# Chapter 2: New Developments





**Please note.** Corrections were made to this workbook through January of 2020. 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.

**About the Author**

**Marshall J. Heap, PhD, EA,** is a Tax Content Development and Instruction Specialist at the University of Illinois Tax School. An EA since 1984, and NTPI Fellow since 2018, Marshall is an ex-Senior Manager of PriceWaterhouseCoopers and has seven years of recent experience as an approved IRS continuing education provider. Marshall's academic background is in Computing and associated fields with degrees from the following UK Universities: The Open University (BSc), London, Birkbeck College (MSc), and Reading (PhD).

Other chapter contributors and reviewers are listed at the front of this volume.

**About the Author**

**Tom O'Saben, EA,** is Assistant Director, Professional Education and Outreach, at the University of Illinois Tax School, and has been an instructor for the Tax School since 2009. During that time, he has also been a presenter with the National Association of Tax Professionals, where he served as a Training Specialist developing curriculum, writing textbooks, and instructing at educational seminars. Tom's practice, established in 1991, provides tax services for approximately 1,000 clients. Tom earned his bachelor's degree from Southern Illinois University Edwardsville.

Other chapter contributors and reviewers are listed at the front of this volume.

## TCJA UPDATE — BUSINESS



This section contains information about recent IRS guidance that tax practitioners may find helpful when preparing business tax returns. The IRS guidance concerns changes introduced by the Tax Cuts and Jobs Act (TCJA).[1]

> **Note.** Many of the changes made by the TCJA are in effect beginning on January 1, 2018, through December 31, 2025. This period during which the TCJA changes remain effective is referred to in this chapter as the "TCJA period."

### IRS PUBLICATION ON TAX REFORM

IRS Pub. 5318, *Tax Reform What's New for Your Business,* summarizes the TCJA provisions affecting the preparation of tax returns for small and medium-sized businesses, including corporations, S corporations, partnerships, limited liability companies (LLCs), and sole proprietorships. The information provided ranges from corporate tax rate changes to changes to deductions, depreciation, expensing, credits, and fringe benefits. It is a useful reference guide, but this publication does not supersede or replace IRS tax forms, instructions, and other official guidance concerning the TCJA.

### RECENT IRS REGULATIONS

Since the beginning of 2019, the IRS has issued several sets of regulations concerning tax changes stemming from the TCJA. Brief summaries of these regulations follow.

#### Controlled Foreign Corporation Transition Tax[2]

One of the most important international provisions contained in the TCJA is the general shift from worldwide to territorial taxation for certain foreign corporate earnings. A key provision in this regard is the 100% deduction that U.S. domestic corporations now receive for the foreign-source portion of dividends from specified 10%-owned foreign corporations.[3] To obtain this 100% dividends received deduction (DRD) or participation exemption, the U.S. shareholder corporation must meet the following requirements.

1. Own 10% or more of the foreign corporation's voting stock[4]
2. Satisfy a minimum stock holding requirement of 366 days[5]

However, the TCJA also imposed a transition tax on the accumulated post-1986 deferred foreign income (DFI) as of **December 31, 2017,** of specified foreign corporations (SFCs).[6] The amount of the transition tax was 15.5% to the extent that the SFC's DFI was held in cash or equivalent form. An 8% tax applied to the remaining DFI. An SFC is either a controlled foreign corporation (CFC)[7] or a foreign corporation in which one or more domestic corporations is a U.S. shareholder.

TD 9846 contains the IRS's final regulations on the calculation of this transition tax, including determination of DFI, the SFC's cash position, applicable foreign tax credits, etc.

---

1. PL 115-97 (Dec. 22, 2017).
2. TD 9846, 2019-09 IRB 583.
3. TCJA §14101(a); IRC §245A.
4. IRC §951(b).
5. IRC §246(c)(5)(A).
6. IRC §965.
7. See IRC §957(a).

### Global Intangible Low-Taxed Income[8]

On June 14, 2019, the IRS issued **final regulations** concerning global intangible low-taxed income (GILTI) under IRC §951A and related Code sections as introduced by the TCJA.[9] These regulations provide guidance on the inclusion of GILTI generated by CFCs in the gross income of certain U.S. shareholders of foreign corporations, including U.S. shareholders who are members of a consolidated group.

Under §951A, newly introduced by the TCJA, a U.S. person who is a shareholder in a CFC is required to include its share of GILTI as currently taxable income, regardless of whether any amount is distributed to the shareholder. For this purpose, a U.S. person includes U.S. individuals, domestic corporations, partnerships, trusts, and estates.[10] The GILTI tax was enacted to discourage U.S. corporations from making excessive profits from invested foreign assets that leverage intellectual property.[11]

This new law is applicable to tax years of foreign corporations beginning after December 31, 2017, and to tax years of U.S. shareholders in which or within which such tax years of foreign corporations end.[12]

The **final regulations** generally retain the anti-abuse provisions that were included in the proposed regulations. However, the domestic partnership provisions were revised to adopt an aggregate approach for purposes of determining the amount of GILTI included in the gross income of a partnership's partners under §951A with respect to CFCs owned by the partnership.

