> × 0.009 =	<input type="text"/>
	Column 1		Column 2																				
5a	Taxable social security wages	<input type="text"/> × 0.124 =	<input type="text"/>																				
5b	Taxable social security tips	<input type="text"/> × 0.124 =	<input type="text"/>																				
5c	Taxable Medicare wages & tips	<input type="text"/> × 0.029 =	<input type="text"/>																				
5d	Taxable wages & tips subject to Additional Medicare Tax withholding	<input type="text"/> × 0.009 =	<input type="text"/>																				
5e	Add Column 2 from lines 5a, 5b, 5c, and 5d	5e	<input type="text"/>																				
5f	Section 3121(q) Notice and Demand—Tax due on unreported tips (see instructions)	5f	<input type="text"/>																				
6	Total taxes before adjustments. Add lines 3, 5e, and 5f	6	<input type="text"/>																				
7	Current quarter's adjustment for fractions of cents	7	<input type="text"/>																				
8	Current quarter's adjustment for sick pay	8	<input type="text"/>																				
9	Current quarter's adjustments for tips and group-term life insurance	9	<input type="text"/>																				
10	Total taxes after adjustments. Combine lines 6 through 9	10	<input type="text"/>																				
11	Qualified small business payroll tax credit for increasing research activities. Attach Form 8974	11	<input type="text"/>																				
12	Total taxes after adjustments and credits. Subtract line 11 from line 10	12	<input type="text"/>																				
13	Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter	13	<input type="text"/>																				
14	Balance due. If line 12 is more than line 13, enter the difference and see instructions	14	<input type="text"/>																				
15	Overpayment. If line 13 is more than line 12, enter the difference	<input type="text"/> Check one: <input type="checkbox"/> Apply to next return. <input type="checkbox"/> Send a refund.																					

► You MUST complete both pages of Form 941 and SIGN it.

Next ►

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher.

Cat. No. 17001Z

Form 941 (Rev. 1-2017)

6

2016 Workbook

Form **8974:** **Qualified Small Business Payroll Tax Credit for Increasing Research Activities** 950817
(January 2017) Department of the Treasury — Internal Revenue Service OMB No. 1545-XXXX

Employer identification number (EIN) <input type="text"/> <input type="text"/> - <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	Report for this quarter . . . Check only one box. <input type="checkbox"/> 1: January, February, March <input type="checkbox"/> 2: April, May, June <input type="checkbox"/> 3: July, August, September <input type="checkbox"/> 4: October, November, December
Name (not your trade name) <input type="text"/>	
The credit from Part 2, line 12, will be reported on (check only one box): <input type="checkbox"/> Form 941, 941-PR, or 941-SS <input type="checkbox"/> Reserved <input type="checkbox"/> Reserved	
Calendar year <input type="text"/> You must select a quarter if you file Form 941, 941-PR, or 941-SS.	

Part 1: Tell us about your income tax return.

- Which income tax return did you file that elected a qualified small business payroll tax credit on Form 6765, Credit for Increasing Research Activities? Check only one box. ☐ Form 1040 ☐ Form 1065 ☐ Form 1120 ☐ Form 1120-F ☐ Form 1120-S
- What tax period was covered by your income tax return?
Calendar year or tax year beginning / / ending / /
- When did you file your income tax return? / /
- If the EIN shown above isn't the same as the EIN used on Form 6765, enter the EIN used on Form 6765. -

Part 2: Determine the credit that you can use this period.

- Enter the amount from Form 6765, line 44, or, if applicable, the amount that was allocated to your EIN 5
- Enter the amount of the credit from line 5 that was taken on a previous period(s) 6
- Subtract line 6 from line 5 7
- Enter the amount from Form 941 (941-PR or 941-SS), line 5a, Column 2. 8
- Enter the amount from Form 941 (941-PR or 941-SS), line 5b, Column 2 9
- Add lines 8 and 9 10
- Multiply line 10 by 50% (0.50). See the instructions if you're a third-party payer of sick pay or if you received a Section 3121(q) Notice and Demand 11
- Credit.** Enter the smaller of line 7 or line 11. Also enter this amount on Form 941 (941-PR or 941-SS), line 11 12

For Paperwork Reduction Act Notice, see the separate instructions. IRS.gov/form8974 Cat. No. 37797C Form **8974** (1-2017)

IRC §179 Deduction

Old Law. Under IRC §179, a taxpayer can elect to deduct the cost of qualifying property rather than to recover such costs through depreciation deductions. For tax years beginning in 2014, the maximum amount a taxpayer could expense was \$500,000 of the cost of qualifying property placed in service during the tax year. This \$500,000 limit is reduced on a dollar-for-dollar basis by the amount by which the cost of qualifying property placed in service during the tax year exceeds \$2 million. The \$500,000 and \$2 million amounts are not indexed for inflation. In addition, the amount deductible is limited to the taxable income for the year from an active business.

Note. For further details on the limitations to the IRC §179 deduction, see Treas. Reg. §1.179-2.

Generally, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Qualifying property excludes investments in air conditioning and heating units. For tax years beginning before 2015, qualifying property for purposes of the §179 deduction includes off-the-shelf computer software and qualifying real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property). The maximum amount of the §179 deduction available for qualified real property is \$250,000 per tax year.

Prior to the passage of the PATH Act, for tax years beginning in 2015 and thereafter, a taxpayer could elect to deduct up to \$25,000 of the cost of qualifying property placed in service during the tax year. The \$25,000 limit is reduced by the amount by which the cost of qualifying property placed in service during the tax year exceeds \$200,000. These amounts are not indexed for inflation.

In general, an election under §179 for any property may not be revoked except with the consent of the IRS. However, an election under §179 may be revoked by filing an amended return without the consent of the IRS for tax years beginning after 2002 and before 2015.

New Law. The PATH Act provides that the maximum amount a taxpayer may expense for tax years beginning after 2014 is **permanently** set at \$500,000 of the cost of qualifying property placed in service during the tax year. The \$500,000 limit is reduced by the amount by which the cost of qualifying property placed in service during the tax year exceeds \$2 million. **The \$500,000 and \$2 million amounts are indexed for inflation for tax years beginning after 2015.** For tax years beginning in 2016, the inflation-adjusted amounts are \$500,000 and \$2,010,000, respectively.²³

In addition, the treatment of off-the-shelf computer software and qualified real property as qualifying property is made **permanent**. For tax years beginning after 2015, the provision removes the \$250,000 limitation on the §179 deduction available for qualified real property. Further, for tax years beginning after 2015, air conditioning and heating units are no longer excluded from the definition of qualifying property.

Moreover, the PATH Act makes permanent the permission granted to a taxpayer to revoke an election under §179 by filing an amended return without obtaining IRS approval.

Gain on Small Business Stock²⁴

Old Law. In general, a taxpayer other than a corporation can exclude 50% of the gain from the sale of certain small business stock acquired at original issue and held at least five years. The amount of the gain that can be excluded by an individual for the sale of stock of any corporation is the greater of:

1. 10 times the taxpayer's basis in the stock, or
2. \$10 million (reduced by the amount of gain eligible for exclusion in prior years).

²³ Rev. Proc. 2016-14, 2016-9 IRB 365.

²⁴ IRC §1202.

To qualify as a small business for purposes of the exclusion, the aggregate gross assets held by the corporation when the stock is issued cannot exceed \$50 million.

Seven percent of the excluded gain is an AMT preference.

For stock acquired after September 27, 2010, and before January 1, 2015, the percentage exclusion for the sale of qualified small business stock is increased to 100%. The AMT preference does not apply.

New Law. The PATH Act makes the 100% exclusion for the sale of qualified small business stock **permanent**. The exception from AMT preference treatment is also **permanent**.

Recognition Period for Built-in Gains Tax²⁵

Old Law. A built-in gains tax is imposed on assets sold by an S corporation that it held when it was converted from a C corporation, unless the assets are held for a statutorily determined recognition period. The **recognition period** is generally the 10-year period beginning with the first day of the first tax year that an S election is in effect. The built-in gains tax is imposed at the highest marginal rate applicable to corporations, which is currently 35%.

For tax years beginning after December 31, 2011, and before January 1, 2015, the **recognition period** for purposes of determining the recognized built-in gain was reduced to five years.

New Law. The PATH Act makes the 5-year recognition period for built-in gains **permanent**.

Work Opportunity Tax Credit²⁶

Old Law. The work opportunity tax credit (WOTC) is available to employers hiring individuals from a targeted group that traditionally face significant barriers to employment. The amount of the credit is determined based on a percentage of qualified wages paid by the employer. **Qualified wages** generally consist of wages attributable to services rendered by a member of a targeted group during the 1-year period beginning with the day the individual begins work for the employer.

Note. For a detailed description of the targeted groups and other information about the WOTC, see the Joint Committee on Taxation report JCX-144-15, which is available for download at uofi.tax/16a6x24 [www.jct.gov/publications.html?func=startdown&id=4861].

The WOTC was scheduled to expire after December 31, 2014.

New Law. The PATH Act extends the WOTC for five years. Therefore, the credit is available through tax years beginning on or before December 31, 2019. In addition, the PATH Act expands the WOTC to employers who hire individuals after December 31, 2015, who are qualified long-term unemployment recipients. Such individuals are those who have been certified by a designated local agency as being unemployed at least 27 weeks. Employers are eligible for a 40% credit on the first \$6,000 of wages paid to such individuals, for a maximum credit of \$2,400 per eligible employee.

Bonus Depreciation²⁷

Old Law. An additional first-year depreciation deduction (“bonus depreciation”) is allowed for 50% of the adjusted basis of qualified property acquired and placed in service before January 1, 2015 (January 1, 2016, for certain longer-lived and transportation property). The taxpayer can elect out of bonus depreciation for any class of property for any tax year.

²⁵ IRC §1374.

²⁶ IRC §§51 and 52.

²⁷ IRC §168(k).

The IRC §280F limitation on the amount of first-year depreciation allowed for certain passenger automobiles is increased by \$8,000 for automobiles that qualify for bonus depreciation (and for which the taxpayer does not elect out of the bonus depreciation deduction).

New Law. The PATH Act extends bonus depreciation for five years. Therefore, it is **generally available through 2019** (through 2020 for certain longer-lived and transportation property). However, the PATH Act modifies bonus depreciation by phasing down the percentage allowed, as shown in the following table.

Calendar Year	Bonus Depreciation Percentage
2015–2017	50%
2018 ^a	40%
2019 ^a	30%

^a The percentages apply to certain longer-lived and transportation property placed in service one year later.

The \$8,000 increase in the limitation on first-year depreciation allowed for certain passenger automobiles is phased down beginning in 2018, as shown in the following table.

Calendar Year	Increase in §280F Limitation for Certain Passenger Automobiles
2015–2017	\$8,000
2018	6,400
2019	4,800

Old Law. Property qualifying for bonus depreciation includes qualified leasehold improvement property. **Qualified leasehold improvement property** is an improvement to an interior portion of a building that is nonresidential real property, provided certain conditions are satisfied. These conditions include the following.

- The improvement must be made under a lease either by the lessee (or sublessee) or the lessor of that portion of the building occupied exclusively by the lessee (or sublessee).
- The improvement must be placed in service more than three years after the date the building was placed in service.

Qualified leasehold improvement property does not include an elevator or escalator, an enlargement of the building, a structural component benefiting a common area, or the internal structural framework of the building.

New Law. After 2015, the PATH Act allows bonus depreciation for qualified leasehold improvement property regardless of whether the improvements are property subject to a lease. The provision also removes the requirement that the improvement must be placed in service more than three years after the date the building was placed in service.

Old Law. The taxable income of a long-term contract is determined under the percentage-of-completion method.²⁸ For purposes of determining the percentage of completion under IRC §460(b)(1)(A), the cost of qualified property that has a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted. This applies for property placed in service before January 1, 2015 (January 1, 2016, for certain longer-lived and transportation property).

²⁸ See IRC §460.

2016 Workbook

New Law. The PATH Act extends the rule regarding the allocation of bonus depreciation to a long-term contract for five years. Thus, the provision applies to property placed in service before January 1, 2020 (January 1, 2021, for certain longer-lived and transportation property).

Note. The PATH Act also modifies and extends the election to accelerate AMT credits in lieu of bonus depreciation and permits certain plants bearing fruits and nuts to be eligible for bonus depreciation when planted or grafted, rather than when placed in service. For details on these provisions, see the Joint Committee on Taxation report JCX-144-15, which is available for download at **uofi.tax/16a6x26** [www.jct.gov/publications.html?func=startdown&id=4861].

Other Business Extenders

The PATH Act includes several business extender provisions in addition to those described above. These other provisions are summarized in the following table.

IRC Section	Provision	Extension Period
170	Extension and expansion of charitable deduction for contributions of food inventory	Permanent
512	Extension of modified tax treatment of certain payments to controlling exempt organizations	Permanent
1367	Extension of basis adjustment to stock of S corporations making charitable contributions of property	Permanent
45P	Extension and modification of employer wage credit for employees who are active duty members of the uniformed services	Permanent
168	Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements	Permanent
871(k)	Extension of treatment of certain regulated investment companies (RIC) dividends	Permanent
953 and 954	Extension of subpart F exception for active financing income	Permanent
42	Extension of temporary minimum low-income housing tax credit rate for non-federally subsidized buildings	Permanent
42	Extension of military housing allowance exclusion for determining whether a tenant in certain counties is low income	Permanent
897 and 1445	Extension of RIC qualified investment entity treatment under the Foreign Investment in Real Property Tax Act	Permanent
45D	Extension of new markets tax credit	Through 12/31/19
954(c)(6)	Extension of look-through treatment of payments between related controlled foreign corporations under foreign personal holding company rules	Through 12/31/19
45A	Extension of Indian employment tax credit	Through 12/31/16

IRC Section	Provision	Extension Period
45G	Extension and modification of railroad track maintenance credit	Through 12/31/16
45N	Extension of mine rescue team training credit	Through 12/31/16
54E	Extension of qualified zone academy bonds	Through 12/31/16
168	Extension of classification of certain race horses as 3-year property	Through 12/31/16
168	Extension of 7-year recovery period for motorsports entertainment complexes	Through 12/31/16
168(j)	Extension and modification of accelerated depreciation for business property on an Indian reservation	Through 12/31/16
179E	Extension of election to expense mine safety equipment	Through 12/31/16
181	Extension of special expensing rules for certain film and television productions; special expensing for live theatrical productions	Through 12/31/16
199	Extension of deduction allowable for income attributable to domestic production activities in Puerto Rico	Through 12/31/16
1391 and 1394	Extension and modification of empowerment zone tax incentives	Through 12/31/16
7652(f)	Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands	Through 12/31/16

ENERGY EXTENDERS

The PATH Act includes several energy-extender provisions that apply to individuals and businesses.

Nonbusiness Energy Property Credit²⁹

Old Law. A 10% credit is allowed for the purchase of qualified energy efficiency improvements to existing homes. A **qualified energy efficiency improvement** includes insulation materials, exterior windows (including skylights) and doors, and certain metal or asphalt roofs.

In addition, specified credits are provided for the purchase of specific energy efficient property originally placed in service by the taxpayer during the tax year. The allowable credit is:

1. \$50 for each advanced main air circulating fan;
2. \$150 for each qualified natural gas, propane, or oil furnace or hot water boiler; and
3. \$300 for each item of energy efficient building property.

The maximum credit per taxpayer for all tax years is \$500. No more than \$200 of the credit can be attributable to expenditures on windows. The credit was scheduled to expire after December 31, 2014.

²⁹ IRC §25C.

2016 Workbook

New Law. The PATH Act extends the credit for **two years**, through December 31, 2016. Additionally, the efficiency standard now requires that windows, skylights, and doors meet Energy Star 6.0 standards.

Note. For more information about the nonbusiness energy property credit, see IRC §25C and the Joint Committee on Taxation report JCX-144-15, which is available for download at **uofi.tax/16a6x26** [www.jct.gov/publications.html?func=startdown&id=4861]. In addition, the **Energy Star website provides helpful information about the types of property that qualify for the credit.** This can be found at **uofi.tax/16a6x27** [www.energystar.gov/about/federal_tax_credits].

Credit for Energy-Efficient New Homes³⁰

Old Law. An eligible contractor can take a credit for each qualified new energy-efficient home that is constructed by the contractor and sold for use as a residence during the tax year. To qualify as a new energy-efficient home, it must be:

1. Located in the United States;
2. Substantially completed after August 8, 2005; and
3. Certified to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30% or 50% reduction in energy usage, compared to a comparable dwelling constructed in accordance with standards in effect on January 1, 2006.

The credit is \$1,000 for a new home that meets the 30% standard and \$2,000 for a home that meets the 50% standard. Before passage of the PATH Act, the credit applies to homes purchased prior to January 1, 2015.

New Law. The PATH Act extends the credit to homes that are acquired prior to January 1, 2017.

Other Energy Extenders

The PATH Act includes several other energy incentives. These provisions are summarized in the following table. They are all extended through December 31, 2016.

IRC Section	Provision
30C	Extension of credit for alternative fuel vehicle refueling property
30D	Extension of credit for electric motorcycles
40(b)(6)	Extension of second generation biofuel producer credit
40A	Extension of biodiesel and renewable diesel incentives
45	Extension of credit for the production of Indian coal facilities
45 and 48	Extension of credits for facilities producing energy from certain renewable resources
168(l)	Extension of special allowance for second generation biofuel plant property
179D	Extension of energy efficient commercial buildings deduction
451(i)	Extension of special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy for qualified electric utilities
6426 and 6427	Extension of excise tax credits and payment provisions relating to alternative fuel
30B	Extension of credit for fuel cell vehicles

³⁰ IRC §45L.

REAL ESTATE INVESTMENT TRUSTS

Several provisions in the PATH Act concern real estate investment trusts (REIT). These are summarized in the following table.

IRC Section	Provision
355	Restriction on tax-free spinoffs involving REITs
856	Reduction in percentage limitation on REIT assets that may be taxable REIT subsidiaries
857	Prohibited transaction safe harbors
562	Repeal of preferential dividend rule for publicly offered REITs; authority for alternative remedies to address certain REIT distribution failures
857	Limitations on designation of dividends by REITs
856	Debt instruments of publicly offered REITs and mortgages treated as real estate assets
856	Asset and income test clarification regarding ancillary personal property
857	Hedging provisions
562 and 857	Modification of REIT earnings and profits calculation to avoid duplicate taxation
857	Treatment of certain services provided by taxable REIT subsidiaries
897 and 1445	Exception from Foreign Investment in Real Property Tax Act of 1980 for certain stock of REITs; exception for interests held by foreign retirement and pension funds
1445	Increase in tax withholding rate (from 10% to 15%) on dispositions of U.S. real property interests
897	Interests in RICs and REITs not excluded from definition of U.S. real property interests
245	Dividends derived from RICs and REITs ineligible for deduction for U.S. source portion of dividends from certain foreign corporations

Note. For more information about REITs, see the 2016 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: Agricultural Issues and Rural Investments.

OTHER PROVISIONS

The primary purpose of the PATH Act concerns the extender provisions discussed in the preceding sections. However, the PATH Act also contains various provisions that cover a wide range of other issues. Those issues that are most likely to be of interest to tax professionals are highlighted in this section.

Due Dates for Information Returns

Old Law. Every person engaged in a trade or business who makes payments totaling \$600 or more in a tax year to a single payee in the course of the payor's trade or business must file a return reporting these payments. These payments are generally reported on Form 1099-MISC, *Miscellaneous Income*.

2016 Workbook

A payor must issue these information returns to the payees by January 31 of the following calendar year. The payor must file the information returns with the IRS by the last day of February of the year following the calendar year for which the return must be filed. However, the due date for most electronically filed information returns is March 31.

Note. For information regarding the penalties associated with failure to file information returns, (or information returns filed late), see IRC §6721.

An employer must report wage amounts paid to employees using Form W-2, *Wage and Tax Statement*. The employer must provide the Form W-2 to the employee by January 31 of the following calendar year. The employer also must submit Forms W-2 and Form W-3, *Transmittal of Wage and Tax Statements*, to the Social Security Administration (SSA) by February 28. The due date for electronically filed Forms W-2 and W-3 is March 31. The SSA shares this information with the IRS.

New Law. A provision in the PATH Act accelerates the due date for filing Forms W-2 and 1099-MISC with the SSA and IRS respectively. **These forms must be filed by January 31 and are no longer eligible for the extended filing date for electronically filed returns.** The due date for employee and payee statements remains the same (January 31). This provision is effective for returns and statements relating to calendar years beginning in 2016 (and filed in 2017).

Additionally, the PATH Act provides that **no credit or refund for an overpayment will be made before February 15** following the close of the tax year for taxpayers who claimed the EIC or ACTC on their tax return. This allows additional time for the IRS to review refund claims based on the EIC and the ACTC in order to reduce fraud and improper payments. This provision applies to credits or refunds made after December 31, 2016.

Safe Harbor for De Minimis Errors on Information Returns

Old Law. Failure to comply with information reporting requirements results in penalties. These may include a penalty for failure to file correct information returns, to furnish correct payee statements, or to comply with other reporting requirements. If the failure is due to reasonable cause, no penalty is imposed.

For information returns or payee statements due after December 31, 2015, the Trade Preferences Extension Act of 2015 increased the failure-to-file penalties to the following amounts.³¹

	Penalty per Return	Maximum Penalty per Calendar Year (for all businesses except small businesses)	Maximum Penalty per Calendar Year (for small businesses ^a)
First tier (return filed no more than 30 days after the due date)	\$ 50	\$500,000	\$175,000
Second tier (return filed more than 30 days after due date but on or before August 1)	100	1.5 million	500,000
Third tier (return not filed by August 1)	250	3 million	1 million

^a A small business is defined as a firm having average annual gross receipts for the three most recent tax years that do not exceed \$5 million.

³¹ IRC §6721.

For failures or misstatements due to intentional disregard, the penalty per return is \$500, and there is no calendar year limit.

Any person who fails to furnish a required payee statement is subject to a penalty in addition to the penalty for failure to file a return with the IRS. The penalties for failure to furnish a correct payee statement are the same as those for the failure to file a return.

New Law. The PATH Act creates a safe harbor from the application of the penalty for failure to file a correct information return and the penalty for failure to furnish a correct payee statement. The safe harbor applies in circumstances in which the return or statement is correctly filed but includes a de minimis error of the amount required to be reported on the return or statement. For this purpose, a **de minimis error** on the return or statement need not be corrected if the error for any single amount does not exceed \$100. A threshold of \$25 applies to errors relating to an amount of withholding or backup withholding.

If a recipient of a payee statement requests a corrected statement, the penalty for failure to file a correct information return and the penalty for failure to furnish a correct payee statement will continue to apply in the case of a de minimis error.

This provision applies to returns required to be filed and payee statements required to be furnished after December 31, 2016.

Expansion of Paid Preparer Due Diligence Requirements

Old Law. A penalty of \$500 may be imposed on a tax return preparer who prepares a return for a taxpayer claiming the EIC if the preparer does not exercise due diligence with respect to the EIC claim.³² The due diligence requirements apply to both the determination of eligibility for the credit and the amount of the credit.

Note. For a detailed explanation of a tax preparer's due diligence requirements with respect to the EIC and the requirements for claiming the credit, see the 2012 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 3: Individual Taxpayer Topics. This can be found at **uofi.tax/arc** [www.taxschool.illinois.edu/taxbookarchive].

New Law. A provision in the PATH Act requires paid tax return preparers to meet due diligence requirements if they prepare a tax return on which a CTC, ACTC, or AOC is claimed. The due diligence requirements are similar to those applicable to returns claiming the EIC. This provision is effective for tax years beginning after December 31, 2015.

Note. In July 2016, the IRS released draft Form 8867, *Paid Preparer's Due Diligence Checklist*. This form, which follows, provides a checklist for the CTC/ACTC and the AOC, along with the checklist for the EIC. The previous version of this form was only required for taxpayers claiming the EIC.

³² See IRC §6695(g).

2016 Workbook

Form **8867**

Department of the Treasury
Internal Revenue Service

Paid Preparer's Due Diligence Checklist

Earned Income Credit (EIC), Child Tax Credit (CTC), and American Opportunity Tax Credit (AOTC)

► To be completed by preparer and filed with Form 1040, 1040A, 1040EZ, 1040NR, 1040SS, or 1040PR.

► Information about Form 8867 and its separate instructions is at www.irs.gov/form8867.

OMB No. 1545-1629

2016
Attachment
Sequence No. 177

Taxpayer name(s) shown on return

Taxpayer identification number

Enter preparer's name and PTIN

Due Diligence Requirements

Please complete the appropriate column for all credits claimed on this return (check all that apply).	EIC	CTC/ACTC	AOTC
1 Did you complete the return based on information for tax year 2016 provided by the taxpayer or reasonably obtained by you?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
2 Did you complete the applicable EIC and/or CTC/ACTC worksheets found in the Form 1040, 1040A, 1040EZ, or 1040NR instructions, and/or the AOTC worksheet found in the Form 8863 instructions, or your own worksheet(s) that provides the same information, and all related forms and schedules for each credit claimed?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
3 Did you satisfy the knowledge requirement? Answer "Yes" only if you can answer "Yes" to both 3a and 3b. To meet the knowledge requirement, did you:	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
a Interview the taxpayer, ask adequate questions, and document the taxpayer's responses to determine that the taxpayer is eligible to claim the credit(s)?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Review adequate information to determine that the taxpayer is eligible to claim the credit(s) and in what amount?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
4 Did any information provided by the taxpayer, a third party, or reasonably known to you in connection with preparing the return appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b. If "No," go to question 5.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
a Did you make reasonable inquiries to determine the correct or complete information?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Did you document your inquiries? (Documentation should include the questions you asked, whom you asked, when you asked, the information that was provided, and the impact the information had on your preparation of the return.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
5 Did you satisfy the record retention requirement? To meet the record retention requirement, did you keep a copy of any document(s) provided by the taxpayer that you relied on to determine eligibility or to compute the amount for the credit(s)?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
In addition to your notes from the interview with the taxpayer, list those documents, if any, that you relied on.			
6 Did you ask the taxpayer whether he/she could provide documentation to substantiate eligibility for and the amount of the credit(s) claimed on the return?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
7 Did you ask the taxpayer if any of these credits were disallowed or reduced in a previous year? (If credits were disallowed or reduced, go to question 7a; if not, go to question 8.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
a Did you complete the required recertification form(s)?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
8 If the taxpayer is reporting self-employment income, did you ask adequate questions to prepare a complete and correct Form 1040, Schedule C?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 26142H

Form **8867** (2016)

Due Diligence Questions for Returns Claiming EIC (If the return does not claim EIC, go to question 10.)