Guidance is also provided in the **final regulations** regarding the determination of foreign tax credits on CFC income following introduction of the DRD (i.e., participation exemption).

The IRS also issued **proposed regulations** regarding the treatment of domestic partnerships with foreign corporate assets and specifically the determination of income from those assets that is includible in partners' gross income.

### Foreign-Derived Intangible Income[13]

Foreign-derived intangible income (FDII) is export income derived from the use of intellectual property in the United States.[14] FDII can result both from the sale of goods and services (e.g., sale of goods overseas by a U.S. company that manufactured them in the United States).[15]

On March 5, 2019, the IRS issued proposed IRC §250 regulations. These **proposed regulations** provide guidance on the determination of FDII, including the §250 deductions available. They also provide rules for computing FDII on consolidated returns and for tax return reporting of FDII and GILTI on Form 8993, *Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)*.

---

8. IRS News Rel. IR-2019-114 (Jun. 14, 2019); 84 Fed. Reg. 29,288 (Jun. 21, 2019); 84 Fed. Reg. 29,114 (Jun. 21, 2019).
9. TD 9866, 2019-29 IRB 261; TCJA §14201.
10. IRC §§957(c) and 7701(a)(30).
11. *A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act*. Pomerleau, Kyle. May 3, 2018. Tax Foundation. [taxfoundation.org/treatment-foreign-profits-tax-cuts-jobs-act] Accessed on Jul. 2, 2019.
12. TCJA §14201(d).
13. IRS News Rel. IR-2019-27 (Mar. 5, 2019); 84 Fed. Reg. 8,188 (Mar. 6, 2019); *A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act*. Pomerleau, Kyle. May 3, 2018. Tax Foundation. [taxfoundation.org/treatment-foreign-profits-tax-cuts-jobs-act] Accessed on Jul. 2, 2019.
14. TCJA §14202; IRC §250.
15. Ibid.

## IRC §199A Regulations[16]



Final IRC §199A Treasury regulations were issued January 18, 2019,[17] and are effective beginning February 8, 2019. On the same date, the IRS also issued proposed §199A regulations that provide guidance on the treatment of previously suspended losses that constitute qualified business income (QBI) and the determination of the qualified business income deduction (QBID) for taxpayers that hold interests in regulated investment companies, charitable remainder trusts, and split-interest trusts.

> **Note.** The 2019 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: QBID Update, includes an in-depth analysis of these regulations.

**Cooperatives and Their Patrons.**[18] On June 18, 2019, the IRS issued **proposed regulations** regarding certain deductions to cooperatives (i.e., subject to IRC §§1381 through 1388) and their patrons that are individuals, partnerships, S corporations, trusts, and estates engaged in domestic trades or businesses.

Specifically, these regulations concern the §199A(a) QBID and the §199A(g) domestic production activities deduction applicable to specified agricultural or horticultural cooperatives and their patrons.

Additionally, these proposed regulations provide guidance on the reduction of the QBID by patrons of specified agricultural or horticultural cooperatives.[19] They also provide a single definition of **patronage** and **nonpatronage** for purposes of determining whether income and deductions of a cooperative are from a patronage or nonpatronage source.[20]

> **Note.** The 2019 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 6: Agricultural Issues and Rural Investments, contains more information on these proposed regulations.

## New Life Insurance Contract Information Reporting Requirements[21]

On March 22, 2019, the IRS issued **proposed regulations** on the new TCJA information reporting requirements on parties involved with the following life insurance contract transactions.[22]

- Reportable policy sales
- Transfers of life insurance contracts to foreign persons
- Payments of reportable death benefits

The purpose of these reporting requirements is to help life insurance contract sellers properly report gains from reportable policy sales and transfers. Two new tax reporting forms have been developed in this regard: Form 1099-LS, *Reportable Life Insurance Sale,* and Form 1099-SB, *Seller's Investment in Life Insurance Contract*.

The **proposed regulations** also provide guidance on determining the IRC §101 death benefits exclusion following a policy sale reportable on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*.

---

16. TD 9847, 2019-09 IRB 670; REG-134652-18, 2019-09 IRB 747.
17. IRS News Rel. IR-2019-04 (Jan. 18, 2019).
18. IRS News Rel. IR-2019-115 (Jun. 18, 2019); 84 Fed. Reg. 28,668 (Jun. 19, 2019).
19. See IRC §199A(b)(7).
20. Prop. Treas. Reg. §1.1388-1(f).
21. IRS News Rel. IR-2019-54 (Mar. 22, 2019); 84 Fed. Reg. 11,009 (Mar. 25, 2019).
22. TCJA §13520; IRC §6050Y.