	EIC	CTC/ACTC	AOTC
9a Did you explain to the taxpayer the rules about claiming the EIC when a child is the qualifying child of more than one person (tie-breaker rules), and have you determined that this taxpayer is, in fact, eligible to claim the EIC for the number of children for whom the EIC is claimed?	<input type="checkbox"/> Yes <input type="checkbox"/> No		
b Did you explain to the taxpayer that he/she may not claim the EIC if the taxpayer has not lived with the child for over half the year, even if the taxpayer has supported the child?	<input type="checkbox"/> Yes <input type="checkbox"/> No		

Due Diligence Questions for Returns Claiming CTC and/or additional CTC (If the return does not claim CTC or Additional CTC, go to question 11.)

10a Does the child reside with the taxpayer who is claiming the CTC/ACTC? (If "Yes," go to question 10c. If "No," answer question 10b.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	
b Did you ask if there is an active Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, or a similar statement in place and, if applicable, did you attach it to the return?	<input type="checkbox"/> Yes <input type="checkbox"/> No	
c Have you determined that the taxpayer has not released the claim to another person?	<input type="checkbox"/> Yes <input type="checkbox"/> No	

Due Diligence Questions for Returns Claiming AOTC (If the return does not claim AOTC, go to *Credit Eligibility Certification*.)

11 Did the taxpayer provide substantiation such as a Form 1098-T and receipts for the qualified tuition and related expenses for the claimed AOTC?	<input type="checkbox"/> Yes <input type="checkbox"/> No
---	--

► **You have complied with all due diligence requirements with respect to the credits claimed on the return of the taxpayer identified above if you:**

- A. Complete this Form 8867 truthfully and accurately and complete the actions described in this checklist for all credits claimed;
- B. Submit Form 8867 in the manner required;
- C. Interview the taxpayer, ask adequate questions, document the taxpayer's responses on the return or in your notes, review adequate information to determine if the taxpayer is eligible to claim the credit(s) and in what amount(s); **and**
- D. Keep all five of the following records for 3 years from the latest of the dates specified in the Form 8867 instructions under *Document Retention*.
 1. A copy of Form 8867,
 2. The applicable worksheet(s) or your own worksheet(s) for any credits claimed,
 3. Copies of any taxpayer documents you may have relied upon to determine eligibility for and the amount of the credit(s),
 4. A record of how, when, and from whom the information used to prepare this form and worksheet(s) was obtained, and
 5. A record of any additional questions you may have asked to determine eligibility for and amount of the credits, and the taxpayer's answers.

► **If you have not complied with all due diligence requirements for all credits claimed, you may have to pay a \$510 penalty for each credit for which you have failed to comply.**

Credit Eligibility Certification

12 Do you certify that all of the answers on this Form 8867 are, to the best of your knowledge, true, correct and complete?	<input type="checkbox"/> Yes <input type="checkbox"/> No
--	--

Form **8867** (2016)

Restrictions on Taxpayers Who Improperly Claimed Credits

Old Law. If a taxpayer claimed the EIC and it was disallowed, they may not claim the EIC for 10 tax years after the most recent tax year for which it was determined that the taxpayer's EIC claim was due to fraud. The disallowance period is two years if it was determined that the taxpayer's EIC claim was due to reckless or intentional disregard of rules and regulations.

In addition, if a taxpayer was previously denied the EIC for any tax year as a result of IRS deficiency procedures, the taxpayer may not subsequently claim the EIC unless they provide a Form 8862, *Information To Claim Earned Income Credit After Disallowance*, with the tax return.

New Law. The PATH Act expands the disallowance rules that apply to the EIC to the CTC and the AOC. Therefore, if a taxpayer claims the CTC or AOC and the credit is denied because of fraud or reckless or intentional disregard of the rules, the taxpayer may not claim the credit for the next 10 or two years, respectively.

Additionally, taxpayers who were previously denied the CTC or AOC as a result of IRS deficiency procedures will be required to provide additional information demonstrating eligibility for the credit.

This provision is effective for tax years beginning after December 31, 2015.

Observation. In the National Taxpayer Advocate's (NTA) 2013 Annual Report to Congress,³³ it was reported that the IRS improperly banned taxpayers from claiming the EIC 40% of the time. In the NTA's 2015 Annual Report to Congress, the IRS's administration of the EIC — including failure to provide public education about the EIC and improper strategies regarding the role of tax preparers with EIC compliance — is noted as a continuing area of concern. More information regarding these issues can be found at uofi.tax/16a6x28 [taxpayeradvocate.irs.gov/reports/2015-annual-report-to-congress/most-serious-problems].

Penalty for Tax Preparers Who Engage in Willful or Reckless Conduct

Old Law. Tax return preparers are subject to a penalty if they prepare a return or refund claim that results in an understatement of tax liability. The penalty is the greater of \$1,000 or 50% of the income derived by the preparer for that return if the understatement is due to an unreasonable position.³⁴ The penalty is the greater of \$5,000 or 50% of the income derived by the preparer for that return if the understatement is due to willful or reckless conduct.³⁵

New Law. The PATH Act increases the penalty for understatements due to willful or reckless conduct to the **greater of \$5,000 or 75%** of the income derived by the preparer for the return or refund claim.

This provision is effective for returns prepared for tax years ending after December 18, 2015.

Higher Education Information Reporting

Old Law. Eligible educational institutions are subject to reporting requirements related to higher education tax benefits. Form 1098-T, *Tuition Statement*, issued by the educational institution must report the aggregate amount of payments received **or** the aggregate amount billed for qualified tuition and related expenses during the calendar year.

New Law. The PATH Act requires eligible educational institutions to report **only** the aggregate amount of qualified tuition and related expenses **received** during the calendar year. This provision is effective for expenses paid after December 31, 2015, for education furnished in academic periods beginning after that date.

Note. In May 2016, the IRS announced that it would not impose penalties solely because an eligible educational institution reports the aggregate amount billed for qualified tuition and related expenses for the 2016 calendar year. Therefore, eligible educational institutions will continue to have the option of reporting either the amount of payments of qualified tuition and related expenses received or the amount billed for 2016 without being subject to penalties.³⁶

³³ 2013 Annual Report to Congress. Taxpayer Advocate Service. [www.taxpayeradvocate.irs.gov/2013-annual-report/downloads/EARNED-INCOME-TAX-CREDIT-The-IRS-Inappropriately-Bans-Many-Taxpayers-from-Claiming-EITC.pdf] Accessed on Jun. 2, 2016.

³⁴ See IRC §6694(a)(2).

³⁵ See IRC §6694(b)(2).

³⁶ IRS Ann. 2016-17, 2016-20 IRB 853.

IRC §529 Qualified Tuition Programs

Old Law. IRC §529 grants special tax status to qualified tuition programs (QTPs). A distribution from a QTP is tax-free if the distribution does not exceed the designated beneficiary's qualified education expenses. Qualified education expenses include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible education institution. For students who are enrolled at least half-time, qualified education expenses also include room and board. For the 2009 and 2010 tax years only, qualified education expenses include the purchase of any computer technology or equipment, or Internet access or related services if the technology or services were to be used by the beneficiary or their family during any of the years the beneficiary was enrolled at an eligible institution.

Distributions from a QTP are excludable from the distributee's gross income to the extent the total distribution does not exceed the beneficiary's qualified education expenses. If a QTP distribution exceeds the beneficiary's qualified education expenses, the taxable portion of the distribution is determined as follows.

Step 1. Reduce the total qualified education expenses by the amount of any tax-free education assistance.

Step 2. Calculate the tax-free earnings amount by multiplying the earnings portion of the distribution by a fraction. The numerator is the amount calculated in step 1, and the denominator is the total amount distributed during the year. For a designated beneficiary with more than one QTP, the earnings portion of the distribution is calculated by aggregating all such accounts.

Step 3. Subtract the amount calculated in step 2 from the earnings portion of the distribution.

Note. For a detailed explanation of QTPs, see the 2014 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Individual Taxpayer Issues. This can be found at uofi.tax/arc [www.taxschool.illinois.edu/taxbookarchive].

New Law. The PATH Act provides that qualified education expenses include the purchase of computer or peripheral equipment,³⁷ computer software,³⁸ or Internet access and related services if the equipment, software, or services are to be used primarily by the beneficiary during any of the years they are enrolled at an eligible educational institution. This provision is effective for tax years beginning after December 31, 2014.

The PATH Act also repeals the rules providing that QTP accounts must be aggregated for purposes of calculating the amount of a distribution that is included in a taxpayer's income. Thus, if a designated beneficiary received multiple distributions from a QTP during the tax year, the portion of a distribution that represents earnings is computed for each distribution, rather than on an aggregate basis. This provision is effective for distributions made after December 31, 2014.

Further, the PATH Act creates a new rule. If a designated beneficiary receives a refund of any higher education expenses, any distribution that was used to pay the refunded expenses is not subject to tax if the beneficiary recontributes the refunded amount to the QTP within 60 days of receiving the refund. This provision is effective for tuition refunded after December 31, 2014.

³⁷ As defined in IRC §168(i)(2)(B).

³⁸ As defined in IRC §197(e)(3)(B).

Qualified ABLE Programs

Old Law. IRC §529A provides for a tax-favored program intended to benefit disabled individuals, known as the Achieving a Better Life Experience (ABLE) program. A qualified ABLE program must allow for the establishment of ABLE accounts only for a designated beneficiary who is either:

- A resident of the state maintaining the ABLE program, or
- A resident of a state that has not established an ABLE program (a “contracting state”) that has entered into a contract with the state to provide the contracting state’s residents with access to the state’s ABLE program.

New Law. The PATH Act eliminates the requirement that ABLE accounts may be established only in the ABLE account owner’s state of residence. Additionally, the provision allows amounts from a QTP to be rolled over to an ABLE account without penalty. These rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account during a tax year.³⁹ Any rolled-over amount that exceeds this limitation is includable in the distributee’s gross income. This provision applies to tax years beginning after December 31, 2014.

Note. For more information about the ABLE program, see the 2015 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: New Developments.

Rollovers to SIMPLE IRAs

Old Law. Certain small businesses can establish a savings incentive match plan for employees (SIMPLE) retirement plan. A SIMPLE plan can be either an IRA for each employee or part of a 401(k) plan.

A distribution from a SIMPLE IRA during the 2-year period beginning on the date the employee first participated in the SIMPLE IRA may be rolled over only to another SIMPLE IRA. Distributions from other employer-sponsored retirement plans and IRAs cannot be rolled over to a SIMPLE IRA, even after this 2-year period.

New Law. The PATH Act permits rollovers of distributions from employer-sponsored retirement plans and traditional IRAs into a SIMPLE IRA after the 2-year period following the date the employee first participated in the SIMPLE IRA. This provision applies to contributions made after December 18, 2015.

Note. For more information about SIMPLE IRAs, see the 2016 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: Retirement.

³⁹ IRC §529A(b)(2)(B).

BIPARTISAN BUDGET ACT OF 2015⁴⁰

On November 2, 2015, President Obama signed into law the Bipartisan Budget Act of 2015 (BBA). The BBA raises the federal debt ceiling and increases spending levels for defense and domestic programs. A summary of items relevant to tax professionals follows.

SOCIAL SECURITY BENEFITS

Old Law

Under the **file and suspend strategy**, an individual who has reached full retirement age (FRA) could apply for social security retirement benefits and then request to have the payments suspended. This entitled the individual's spouse to receive a spousal benefit (which is generally half of the higher earner's benefit) while the worker continued to earn delayed retirement credits (DRCs) at the rate of 8% per year up to age 70.

New Law

The BBA changes the rules so that if an individual suspends benefits, no one can claim benefits based on that individual's earnings record. This provision is effective for benefits payable beginning six months after the enactment of the BBA (i.e., April 30, 2016).⁴¹

The BBA eliminates the file and suspend strategy by extending the **deemed filing** concept. Deemed filing means that if a married person files for social security benefits, they are deemed to file for both their own retirement benefit and their spousal benefit, and social security will pay only the larger of the two benefits. Under social security rules previously in effect, deemed filing ended at an individual's FRA. Under the BBA, the deemed filing rule is extended to age 70. The option to delay retirement benefits while earning DRCs and receiving only spousal benefits is no longer available. However, an individual will still be entitled to the larger of their own retirement benefit or their spousal benefit.⁴²

Under the BBA, the changes to the deemed filing provisions are effective for individuals who attain age 62 after 2015.

Note. For more information about the changes to social security benefits under the BBA, see the 2016 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: Retirement and **uofi.tax/16a6x16** [www.ssa.gov/legislation/Bipartisan%20Budget%20Act%20Closes%20Social%20Security%20Loophole%20updated.pdf].

⁴⁰ *Bipartisan Budget Act of 2015*. House Committee on Rules. [<http://docs.house.gov/meetings/RU/RU00/CPRT-114-RU00-D001.pdf>] Accessed on Oct. 30, 2015; and *H.R. 1314; Bipartisan Budget Act of 2015*. Oct. 28, 2015. House Republicans. [www.gop.gov/bill/h-r-1314-bipartisan-budget-act-of-2015/] Accessed on Oct. 30, 2015.

⁴¹ *Budget Deal Nixes Popular Social Security Claiming Strategies*. Sheedy, Rachel L. Oct. 28, 2015. Kiplinger.com. [www.kiplinger.com/article/retirement/T051-C000-S001-budget-deal-nixes-popular-social-security-claiming.html] Accessed on Oct. 30, 2015.

⁴² *New Budget Deal Is Cutting Your Social Security Benefits And It's A Good Thing*. Hopkins, Jamie. Oct. 29, 2015. Forbes. [www.forbes.com/sites/jamiehopkins/2015/10/29/new-budget-deal-is-cutting-your-social-security-benefits-and-its-a-good-thing/] Accessed on Oct. 30, 2015.

MEDICARE PART B PREMIUMS

Old Law

Medicare Part B premiums generally cover physician and laboratory services, outpatient care, certain medical equipment, and some home health care services.⁴³ Part B premiums are deducted directly from a recipient's monthly social security benefit. Therefore, if Part B premiums increase, the amount of the monthly social security benefit may be reduced. However, the Social Security Act has a provision, referred to as the "hold-harmless rule," that protects social security income for certain recipients in years in which Medicare Part B premiums rise.

The hold-harmless rule provides that social security benefits cannot decline because of rising Part B premiums. Therefore, increases in Part B premiums cannot be greater than the annual increase in the social security cost of living adjustment (COLA). Because social security recipients did not receive a COLA in 2016, their Part B premiums could not be increased. The 2015 standard monthly Medicare Part B premium is \$104.90. The hold-harmless rule protects approximately 70% of Medicare enrollees from a benefit reduction in such years.

This special rule has received increased attention since 2015 because of the absence of a social security COLA adjustment for 2016 coupled with dramatic projected Part B program costs.⁴⁴ This would result in a substantial reduction in monthly social security benefits by those who are **not** protected by the hold-harmless rule. Those who are not held harmless include the following.⁴⁵

- Individuals eligible for premium assistance through their state Medicaid program
- Individuals who pay the premiums applicable to higher-income beneficiaries (Higher-income beneficiaries for Medicare purposes are individuals with incomes over \$85,000 per year and married couples with incomes over \$170,000 per year.)
- Individuals whose Medicare premiums are not deducted from social security benefits
- New enrollees in 2016

Note. For further details on the hold-harmless rule and increased Medicare Part B costs, see **uofi.tax/16a6x17** [www.fas.org/sgp/crs/misc/R44224.pdf].

New Law

The BBA prevents the large Medicare Part B premium increase from adversely affecting those not protected by the hold-harmless rule. The BBA establishes a new 2016 basic Part B monthly premium of **\$121.80 (a 16% increase)** for those who are not held harmless. This \$121.80 includes a \$3 monthly surcharge. The surcharge will be used to cover the difference between the lower premiums and the higher actual Medicare Part B program costs.⁴⁶ Medicare beneficiaries who pay higher monthly Medicare premiums based on their income will pay more than \$3 per month.

Note. For more information about the hold-harmless provision, see the Congressional Research Service report at **uofi.tax/16a6x18** [fas.org/sgp/crs/misc/R40082.pdf] and the Kaiser Family Foundation report at **uofi.tax/16a6x19** [kff.org/medicare/issue-brief/whats-in-store-for-medicare-part-b-premiums-and-deductible-in-2016-and-why/].

⁴³ *Potential Impact of No Social Security COLA on Medicare Part B Premiums in 2016*. Oct. 20, 2015. Congressional Research Service. [www.fas.org/sgp/crs/misc/R44224.pdf] Accessed on May 26, 2016.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ *What's in Store for Medicare's Part B Premiums and Deductible in 2016, and Why?* Cubanski, Juliette and Neuman, Tricia. Nov. 11, 2015. Kaiser Family Foundation. [kff.org/medicare/issue-brief/whats-in-store-for-medicare-part-b-premiums-and-deductible-in-2016-and-why/] Accessed on Jun. 1, 2016.

PBGC PREMIUM RATES

Old Law

Single-employer pension plans pay an annual fixed premium to the Pension Benefit Guaranty Corporation (PBGC), which is indexed for inflation. **The annual fixed premium for 2016 is \$64 for each individual who is a plan participant during the year.** The trustee of the plan pays the premium out of the general assets of the fund. Single-employer plans also pay a variable rate premium, which is indexed to inflation. This premium will be \$30 per \$1,000 of underfunding in 2016.

New Law

The BBA raised the single-employer fixed premium to \$68 for 2017, \$73 for 2018, and \$78 for 2019. After 2019, it will be reindexed for inflation. The variable rate premium will continue to be indexed for inflation, but will be increased by an additional \$2 in 2017, an additional \$3 in 2018, and an additional \$3 in 2019.

REPEAL OF ACA'S AUTOMATIC ENROLLMENT REQUIREMENT

Old Law

A provision in the Affordable Care Act (ACA) would have required employers with more than 200 employees to automatically enroll new full-time employees into a qualifying health insurance plan offered by that employer and to automatically continue enrollment of current employees.

New Law

The BBA repeals the ACA automatic enrollment provision. Employers may still voluntarily use an automatic enrollment provision within the administration of a health insurance plan for employees.

PARTNERSHIP AUDITS AND ADJUSTMENTS

Old Law

Three different regimes currently apply to partnership audits.

1. For partnerships that have 10 or fewer partners, the IRS generally applies the audit procedures for individual taxpayers and audits the partnership and each partner separately.
2. For most large partnerships with more than 10 partners, the IRS conducts a single administrative proceeding to resolve audit issues regarding partnership items that are more appropriately determined at the partnership level rather than at the partner level. These rules were adopted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Under TEFRA, the IRS must recalculate each partner's tax liability for the audit year after the audit is completed and the resulting adjustments are determined.
3. A third audit regime applies to partnerships with 100 or more partners that elect to be treated as electing large partnerships (ELP) for reporting and audit purposes. Under the ELP audit rules, partnership adjustments generally flow through to the partners for the year in which the adjustment takes effect, rather than the year under audit. Consequently, the current-year partners' shares of current-year partnership items of income, gains, losses, deductions, or credits are adjusted to reflect partnership adjustments relating to a prior-year audit.

New Law

Under a BBA provision, the TEFRA and ELP rules are repealed, and the partnership audit rules will be streamlined into a single set of rules for auditing partnerships and their partners at the partnership level. The BBA provision permits partnerships with 100 or fewer qualifying partners to opt out of the new rules, in which case the partnership and partners will be audited under the general rules applicable to individual taxpayers.

Under the streamlined audit approach, the IRS will examine the partnership's income, gains, losses, deductions, credits, and the partners' distributive shares for the particular year under review (the "reviewed year"). Any adjustments will be taken into account by the partnership (not the individual partners) in the year that the audit is completed (the "adjustment year"). Partners will not be subject to joint and several liability for the partnership-level liability.

Observation. Under these new partnership audit rules, IRS audits of partnerships will generally become easier. The IRS may assess and collect any additional taxes directly from the partnership instead of the partners. The partnership will be liable for the additional taxes. However, the new rules do allow certain partnerships, under some circumstances, to make a special election under IRC §6226 to shift any additional tax liability back to the partners. Further guidance from the IRS is expected to clarify aspects of this election.⁴⁷ Moreover, these new rules may necessitate amendments to partnership agreements by partners of affected partnerships in order to ensure that issues involving the responsibility for tax liabilities under the new rules are properly addressed.

Instead of taking the adjustments into account at the partnership level, a partnership will be permitted to issue adjusted information returns (i.e., Schedules K-1) to the partners. In this situation, the affected partners would take the adjustments into account on their individual returns in the adjustment year through a simplified amended-return process. Accordingly, partnerships would not be required to issue amended Schedules K-1 after the partnership return is filed; instead, the partnership would use the adjusted Schedule K-1 process.

This provision applies to returns filed for partnership tax years beginning after 2017 but can be elected for tax years beginning after November 2, 2015.

Note. For additional information on these new partnership audit rules, including the changes made to IRC §§6221-6223 and other relevant Code sections, see **uofi.tax/16a6x20** [www.journalofaccountancy.com/news/2015/oct/partnership-audit-and-adjustment-rules-201513294.html] and **uofi.tax/16a6x21** [www.americanbar.org/publications/blt/2016/02/02_boyd.html].

⁴⁷ *New Partnership Tax Audit Rules Will Impact Private Investment Fund Vehicles*. Nov. 2015. Jones Day. [www.jonesday.com/new-partnership-tax-audit-rules-will-impact-private-investment-fund-vehicles-11-30-2015/] Accessed on May 31, 2016.

FIXING AMERICA'S SURFACE TRANSPORTATION ACT⁴⁸

On **December 4, 2015**, President Obama signed into law the Fixing America's Surface Transportation Act (FAST). FAST provides long-term funding certainty for surface transportation, which means state and local governments can proceed with critical transportation projects, including new highways and transit lines.⁴⁹ In addition, FAST contains various tax provisions. A summary of the most important of these items follows.

HIGHWAY TRUST FUND EXCISE TAXES

Old Law

The federal highway trust fund program is financed through the imposition of six separate excise taxes. The six taxes are summarized as follows.

- Highway motor fuels taxes
 - ♦ Gasoline (18.3 cents per gallon)
 - ♦ Diesel fuel and kerosene (24.3 cents per gallon)
 - ♦ Alternative fuels (18.3 or 24.3 cents per gallon)
- Nonfuel highway trust fund excise taxes
 - ♦ 12% excise tax on first retail sale of heavy highway vehicles, tractors, and trailers
 - ♦ An excise tax on highway tires with a rated load capacity exceeding 3,500 pounds, which is generally at a rate of 0.945 cents per 10 pounds of excess
 - ♦ Annual use tax on highway vehicles having a taxable gross weight of 55,000 pounds or more (The maximum tax is \$550 per year.)

The annual use tax on heavy vehicles was scheduled to expire on October 1, 2017. The remaining taxes were scheduled to expire after October 1, 2016, except for 4.3 cents per gallon of the highway trust fund fuels tax rate, which is permanent.

New Law

FAST generally extends these taxes through September 30, 2022, except for the heavy vehicle use tax, which is extended through September 30, 2023.

REPORTING DUE DATES FOR EMPLOYEE BENEFIT PLANS

Old Law

An employer that maintains a pension, annuity, profit-sharing, stock bonus, or other funded deferred compensation plan is required to annually file Form 5500, *Annual Return/Report of Employee Benefit Plan*. In addition, certain pension and welfare benefit plans must file annual reports disclosing information to the Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC). Plan administrators also comply with these requirements by filing Form 5500.

⁴⁸ *Joint Explanatory Statement of the Committee of the Conference*. [transportation.house.gov/uploadedfiles/joint_explanatory_statement.pdf] Accessed on Feb. 29, 2016.

⁴⁹ *The Fixing America's Surface Transportation Act or "FAST Act."* Feb. 24, 2016. U.S. Department of Transportation. [www.transportation.gov/fastact/] Accessed on Feb. 29, 2016.

Forms 5500 are filed with the DOL, and information from the forms is shared with the IRS and PBGC. Form 5500 is due by the last day of the 7th month following the close of the plan year. DOL and IRS rules allow the due date to be automatically extended by 2½ months if a request for extension is filed. Therefore, for a calendar-year plan, the extended Form 5500 due date is October 15.

Under the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, the maximum extension for Forms 5500 for tax years beginning after December 31, 2015, was changed to an automatic 3½-month period ending on November 15 for calendar-year plans.

New Law

FAST repeals the provision in the Surface Transportation and Veterans Health Care Choice Improvement Act that provides for an automatic 3½-month extension of the due date for Form 5500. Therefore, the due date for Forms 5500 is restored to an automatic 2½-month extension. This provision is effective for returns for tax years beginning after December 31, 2015.

USE OF PRIVATE DEBT COLLECTION COMPANIES

Old Law

IRC §6306 allows the IRS to use private debt collection companies to locate and contact taxpayers and to arrange payment of outstanding tax liabilities of any type. For an outstanding tax liability to exist, there must be an assessment under IRC §6201. An assessment is the formal recording of the taxpayer's tax liability and must be made before the IRS can commence enforcement actions. An assessment is generally made at the conclusion of all examination and appeals processes within the IRS.

The Omnibus Appropriations Act of 2009, which made appropriations for the fiscal year ending September 30, 2009, included a provision stating that none of the appropriated funds could be used to fund or administer §6306. At about this same time, the IRS announced that it would not renew its contracts with private debt collection agencies.

New Law

A provision in FAST requires the Secretary of the Treasury to enter into **qualified tax collection contracts**⁵⁰ with private debt collection agencies for the collection of inactive tax receivables. An **inactive tax receivable** is any tax receivable:

- Removed from the active inventory for lack of resources or inability to locate the taxpayer,
- For which more than one-third of the applicable limitations period has lapsed and no IRS employee has been assigned to collect the receivable, or
- For which a receivable has been assigned for collection but more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection.

The provision designates certain tax receivables as **not eligible** for collection under qualified tax collection contracts. These include receivables in the following categories.

- Subject to a pending or active offer-in-compromise or installment agreement
- Classified as an innocent spouse case
- Involves a taxpayer who is deceased, under the age of 18, in a designated combat zone, or a victim of identity theft
- Currently under examination, litigation, criminal investigation, or levy
- Currently subject to a proper exercise of a right of appeal

⁵⁰ See IRC §6306.

FAST further requires that the amount that was used by the IRS for collection enforcement activities under §6306 instead be used to fund a newly created special compliance personnel program. Special compliance personnel are IRS employees who serve either as revenue officers performing field collection functions or as persons operating the automated collection system.

The provision regarding qualified tax collection contracts applies to tax receivables identified by the IRS after December 4, 2015. The provision regarding the special compliance personnel program applies to amounts collected by the IRS after December 4, 2015.

PASSPORT REVOCATION OR DENIAL

Old Law

The Department of State (DOS) is responsible for the administration of passports. The DOS may refuse to issue or renew a passport if the applicant owes certain types of federal debt or child support over \$2,500. However, this authority does not extend to rejection or revocation of a passport because of delinquent federal taxes.

New Law

Under a provision in FAST, the DOS is **required** to deny a passport (or passport renewal) to a seriously delinquent taxpayer and is permitted to revoke any passport previously issued to such taxpayer.

A **seriously delinquent taxpayer** generally includes a taxpayer who owes an outstanding debt for federal taxes **exceeding \$50,000**, including interest and penalties, for which a notice of lien or levy has been filed.⁵¹ The \$50,000 threshold will be adjusted for inflation annually. Even if a tax debt meets the statutory threshold, it may not be considered seriously delinquent if:

- The debt is being timely paid under an installment agreement or offer in compromise, or
- Collection action for the debt is suspended because a collection due process hearing or innocent spouse relief has been requested or is pending.

A taxpayer's passport may be revoked only after the IRS has followed its examination and collection procedures and the taxpayer's administrative and judicial rights have been exhausted.

This provision is effective on December 4, 2015.

Note. For further information regarding passport revocation or denial to a seriously delinquent taxpayer, see IRC §7345, which is the relevant Code section established by FAST.

⁵¹ IRC §7345(b)(1).

SURFACE TRANSPORTATION AND VETERANS HEALTH CARE CHOICE IMPROVEMENT ACT OF 2015⁵²

Note. This section was originally published in the 2015 *University of Illinois Federal Tax Workbook*. It is reproduced here because the important changes explained in this section take effect in 2016 and 2017.

On July 31, 2015, President Obama signed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, also known as the Temporary Highway Funding Law.

This law contains several tax provisions that will significantly impact tax practitioners. Even though the highway funding section is short-term, the tax law provisions are not. Following is a summary of these new provisions.

MODIFICATION OF MORTGAGE REPORTING REQUIREMENTS

After December 31, 2016, Forms 1098, *Mortgage Interest Statement*, will be required to contain the following information in addition to current requirements.⁵³

- The amount of outstanding principal on the mortgage as of the beginning of the calendar year
- The date of the origination of the mortgage
- The address of the property that secures the mortgage

LIMITATIONS ON BASIS OF INHERITED ASSETS AND NEW REPORTING REQUIREMENT

The new law requires that the tax basis of property inherited from a decedent not be greater than the fair market value (FMV) of such property as reported for federal estate tax purposes.⁵⁴ In addition, there is a new requirement that any estate executor required to file an estate tax return must furnish a statement identifying the value of the recipient's interest in the property to the IRS and to any person acquiring an interest in the property.

Note. For a detailed explanation of the basis limitations and the reporting requirements, see the 2016 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 3: Trust and Estate Taxation.

CLARIFICATION OF 6-YEAR STATUTE OF LIMITATIONS IN CASE OF OVERSTATEMENT OF BASIS

In general, the IRS may go back and assess tax on any of the last three tax years. The new law clarifies that a 6-year statute of limitations⁵⁵ applies to omissions of income exceeding 25% of gross income as a result of overstated basis. The U.S. Supreme Court in *Home Concrete & Supply, LLC v. U.S.*,⁵⁶ had found that the 3-year statute of limitations applied in such cases. The bill amends IRC §6501(e)(1)(B) to state, "An overstatement of unrecovered cost or other basis is an omission from gross income."

This clarification applies to returns filed after July 31, 2015, and also to returns filed on or before that date if the tax years are still open under IRC §6501.

⁵² *Temporary Highway Funding Law Contains Multiple Provisions Impacting Tax Filings*. Tidgren, Kristine. Jul. 31, 2015. Center for Agricultural Law and Taxation. [www.calt.iastate.edu/article/temporary-highway-funding-law-contains-multiple-provisions-impacting-tax-filings] Accessed on Aug. 7, 2015.

⁵³ IRC §6050H.

⁵⁴ IRC §1014.

⁵⁵ IRC §6501(e)(1)(A).

⁵⁶ *Home Concrete & Supply, LLC v. U.S.*, 132 S. Ct. 1836 (2012).

TAX RETURN DUE DATES

The Act also modifies due dates for various types of tax returns. Those changes include the following.

Partnerships

For tax years beginning after December 31, 2015, returns for calendar-year partnerships will be due on March 15 (instead of April 15). Returns for fiscal year partnerships will be due on the 15th day of the third month following the close of the fiscal year.

The maximum extension allowed is six months for Form 1065, *U.S. Return of Partnership Income*.

Note. The due dates for S corporation tax returns have not changed and remain the 15th day of the third month following the end of the tax year.

C Corporations

The new law establishes that the due date for most C corporation returns is the 15th day of the **fourth** month (instead of the third month) following the end of the corporation's tax year. This change is applicable to tax years beginning after December 31, 2015, **unless the corporate year ends on June 30**. In such cases, the new deadlines apply to returns for tax years beginning after December 31, **2025**.

Under the new law, C corporations may also be granted a 6-month extension (in contrast to current 3-month extensions). However, calendar-year C corporations may receive a 5-month extension and C corporations with a yearend of June 30 may receive a 7-month extension for the next 10 years.

The new due dates for C corporations are outlined in the following table.

Tax Year Ending	Tax Return Due Date 15th Day of...	Extension Period
Dec. 31	4th month	5 months
Jun. 30	3rd month	7 months
All others	4th month	6 months

Trusts Filing Form 1041

Trusts are generally required to file Form 1041, *U.S. Income Tax Return for Estates and Trusts*, on a calendar-year basis. Form 1041 is generally due by April 15 following the end of the tax year. The maximum extension allowed for returns of trusts filing Form 1041 is **five and one-half months** (ending on September 30) for calendar-year taxpayers with tax years beginning after December 31, 2015. There are no changes to due dates and extensions for **estate** income tax returns.

FinCEN Report 114 (Relating to FBAR) and Form 3520

The new due date for filing FinCEN Form 114, *Report of Foreign Bank and Financial Accounts*, under the new law is changed from June 30 to April 15. However, taxpayers are now allowed a 6-month extension for this filing. The same due date and extension apply to Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Foreign Gifts*.

These changes apply to forms required for tax years beginning after December 31, 2015.

Other Extension Due Dates

The due dates for extensions filed for the returns shown in the following table have also changed. These revised extension due dates apply to returns for tax years beginning after December 31, 2015.

Organization Filing Return	Type of Return	Extension Due Date
Organizations exempt from income tax	Form 990 series	6 months ending on November 15 for calendar-year plans
Organizations exempt from income tax	Form 4720	6 months after the due date for the return
Trusts	Form 5227	6 months after the due date for the return
Tax-exempt black lung benefit trusts	Form 6069	6 months after the due date for the return
Certain charitable organizations described in IRC §170(c) or charitable remainder trusts described in IRC §664(d)	Form 8870	6 months after the due date for the return
Foreign trusts with a U.S. owner	Form 3520-A	6 months after the end of the tax year

OMNIBUS OF 2015⁵⁷

As mentioned earlier, on December 18, 2015, President Obama signed into law an omnibus spending package along with the PATH Act. The omnibus funds the government through September 2016. A summary of the tax provisions included in the omnibus that are most likely to be of interest to practitioners follows.

HIGH-COST EMPLOYER-SPONSORED HEALTH COVERAGE EXCISE TAX

Old Law. For years beginning after December 31, 2017, an excise tax is imposed on the provider of applicable employer-sponsored health coverage. The excise tax applies if the aggregate cost of the coverage for an employee exceeds a threshold amount. These high cost health insurance plans are often referred to as “Cadillac” plans.

The threshold amount for 2018 is \$10,200 for self-only coverage and \$27,500 for other coverage (including family coverage) multiplied by a one-time health cost adjustment percentage. The threshold amount is adjusted annually by an excess premium amount related to age and gender.

New Law. The omnibus delays the effective date for the excise tax for two years; therefore, the tax is effective for years beginning after December 31, 2019.

ENERGY INVESTMENT CREDIT

Old Law. Under IRC §48, a 10% business energy credit is allowed for the cost of new equipment that either:

- Uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat; or
- Is used to produce, distribute, or use energy derived from a geothermal deposit.

⁵⁷ Joint Committee on Taxation. *General Explanation of Tax Legislation Enacted in 2015*. JCS-1-16. (Mar. 2016).

New Law. The omnibus modifies the credit rate but only for property that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. The credit rate varies by year, as shown in the following table.

Year	Credit Rate
2017, 2018, and 2019	30%
2020	26%
2021	22%
2022 and subsequent years	10%

The credit rate is determined by the year in which construction of the property begins and applies when the property is placed into service. Property must be placed in service prior to December 31, 2023, to qualify for a rate higher than 10%.

RESIDENTIAL ENERGY EFFICIENT PROPERTY CREDIT

Old Law. IRC §25D provides a tax credit for the purchase of the following items.

Property Type	Credit rate
Qualified solar electric property	30%
Qualified solar water heating property used exclusively for purposes other than heating swimming pools and hot tubs	30%
Qualified geothermal heat pump property	30%
Qualified small wind energy property	30%
Qualified fuel cell power plants	30% ^a

^a Not to exceed \$500 for each 0.5 kilowatt of capacity.

The §25D credit applies to property placed in service prior to January 1, 2017.

New Law. The omnibus extends the credit for five years but **only** for qualified **solar** electric property and qualified **solar** water heating property. Therefore, the credit is available for these types of property through December 31, 2021. The provision modifies the credit rate, as shown in the following table.

Year Property Placed in Service	Credit Rate
2017–2019	30%
2020	26%
2021	22%

Note. For a description of property that qualifies for the residential energy efficient property credit, see the instructions to Form 5695, *Residential Energy Credits*.

IDENTITY THEFT ISSUES

OFFICE SECURITY

Tax preparers are increasingly becoming targets for data theft because of the sensitive information they store.⁵⁸ The IRS urges tax preparers to take an active role in combating identity theft. One of the ways to do this is to regularly perform a **deep scan** of computer drives and devices rather than the usual **quick scan**.

- A **quick scan** checks common areas for computers viruses and malware. Scanned areas can include the computer memory and common areas of the hard drive, including the temporary Internet files and the operating system directory. A quick scan typically takes less than 30 minutes to complete.
- A **full/deep scan** checks every area of the computer, including memory, hard drives and sometimes external devices connected to the computer (e.g., external hard drives and USB flash drives). Because the full scan checks everything, it takes longer to perform. Depending on how much memory and hard drive space is utilized, it could take from 30 minutes to several hours to complete a full scan.

Phishing emails often appear to come from the IRS. They target tax preparers and are designed to steal sensitive information like passwords or taxpayer data stored on computers.

In order to mitigate threats from identity thieves, the IRS recommends all tax return preparers take the following actions.⁵⁹

1. Ensure that the firm and employees have **robust security software** that helps block malware and viruses and that it is turned on and active at all times.
2. Periodically perform a deep scan to fully scour all computer drives and files for any malware or viruses. These bugs can hide in places that a quick scan does not search.
3. Ensure that security software is updated automatically so it is always up-to-date to guard against new and emerging malware and viruses.
4. Review the security plan for the office and operations. Review the checklist suggested by IRS Pub. 4557, *Safeguarding Taxpayer Data*, if the firm does not have a security plan.
5. Educate employees about the dangers of phishing, malware, emails, and other scams that could lead to malware/virus infections. One phishing email can result in all office computers being hacked for sensitive data.

⁵⁸ IRS Pub. 4557, *Safeguarding Taxpayer Data*.

⁵⁹ *Tax Preparers: Perform a Deep Security Scan of Your Computer Drives*. Jan. 21, 2016. IRS. [www.irs.gov/uac/Tax-Preparers-Perform-a-Deep-Security-Scan-of-Your-Computer-Drives] Accessed on Mar. 7, 2016.

Data security includes **all** aspects of the business. Tax preparers should review administrative practices, facility protection, computer security, personnel, and information systems.⁶⁰ Tax preparers should implement the following measures.

- Assure that taxpayer data, including data on hardware and media, is never left unsecured.
- Securely dispose of taxpayer information.
- Require strong passwords (i.e., a combination of numbers, symbols, upper and lowercase letters) on all computers and tax software programs.
- Require periodic password changes every 60–90 days.
- Store taxpayer data in secure systems and encrypt information when transmitting across networks.
- Ensure that e-mail that contains taxpayer data is encrypted and secure.
- Keep paper documents, computer disks, flash drives, and other media in a secure location and restrict access to authorized users only.
- Use caution when allowing or granting remote access to internal networks containing sensitive data.
- Terminate access to taxpayer information for anyone who is no longer employed by the business.
- Create security requirements for the entire staff regarding computer information systems, paper records, and use of taxpayer data.
- Provide periodic training to update staff members on any changes and to ensure compliance.
- Protect your facilities from unauthorized access and potential dangers.
- Create a plan for the required steps to notify clients if the business is the victim of a data breach or theft.
- Complete a risk assessment to identify the risks and potential impacts of unauthorized access.
- Write and follow an information security plan.
- Consider performing background checks, and screen individuals before granting access to client information.

Putting safeguards in place to protect client data helps prevent fraud and identity theft and enhances client confidence and trust. These safeguards will help:

- Preserve the confidentiality and privacy of client data by restricting access and disclosure,
- Protect the integrity of data by preventing improper or unauthorized modification or destruction, and
- Maintain the availability of data by providing timely and reliable access and data recovery.

Note. The IRS recommends tax preparers redact or mark out the social security numbers (SSN) and bank account information on copies of tax returns to prevent identity theft.⁶¹ Most software has a print option to suppress this information.

The following checklists found in IRS Pub. 4557 address the various areas with activities that can mitigate risk.⁶²

⁶⁰ IRS FS-2016-23 (Jul. 2016).

⁶¹ *Identity Theft Information for Tax Preparers*. Jan. 6, 2016. IRS. [www.irs.gov/individuals/identity-theft-information-for-tax-preparers] Accessed on May 20, 2016.

⁶² IRS Pub. 4557, *Safeguarding Taxpayer Data*.

Checklist 1

ONGOING	DONE	N/A	Administrative Activities
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Complete a Risk Assessment. Identify the risks and potential impacts of unauthorized access, use, disclosure, disruption, modification or destruction of information and information systems that can be used to access taxpayer data. How vulnerable is your customer's data to theft, disclosure, unauthorized alterations or unrecoverable loss? What can you do to reduce the impact to your customers and your business in such an event? What can you do to reduce vulnerability?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Write and follow an Information Security Plan that:
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Addresses every item identified in the risk assessment.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Defines safeguards you want affiliates and service providers to follow
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Requires a responsible person to review and approve the Information Security Plan.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Requires a responsible person to monitor, revise, and test the Information Security Plan on a periodic (recommended annual) basis to address any system or business changes or problems identified.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Periodically (recommended annually) perform a Self-Assessment to:
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Evaluate and test the security plan and other safeguards you have in place.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	• Document information safeguards deficiencies. Create and execute a plan to address them.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Retain a copy of the Self-Assessment and ensure it is available for any potential reviews.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	If required by the FTC Privacy Rule, provide privacy notices and practices to your customers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Specify in contracts with service providers the safeguards they must follow and monitor how they handle taxpayer information.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Ask service providers to give you a copy of their written security policy on safeguarding information.

Checklist 2

ONGOING	DONE	N/A	Facilities Security
<input type="checkbox"/>	<input type="checkbox"/>		Protect from unauthorized access and potential danger (e.g., theft, floods and tornados) all places where taxpayer information is located.
<input type="checkbox"/>	<input type="checkbox"/>		Write procedures that prevent unauthorized access and unauthorized processes.
<input type="checkbox"/>	<input type="checkbox"/>		Assure that taxpayer information, including data on hardware and media, is not left un-secured on desks or photocopiers, in mailboxes, vehicles, trash cans or rooms in the office or at home where unauthorized access can occur.
<input type="checkbox"/>	<input type="checkbox"/>		Authorize and control delivery and removal of all taxpayer information, including data on hardware and media.
<input type="checkbox"/>	<input type="checkbox"/>		Lock doors to file rooms and/or computer rooms.
<input type="checkbox"/>	<input type="checkbox"/>		Provide secure disposal of taxpayer information, such as shredders, burn boxes or temporary file areas until it can be securely disposed.

Checklist 3

ONGOING	DONE	N/A	Personnel Security
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Create and distribute Rules of Behavior that describe responsibilities and expected behavior regarding computer information systems as well as paper records and usage of taxpayer data. Have all information system users complete, sign, and submit an acknowledgement that they have read, understood, and agree to comply with the rules of behavior. An example of rules of behavior can be found in Appendix A of NIST SP-800 18 <i>Guide for Developing Security Plans for Federal Information Systems</i> .
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Ensure personnel from third-party providers such as service bureaus, contractors, and other businesses providing information technology services meet the same security requirements as those applied to your personnel.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Address Rules of Behavior for computer system management.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	When interviewing prospective personnel, explain the expected Rules of Behavior.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	When possible, perform a background and/or reference check on new employees who will have contact with taxpayer information. Conduct background screenings that are appropriate to the sensitivity of an assigned position.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Screen personnel prior to granting access to any paper or electronic data. This will help ensure their suitability for a position requiring confidentiality and trust.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have personnel who will have access to taxpayer information sign nondisclosure agreements on the use of confidential taxpayer information.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Develop and enforce formal compliance policies and processes, including possible disciplinary action, for all personnel who do not comply with the businesses' established information security policies and procedures.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Terminate access to taxpayer information (e.g., login IDs and passwords) for those employees who are terminated or who no longer need access.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	For each employee who is terminated, conduct an exit interview and ensure the employee returns property that allows access to taxpayer information (e.g., laptops, media, keys, identification cards and building passes).
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Train staff on Rules of Behavior for access, non-disclosure and safeguards of taxpayer information. Provide refresher training periodically.

Checklist 4

ONGOING	DONE	N/A	Information Systems Security
<input type="checkbox"/>	<input type="checkbox"/>		Information systems include both automated and manual systems made up of people, machines and/or methods for collecting, processing, transmitting, storing, archiving and distributing data. To help ensure the accuracy, validity, consistency and reliability of taxpayer data, you should manage taxpayer data information systems based on the guidelines below.
<input type="checkbox"/>	<input type="checkbox"/>		Grant access to taxpayer information systems only on a valid need-to-know basis that is determined by the individual's role within the business.
<input type="checkbox"/>	<input type="checkbox"/>		Put in place a written contingency plan to perform critical processing in the event that your business is disrupted. It should include a plan to protect both electronic and paper taxpayer information systems. Identify individuals who will recover and restore the system after disruption or failure.
<input type="checkbox"/>	<input type="checkbox"/>		Periodically test your contingency plan.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Back up taxpayer data files regularly (e.g., daily or weekly) and store backup information at a secure location.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Maintain hardware and software as needed and keep maintenance records.

Checklist 5

ONGOING	DONE	N/A	Computer Systems Security
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Identify and authenticate computer system users who require access to electronic taxpayer information systems before granting them access.
			You can manage user identities by:
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Identifying authorized users of electronic taxpayer information systems and grant specific access rights/privileges.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Assigning each user a unique identifier.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Verifying the identity of each user.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Disabling user identifiers after an organization-defined time period of inactivity.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Archiving user identities.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Implement password management procedures that require strong passwords.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Require periodic password changes.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Disable and remove inactive user accounts.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Protect electronic taxpayer information systems connected to the Internet with a barrier device (e.g., firewall, router or gateway). Any failure of these devices should not result in an unauthorized release of taxpayer data.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	When storing taxpayer information electronically, consider following best practices and store it on separate secure computers or media that are not connected to a network and that are password protected and encrypted.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Encrypt taxpayer information when attached to email.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Encrypt taxpayer information when transmitting across networks.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Regularly update firewall, intrusion detection, anti-spyware, anti-adware, anti-virus software and security patches.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Monitor computer systems for unauthorized access by reviewing system logs.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Lock out computer system users after three consecutive invalid access attempts.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Remove all taxpayer information once the retention period expires by using software designed to securely remove data from computers and media prior to disposing of hardware or media. The FTC Disposal Rule has information on how to dispose of sensitive data.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	As recommended by the FTC, reduce risks to computer systems by performing vulnerability scans and penetration tests periodically. You can learn more about this at the FTC Web site in their article "FTC Facts for Business – Security Check: Reducing Risks to Your Computer Systems."

Checklist 6

ONGOING	DONE	N/A	Media Security
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Store computer disks, removable media, tapes, compact disks, flash drives, audio and video recordings of conversations and meetings with taxpayers, and paper documents in a secure location, cabinet, or container.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Secure media storage areas, including rooms, cabinets, and computers by locks or key access. Where appropriate, employ an automated mechanism to ensure only authorized access.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Restrict authorized access to media storage.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Limit removal of taxpayer information to authorized persons and perform information access audits regularly.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Securely remove all taxpayer information when disposing of computers, diskettes, magnetic tapes, hard drives, or any other electronic media that contain taxpayer information. The FTC Disposal Rule has information on how to dispose of sensitive data.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Shred or burn paper documents before discarding them.

6

Checklist 7

ONGOING	DONE	N/A	Certifying Information Systems For Use
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Determine if risks are acceptable to certify systems for use.
<input type="checkbox"/>	<input type="checkbox"/>		Sign an authority to operate.
			If you use a certified independent certification company, consider the following:
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> On a periodic (recommended annual) basis, have an independent individual or business with relevant security expertise, evaluate the security plans, controls, and any other safeguards implemented in your business against best practices.
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> Have a report generated from the audit that certifies that your business follows best practices.
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> Ensure the report highlights any deficiencies and provides recommendations for their correction.
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> Develop a plan for your business to correct any deficiencies found and to ensure that the plan is successfully executed.
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> Retain a copy of the audit report to ensure it is available for any potential reviews.
<input type="checkbox"/>	<input type="checkbox"/>		<ul style="list-style-type: none"> Be prepared to show how you mitigate risks.

E-Filing Security⁶³

Electronic filing (e-file) providers are responsible for safeguarding data from fraud and abuse. Providers have a responsibility to:

- Report fraud and abuse to the IRS,
- Cooperate with any IRS investigations by making information and documents relating to returns with potential fraud or abuse available to the IRS upon demand, and
- Appoint an individual as a responsible official who ensures the firm meets IRS e-file rules and requirements.

Providers with fraud and abuse problems may be suspended or expelled from the e-file program. Additionally, the IRS may assess civil and preparer penalties or the provider may be subject to legal action.

The IRS has mandated that online providers of individual income tax returns follow the following six security, privacy, and business standards to better serve taxpayers and to protect information collected, processed, and stored.

1. **Possess an extended validation secure socket layer (SSL) certificate** using SSL 3.0/TLS 1.0 or later and a minimum 1024-bit RSA/128-bit AES. This standard applies to authorized e-file providers participating in online filing of individual income tax returns that collect taxpayer information via the Internet.
2. **Perform weekly external vulnerability scans** of all system components (any network component, server, or application included in or connected to the part of the network that possesses taxpayer data or sensitive authentication data). This standard applies to providers participating in online filing of individual income tax returns that collect, transmit, process, or store taxpayer information.
3. **Maintain written information privacy and safeguard policies consistent with applicable government and industry guidelines** that include the statement, “We maintain physical, electronic, and procedural safeguards that comply with applicable laws and federal standards.” In addition, a privacy seal vendor acceptable to the IRS must certify the provider’s compliance with these policies. This standard applies to providers participating in online filing of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed, or stored.
4. **Install a challenge-response protocol (e.g., CAPTCHA) test** that requires a user to successfully complete the challenge-response test before collecting, transmitting, processing, or storing taxpayer information. This standard applies to providers participating in online filing of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed, or stored.
5. **Register the public domain name** with a domain name registrar **located in the United States** and accredited by the Internet Corporation for Assigned Names and Numbers (ICANN). This standard applies to providers participating in online filing of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed, or stored.
6. **Report security incidents** (i.e., events that could result in unauthorized disclosure, misuse, modification, or destruction of taxpayer information) to the IRS no later than the next business day after confirmation of the incident. This standard applies to providers participating in online filing of individual income tax returns that collect, transmit, process, or store taxpayer information.

⁶³ IRS Pub. 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*.

REPORTING A BREACH

Notifying Law Enforcement⁶⁴

An identity theft compromise that could result in harm to a person or business should be reported to the local police department. If the local police department is not equipped to investigate identity theft issues, contact the local office of the FBI or the U.S. Secret Service. Mail theft should be reported to the U.S. Postal Inspection Service.

Note.

- Local FBI field offices are listed at **uofi.tax/16a6x9** [www.fbi.gov/contact-us/field].
- Field offices for the U.S. Secret Service are found at **uofi.tax/16a6x10** [www.secretservice.gov/contact/field-offices].
- U.S. Postal Inspection Service offices can be found at **uofi.tax/16a6x11** [locator.uspis.gov/locator].

Notifying Affected Businesses⁶⁵

If a business's data is compromised, it can affect other businesses such as banks or credit issuers. If the compromised business has account access information (e.g., credit card or bank account numbers) that is not maintained by the business, the institution that maintains the account should be notified. If the compromised business collects or stores personal information on behalf of other businesses, those other businesses should be notified.

Compromised businesses can contact the major credit bureaus if names and social security numbers (SSNs) are stolen. Major credit bureaus offer additional information and advice. If the compromise involves a large group of people, the credit bureaus should be alerted that a large number of individuals are going to request fraud alerts due to the compromise.

Note. Taxpayers only need to request a fraud alert from **one** of the three major credit bureaus. One bureau must notify the other two when an alert is requested. Fraud alerts are free, last for 90 days, and are renewable. Fraud alerts provide a red flag to businesses where thieves may be trying to open accounts and encourage legitimate businesses to conduct additional checks to verify identities.⁶⁶

The contact information for the three major credit bureaus follows.

Equifax

uofi.tax/16a6x12 [www.Equifax.com/CreditReportAssistance]

888-766-0008

P.O. Box 740241

Atlanta, GA 30374

Experian

uofi.tax/16a6x13 [www.Experian.com/fraudalert]

888-397-3742

P.O. Box 4500

Allen, TX 75013

TransUnion

uofi.tax/16a6x14 [www.TransUnion.com/fraud]

800-680-7289

P.O. Box 2000

Chester, PA 19016

⁶⁴ *Information Compromise and the Risk of Identity Theft: Guidance for Your Business*. Jun. 2004. FTC. [www.ftc.gov/system/files/documents/plain-language/bus59-information-compromise-and-risk-id-theft-guidance-your-business.pdf] Accessed on Mar. 7, 2016.

⁶⁵ Ibid.

⁶⁶ *Tips for Using Credit Bureaus to Help Protect Your Financial Accounts*. Apr. 12, 2016. IRS. [www.irs.gov/uac/Tips-for-Using-Credit-Bureaus-to-Help-Protect-Your-Financial-Accounts] Accessed on Aug. 16, 2016.

Any information posted on a company's webpage that leads to an information compromise should be taken down immediately. Internet search engines store information for a period of time but companies can contact them to ensure that they do not archive the information posted in error.

Notifying Individuals⁶⁷

Early notification is vital to mitigate the damage from any compromised information. When deciding if notification is warranted, consider the following.

- The nature of the compromise
- The type of information taken
- The likelihood of misuse
- The potential damage arising from misuse

The Federal Trade Commission (FTC) recommends that an impacted business designate a contact person within the organization to release the latest information about the breach, the business's response, and how individuals should respond. The timing and content of this notification should not impede any investigation. The notice should have the following information.

1. A clear description of the compromise including how it happened, what information was taken, how the thieves used the information, and any actions the organization has already taken to remedy the situation
2. How to reach the contact person
3. Explanation of what responses are appropriate (e.g., for compromised SSN, contact credit bureaus to put fraud alerts on credit report)
4. Current information about identity theft
5. Contact information for the law enforcement officer working on the case and a case number if applicable (Victims should request a copy of the police report and make copies for creditors who accepted unauthorized purchases as evidence to absolve a victim of fraudulent debts.)
6. Encouragement to victims to file a complaint with the FTC at **uofi.tax/16a6x15** [www.ftc.gov/idtheft] or at 1-877-ID-THEFT

⁶⁷ *Information Compromise and the Risk of Identity Theft: Guidance for Your Business*. Jun. 2004. FTC. [www.ftc.gov/system/files/documents/plain-language/bus59-information-compromise-and-risk-id-theft-guidance-your-business.pdf] Accessed on Mar. 7, 2016.

The FTC provides the following model letter that businesses can send out to victims of identity theft.

MODEL LETTER FOR THE COMPROMISE OF SOCIAL SECURITY NUMBERS

Dear _____:

We are contacting you about a potential problem involving identity theft.
[Describe the information compromise and how you are responding to it.]

We recommend that you place a fraud alert on your credit file. A fraud alert tells creditors to contact you before they open any new accounts or change your existing accounts. Call any one of the three major credit bureaus. As soon as one credit bureau confirms your fraud alert, the others are notified to place fraud alerts. All three credit reports will be sent to you, free of charge, for your review.

Equifax

888-766-0008

Experian

888-397-3742

TransUnionCorp

800-680-7289

Even if you do not find any suspicious activity on your initial credit reports, the Federal Trade Commission (FTC) recommends that you check your credit reports periodically. Victim information sometimes is held for use or shared among a group of thieves at different times. Checking your credit reports periodically can help you spot problems and address them quickly.

If you find suspicious activity on your credit reports or have reason to believe your information is being misused, call [insert contact information for law enforcement] and file a police report. Get a copy of the report; many creditors want the information it contains to absolve you of the fraudulent debts. You also should file a complaint with the FTC at www.ftc.gov/idtheft or at 1-877-ID-THEFT (877-438-4338). Your complaint will be added to the FTC's Identity Theft Data Clearinghouse, where it will be accessible to law enforcers for their investigations.

We have enclosed a copy of *Take Charge: Fighting Back Against Identity Theft*, a comprehensive guide from the FTC to help you guard against and deal with identity theft.

[Insert closing]

Your Name

WARNING SIGNS OF TAX-RELATED IDENTITY THEFT⁶⁸

The first sign of identity theft may be when a tax preparer attempts to file an income tax return and it is rejected. A taxpayer may also receive a notice from the IRS regarding any of the following issues that indicate data may be compromised.

- A return is rejected because more than one tax return was filed using the taxpayer's SSN.
- There is a balance due, refund offset, or a collection action taken for a year in which the taxpayer did not file a tax return.
- IRS records indicate that the taxpayer received wages from an unknown employer.
- A business taxpayer receives an IRS letter about an amended tax return, fictitious employees, or a defunct, closed, or dormant business.
- A business return is accepted as an amended return but the taxpayer has not filed an original return for that year.⁶⁹

A tax preparer who has a client who receives a notice from the IRS should respond immediately to the phone number provided. Additionally, the taxpayer should complete Form 14039, *Identity Theft Affidavit*, and fax or mail it to the IRS.

Note. Tax preparers must have Form 2848, *Power of Attorney and Declaration of Representative*, on file with the IRS to inquire about any specific client information.⁷⁰

Note. The IRS reminds taxpayers that it **will not**:⁷¹

- Call to demand immediate payment,
- Call without first sending a bill in the mail,
- Demand a taxpayer pay taxes and not let them question or appeal the amount owed,
- Require taxpayers pay taxes in a certain way (e.g., with a prepaid debit card),
- Ask for credit or debit cards over the phone, or
- Threaten to bring in the police or other agencies to arrest a taxpayer for not paying.

⁶⁸ *Identity Theft Information for Tax Preparers*. Jan. 6, 2016. IRS. [www.irs.gov/Individuals/Identity-Theft-Information-for-Tax-Preparers] Accessed on Mar. 7, 2016.

⁶⁹ IRS Pub. 5199, *Tax Preparer Guide to Identity Theft*.

⁷⁰ *Identity Theft Information for Tax Preparers*. Jan. 6, 2016. IRS. [www.irs.gov/Individuals/Identity-Theft-Information-for-Tax-Preparers] Accessed on Mar. 7, 2016.

⁷¹ *Don't Fall for New Tax Scam Tricks by IRS Posers*. Oct. 16, 2015. IRS. [www.irs.gov/uac/Dont-Fall-for-New-Tax-Scam-Tricks-by-IRS-Posers] Accessed on Mar. 7, 2016.

THE ACA AND TAX RETURN PREPARATION

Effective January 1, 2014, under the Affordable Care Act (ACA) individual mandate, individuals have generally been required to maintain qualifying health insurance or pay a penalty unless exemptions apply.

Tax preparers must have a working knowledge of ACA rules and key definitions. They must exercise due diligence in asking the taxpayer relevant health coverage-related questions for accurate tax reporting. They should also ensure that taxpayers understand key ACA terms to prevent inaccurate preparation of their returns.

This section addresses some practical ACA issues that have evolved since 2014 with the advent of the individual mandate.

MINIMUM ESSENTIAL COVERAGE

In order to meet the individual mandate, it is necessary for the taxpayer and the taxpayer's family to be covered by health insurance that qualifies as minimum essential coverage (MEC). Although MEC generally includes coverage offered by the Marketplace (which is the system of state insurance exchanges through which taxpayers may obtain MEC), it does not include short-term, limited duration coverage.⁷² Accordingly, it may be necessary for the tax preparer to ascertain whether a taxpayer has MEC. A taxpayer may receive one of the following forms regarding their health insurance coverage.

- Form 1095-A, *Health Insurance Marketplace Statement*, which is filed by the Marketplace
- 1095-B, *Health Coverage*, which is filed by insurers
- 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, which is filed by employers

Draft versions of those forms follow.

⁷² Treas. Reg. §1.5000A-2(d).

2016 Workbook

Form **1095-A**

Health Insurance Marketplace Statement

☐ VOID

OMB No. 1545-2232

Department of the Treasury
Internal Revenue Service

► Information about Form 1095-A and its separate instructions
is at www.irs.gov/form1095a.

☐ CORRECTED

2016

Part I Recipient Information

1 Marketplace identifier	2 Marketplace-assigned policy number	3 Policy issuer's name	
4 Recipient's name	5 Recipient's SSN	6 Recipient's date of birth	
7 Recipient's spouse's name	8 Recipient's spouse's SSN	9 Recipient's spouse's date of birth	
10 Policy start date	11 Policy termination date	12 Street address (including apartment no.)	
13 City or town	14 State or province	15 Country and ZIP or foreign postal code	

Part II Covered Individuals

A. Covered individual name	B. Covered individual SSN	C. Covered individual date of birth	D. Coverage start date	E. Coverage termination date
16				
17				
18				
19				
20				

Part III Coverage Information

Month	A. Monthly enrollment premiums	B. Monthly second lowest cost silver plan (SLCSP) premium	C. Monthly advance payment of premium tax credit
21 January			
22 February			
23 March			
24 April			
25 May			
26 June			
27 July			
28 August			
29 September			
30 October			
31 November			
32 December			
33 Annual Totals			

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 60703Q

Form **1095-A** (2016)

1095-B

Form

Department of the Treasury
Internal Revenue Service

OMB No. 1545-2252

☐ VOID**2016****Health Coverage**

▶ Do not attach to your tax return. Keep for your records.

▶ Information about Form 1095-B and its separate instructions is at www.irs.gov/form1095b.**Part I Responsible Individual**

1 Name of responsible individual

2 Social security number (SSN or other TIN) 3 Date of birth (if SSN or other TIN is not available)

4 Street address (including apartment no.)

5 City or town

6 State or province

7 Country and ZIP or foreign postal code

9 Reserved

8 Enter letter identifying Origin of the Health Coverage (see instructions for codes):

Part II Information about Certain Employer-Sponsored Coverage (see instructions)

10 Employer name

11 Employer identification number (EIN)

12 Street address (including room or suite no.)

13 City or town

14 State or province

15 Country and ZIP or foreign postal code

Part III Issuer or Other Coverage Provider (see instructions)

16 Name

18 Contact telephone number

19 Street address (including room or suite no.)

20 City or town

21 State or province

22 Country and ZIP or foreign postal code

Part IV Covered Individuals (Enter the information for each covered individual.)

(a) Name of covered individual(s)	(b) SSN or other TIN	(c) DOB (if SSN or other TIN is not available)	(d) Covered all 12 months	(e) Months of coverage													
				Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		
23			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
26			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
27			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 60704B

Form **1095-B** (2016)

Form 1095-C

Department of the Treasury
Internal Revenue Service

Employer-Provided Health Insurance Offer and Coverage

Do not attach to your tax return. Keep for your records.
Information about Form 1095-C and its separate instructions is at www.irs.gov/form1095c

☐ VOID
☐ CORRECTED

OMB No. 1545-2251

2016

Part I Employee

Applicable Large Employer Member (Employer)

1 Name of employee	2 Social security number (SSN)	7 Name of employer	8 Employer identification number (EIN)
3 Street address (including apartment no.)		9 Street address (including room or suite no.)	10 Contact telephone number

4 City or town	5 State or province	6 Country and ZIP or foreign postal code	11 City or town	12 State or province	13 Country and ZIP or foreign postal code
----------------	---------------------	--	-----------------	----------------------	---

Part II Employee Offer of Coverage

Plan Start Month (Enter 2-digit number):

	All 12 Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
14 Offer of Coverage (enter required code)													
15 Employee Required Contribution (see instructions)	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
16 Section 4980H Safe Harbor and Other Relief (enter code, if applicable)													

Part III Covered Individuals

If Employer provided self-insured coverage, check the box and enter the information for each individual enrolled in coverage, including the employee. ☐

(a) Name of covered individual(s)	(b) SSN or other TIN	(c) DOB (if SSN or other TIN is not available)	(d) Covered all 12 months	(e) Months of Coverage												
				Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	
17			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 60705M

Form 1095-C (2016)

Observation. Although the Marketplace offers MEC, the Marketplace exchanges in many states also offer several limited benefit plans that do not qualify as MEC. Taxpayers may not understand the need for coverage that meets MEC guidelines and may be tempted to purchase less costly limited benefit plans. This may result in large reconciliation discrepancies and unexpected additional tax liability for the taxpayer. Reconciliation discrepancies are reported on Form 8962, *Premium Tax Credit (PTC)*, which is discussed later. If no other documentation exists, a coverage benefit card or statement may indicate that the coverage is limited.

Note. For regulatory guidance about what coverage qualifies as MEC, including details about qualifying Marketplace, employer-sponsored, and government-sponsored programs, see Treas. Reg. §1.5000A-2. In addition, see the 2012 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: Healthcare Reform Act. This can be found at **uofi.tax/arc** [www.taxschool.illinois.edu/taxbookarchive].

Exemptions

An individual that fails to maintain MEC for some or all of the tax year is subject to a tax penalty. This penalty is called a **shared responsibility payment (SRP)**.⁷³ For returns that show an SRP owed by the taxpayer because the taxpayer did not have MEC, the tax preparer should determine if the taxpayer qualifies for one of the exemptions. The available exemptions include the following.⁷⁴

- Members of recognized religious sects
- Members of healthcare sharing ministries
- Individuals without access to affordable coverage
- Individuals with household income below the filing threshold for a federal tax return
- Individuals with a hardship

Note. For a list of circumstances that may constitute hardship, including death of a close family member, domestic violence, receipt of a utility shut-off notice, or unpaid medical expenses, see **uofi.tax/16a6x1** [www.healthcare.gov/health-coverage-exemptions/exemptions-from-the-fee].

Observation. In order to avoid the SRP, it may be possible to file an extension for the tax return and have the taxpayer obtain the necessary exemption certificate from the Marketplace. The certificate can subsequently be filed with the return to eliminate an unnecessary SRP.

⁷³ See IRC §5000A(b)(1).

⁷⁴ Treas. Reg. §1.5000A-3.

Penalties⁷⁵

An individual who does not have an exemption, can afford health insurance, and chooses not to buy it, is responsible for the SRP. The fee for not having health insurance in 2016 is the higher of either:

- 2.5% of household income (defined later) up to a maximum of the total yearly premium for the national average price of a bronze plan sold through the Marketplace, or
- \$695 per adult (\$347.50 per child under 18), up to a maximum of \$2,085.

Note. For additional information about the SRP, see the 2015 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: New Developments.

PREMIUM TAX CREDIT RECONCILIATION

Generally, taxpayers with incomes between 100% and 400% of the federal poverty guidelines applicable for the taxpayer's family size may be entitled to the premium tax credit (PTC), which is a refundable tax credit. For the taxpayer or qualifying individual within the taxpayer's household to qualify for the PTC, the taxpayer must have MEC. A taxpayer's PTC is based on the number of coverage months⁷⁶ during the year in which the taxpayer qualifies for the PTC.

Note. For the definition of applicable taxpayers, MEC, and related rules associated with qualification for the PTC, see IRC §36B and related regulations and the 2012 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: Healthcare Reform Act. This can be found at **uofi.tax/arc** [www.taxschool.illinois.edu/taxbookarchive]. For federal poverty guideline amounts, which are updated annually, see **uofi.tax/16a6x2** [www.healthcare.gov/glossary/federal-poverty-level-FPL].

The PTC is intended to assist qualifying taxpayers with the cost of MEC. A taxpayer who qualifies for the PTC may either:⁷⁷

- Pay the full amount of the monthly health insurance premiums (or make one annual payment for the year), or
- Choose to receive an advance premium tax credit (APTC), which provides direct monthly payment to the health insurance company on the taxpayer's behalf to assist with the monthly cost of their health coverage.

Generally, the amount of PTC the taxpayer is entitled to is estimated based on the following formula.⁷⁸

Amount of PTC available = Cost of applicable benchmark plan – Maximum premium taxpayer is expected to pay

This PTC estimate is based on several factors, including the taxpayer's estimated income for the year and the Marketplace's premium amount for the benchmark plan.

Note. For additional details on PTC eligibility and on the calculation of a taxpayer's PTC, including the definition of "applicable benchmark plan," see Treas. Reg. §1.36B-3 and the 2012 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: Healthcare Reform Act. This can be found at **uofi.tax/arc** [www.taxschool.illinois.edu/taxbookarchive].

⁷⁵ *If you don't have health insurance: How much you'll pay.* Healthcare.gov. [www.healthcare.gov/fees/fee-for-not-being-covered] Accessed on Aug. 11, 2016.

⁷⁶ IRC §36B(b)(1).

⁷⁷ *Questions and Answers on the Premium Tax Credit*, Apr. 21, 2016. IRS. [www.irs.gov/affordable-care-act/individuals-and-families/questions-and-answers-on-the-premium-tax-credit] Accessed on Aug. 9, 2016.

⁷⁸ IRC §36B; Treas. Reg. §1.36B-3.

Generally, at the time a taxpayer applies for Marketplace coverage, the taxpayer provides the Marketplace with an income estimate for the year. This income estimate affects the provisional amount of PTC the taxpayer will receive for the year. This amount is later reconciled with actual income on the taxpayer's return for the year using Form 8962. Multiple factors can result in a difference between the estimated PTC (upon which APTCs used to pay for premiums during the year are based) and the actual PTC (calculated later on the taxpayer's return for the year). Some of these factors include the following.

- The taxpayer's actual **household income** is higher or lower than the amount estimated. (Household income is discussed later.)
- The taxpayer, or a member of the taxpayer's household, becomes eligible or ineligible for MEC.
- The taxpayer, or a member of the taxpayer's household, becomes eligible for employer-sponsored coverage (and therefore no longer qualifies for the PTC).
- Events such as a birth or adoption of a child, a divorce, or a marriage affects the taxpayer's family size.

As mentioned earlier, taxpayers who receive APTCs to assist with premium payments during the year must **reconcile** the estimated PTC with the actual PTC for which they are eligible.⁷⁹ If APTC payments exceed the PTC for which the taxpayer actually qualifies, the excess is reported as additional tax liability on the taxpayer's return for the year.⁸⁰ However, if the taxpayer who received an excess APTC has a household income of less than 400% of the federal poverty guideline, the amount of any such repayment is limited. The repayment limitations are discussed later.

Note. For additional details about repayment of excess APTC amounts and estimating income for the year, see **uofi.tax/16a6x3** [www.healthcare.gov/income-and-household-information/how-to-report].

Observation. Because these reconciliation and APTC recovery rules are complex, frequently a taxpayer does not understand why they either owe tax or have a substantially reduced tax refund from the amount they anticipated. It is essential for the tax preparer to advise taxpayers to be as accurate as possible with income estimates provided to the Marketplace. To prevent an unexpected tax liability, updated income information should be provided to the Marketplace.

IRS Premium Tax Credit Reconciliation Measures

Health insurers provide the IRS with taxpayer coverage information through the Coverage Data Repository (CDR). The CDR is a database the IRS uses to check tax return health insurance information, including the amounts of APTCs the taxpayer received.

Note. For further information about the CDR and some of the risks inherent in its development and use, see **uofi.tax/16a6x4** [www.treasury.gov/tigta/auditreports/2015reports/201523041fr.pdf].

⁷⁹ IRC §36B(f).

⁸⁰ IRC §36B(f)(2).

The CDR may alert the IRS that the taxpayer has not reported the full amount of APTCs received for the year on their tax return. In this case, the IRS has the authority to adjust the return for math or clerical errors⁸¹ and send a notice of the adjustment to the taxpayer. The items that are subject to IRS adjustment include the following.⁸²

- Household income
- Family size
- Federal poverty guideline amount
- Annual or monthly contribution (i.e., cost of coverage paid by the taxpayer)
- Reconciled or excess APTC

Note. Guidance on IRS recalculation and collection procedures associated with health insurance coverage, including APTC reconciliation calculations, can be found at IRM 21.6.3.4.2.16 *et seq.*

Definition of Household Income

For a taxpayer to provide an accurate income estimate to the Marketplace, it is essential that the taxpayer understand what is included in the definition of income. For health coverage calculation purposes, **income** means **household income**, which is defined as the sum of the following.⁸³

- The taxpayer's modified adjusted gross income (MAGI)
- The aggregate MAGI of other members of the taxpayer's family who are required to file a tax return for the year

MAGI is defined as the taxpayer's adjusted gross income increased by:

- Tax-exempt interest,
- The nontaxable portion of social security benefits, and
- Untaxed foreign income.

The **taxpayer's family** includes individuals for whom the taxpayer may appropriately claim a personal exemption.⁸⁴

Note. Many taxpayers think that social security benefits, disability income, or other benefits are not part of their income for purposes of a Marketplace income estimate. Tax preparers should advise clients of the broad definition of household income so that the taxpayer may provide a more accurate estimate. This will help prevent large discrepancies in PTC reconciliations on Form 8962.

Note. For taxpayers who anticipate a change in household income or family size during the year, the Taxpayer Advocate Service provides an online Premium Tax Credit Change Estimator that may be used to predict the amount by which the taxpayer's PTC will change as a result of such events during the year. **This online tool may be found at uofi.tax/16a6x5** [www.taxpayeradvocate.irs.gov/estimator/premiumtaxcreditchange].

⁸¹ IRC §6213(b).

⁸² IRM 21.6.3.4.2.16.3.1 (2015).

⁸³ Treas. Reg. §1.5000A-1(d)(10).

⁸⁴ Treas. Reg. §1.5000A-1(d)(4).

Taxpayers with MEC for each month of the year for every member of their family should indicate this by checking the box on Form 1040, *U.S. Individual Income Tax Return*, line 61. Alternatively, the taxpayer can use Form 8965, *Health Coverage Exemptions*, to claim one or more exemptions from the coverage mandate. Generally, if a return is filed without either the box on line 61 checked or a Form 8965 attached, the IRS will accept the return but it is likely the return may be subject to increased IRS attention.⁸⁵

Observation. In order to prevent the taxpayer from receiving unnecessary correspondence, the tax preparer must clearly indicate whether the taxpayer (and household members, if applicable) has coverage for the year or is claiming an exemption.

Repayment Limitations

If the APTCs exceed the amount of PTC for which the taxpayer actually qualifies, the taxpayer owes an additional tax liability on the return filed for the year.⁸⁶ However, taxpayers who must repay APTC amounts may benefit from the caps on such repayments if household income is below 400% of the federal poverty guideline for their family size. The limits on repayment of the APTC are shown in the following table.⁸⁷

Household Income Percentage of Federal Poverty Guideline	Maximum Repayment (Single Filing Status)	Maximum Repayment Amount (Filing Status other than Single)
Less than 200%	\$ 300	\$ 600
At least 200% but less than 300%	750	1,500
At least 300% but less than 400%	1,250	2,500

For taxpayers with household incomes that are slightly above 400% of the federal poverty guideline applicable to the taxpayer's family size, it may be possible to reduce the taxpayer's MAGI in order to limit the repayment amount. Such a taxpayer would otherwise not qualify for a repayment limitation.

Practitioner Tip. Practitioners should consider the following strategies to reduce a taxpayer's MAGI to prevent or reduce a potential PTC repayment. The goal of these strategies is to keep the taxpayer's MAGI at or below 400% of the federal poverty guideline amounts.

Taxpayers may reduce their MAGI and thus reduce their household income by the following.

- IRA deduction
- Health savings account deduction
- Self-employed retirement plan contributions (e.g., SEP, SIMPLE, and 401(k))
- Other above-the-line deductions, such as depreciation, IRC §179 expense, tuition and fees, Schedule C elections, and Schedule F elections

⁸⁵ *IRS Signals PPACA Compliance Issues*. Phillips, A., et al. Dec. 31, 2014. The Tax Adviser. [www.thetaxadviser.com/issues/2015/jan/buttonow-jan15.html#fn_20] Accessed on Jun. 8, 2016.

⁸⁶ Treas. Reg. §1.36B-4(a)(1)(i).

⁸⁷ Treas. Reg. §1.36B-4(a)(3).

2016 Workbook

Example 1. Bob, who is single and self-employed, obtained health insurance coverage for himself through a state exchange. He estimated his 2015 income would be \$24,000 when he applied for coverage. Based on his age and income, he qualified for a subsidy (APTC) of \$495 per month or \$5,940 for the year.

When Bob filed his 2015 tax return, his MAGI was \$50,000. Because Bob's MAGI was greater than 400% of the federal poverty level ($\$11,770 \times 4 = \$47,080$), he must repay the entire subsidy of \$5,940 in addition to other taxes on his 2015 return.

If Bob contributed \$5,500 to his traditional IRA for 2015, it would lower his MAGI to \$44,500 and qualify him for the repayment limitation of \$1,250 (income between 300% and 400% of the federal poverty guideline). This will save Bob \$4,690 ($\$5,940 - \$1,250$) in subsidy repayment.

ADDITIONAL RESOURCES

Tax preparers may find the following additional resources regarding the ACA tax rules helpful in connection with the preparation of returns and developing practical advice for clients.

Resource Description	Website
Individual Mandate Under the ACA, Congressional Research Service (May 2015)	uofi.tax/16a6x6 [www.fas.org/sgp/crs/misc/R41331.pdf]
Review of the Accounting Structure Used for the Administration of Premium Tax Credits, Treasury Inspector General for Tax Administration (Mar. 2015)	uofi.tax/16a6x7 [www.treasury.gov/tigta/auditreports/2015reports/201513029fr.html]
Affordable Care Act: Interim Results of the IRS Verification of Premium Tax Credit Claims, Treasury Inspector General for Tax Administration (May 2015)	uofi.tax/16a6x8 [www.treasury.gov/tigta/auditreports/2015reports/201543057fr.pdf]