### New Excise Tax on Certain Private Colleges and Universities[23]

On June 28, 2019, the IRS issued **proposed regulations** for the new 1.4% excise tax on the net investment income (NII) of certain private colleges and universities.[24]

Effective for tax years beginning **after December 31, 2017,**[25] this excise tax applies to any private college or university that met the following conditions in the preceding tax year.[26]

1. Had at least 500 full-time tuition-paying students (more than 50% of whom are in the United States)
2. Had at least $500,000 in assets per student (other than those used in its charitable activities)

For the estimated 40 or fewer institutions affected, the regulations provide guidance on determining NII and assets directly used (or held for use) in carrying out the institution's exempt purpose.[27] They also provide guidance on determining the NII and assets of related organizations that are considered in determining this excise tax.[28]

The proposed regulations also incorporate the interim guidance provided in IRS Notice 2018-55.[29] This guidance pertains to the determination of capital gains included in NII. For this purpose, the basis of property held on December 31, 2017, that is later sold at a gain is not less than its December 31, 2017 fair market value (FMV), plus or minus subsequent normal basis adjustments.

## REAL PROPERTY EXPENSING AFTER 2017[30]

Rev. Proc. 2019-08 provides guidance on the implementation of TCJA provisions regarding IRC §179 expensing and recovery periods of qualified real property and use of the alternative depreciation system for electing real property trades or businesses and electing farming businesses (discussed later).[31] This revenue procedure is effective December 21, 2018.

Effective for tax years **beginning after 2017**, qualified improvement property and nonresidential real property improvements may be eligible for §179 expensing, as discussed next.[32]

### Qualified Improvement Property[33]

Generally, qualified improvement property (QIP) is "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service."

Rev. Proc. 2019-08 refers to Rev. Proc. 2017-33[34] for further guidance on the definition of QIP. However, the examples listed there refer to leasehold improvement property and restaurant property, which were inadvertently stricken from IRC §168(e)(6) by the TCJA. Therefore, absent a technical correction, these types of QIP are 39-year property[35] and are **no longer eligible for bonus depreciation but remain eligible for §179 expensing.**

23. IRS News Rel. IR-2019-120 (Jun. 28, 2019); REG-106877-18, 2019-30 IRB 441.
24. TCJA §13701; IRC §4968.
25. TCJA §13701(c).
26. IRC §4968(b).
27. Treas. Reg. §§53.4968-1(a)(4) and (b).
28. Treas. Reg. §§53.4968-1(b) and (c).
29. IRS News Rel. IR-2018-134 (Jun. 8, 2018).
30. Rev. Proc. 2019-08, 2019-03 IRB 347.
31. See TCJA §§13101(b), 13204(a)(3), and 13205.
32. Rev. Proc. 2019-08, 2019-03 IRB 347 (§§3.01(a) and (b)).
33. IRC §168(e)(6).
34. Rev. Proc. 2017-33, 2017-19 IRB 1236 (§4.02).
35. IRC §168(c).

**Excluded Property.** QIP does not include any improvement attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.[36]

### Nonresidential Real Property Improvements[37]

Nonresidential real property is IRC §1250 property that is **not** residential rental property or property with a class life of less than 27.5 years.[38]

An improvement to nonresidential real property that constitutes §1250 property is eligible for §179 expensing provided that the improvement is placed in service by the taxpayer after the date the original nonresidential real property was first placed in service by any person.

Improvements to nonresidential real property that are eligible for §179 expensing also include the following.

- A roof
- Heating, ventilation, and air-conditioning property (HVAC) (A central HVAC system includes all components that are in, on, or adjacent to the nonresidential real property (see Treas. Reg. §1.48–1(e)(2))
- A fire protection and alarm system
- A security system

### IRC §179 Election[39]

Under §179(a), a taxpayer can make an election to expense qualified real property placed in service during any tax year beginning after 2017 by filing an original or amended federal tax return for that year.

Taxpayers can also increase the amount expensed under §179 in a tax year beginning after 2017 by filing an amended tax return for that year without such increase being considered a revocation of the §179 election for that prior year.

## REAL PROPERTY DEPRECIATION CHANGE AFTER 2017[40]

Under the alternative depreciation system (ADS), there is a **30-year** recovery period for residential rental property placed in service **after** December 31, 2017,[41] in contrast to the **40-year** recovery period for residential rental property placed in service **before** January 1, 2018.

### Electing Real Property or Farming Businesses

For tax years beginning **after** December 31, 2017, real property trades or businesses or farming business that elect out of the IRC §163(j) business interest deduction limitation (electing businesses) **must** use the ADS.[42]

The ADS applies to the following modified accelerated cost recovery system (MACRS) property[43] held by an **electing real property trade or business.**

- Nonresidential real property (defined earlier)
- Residential rental property (buildings or structures with 80% or more gross rental income from dwelling units)[44]
- QIP (defined earlier)

36. IRC §168(e)(6)(B).
37. Rev. Proc. 2019-08, 2019-03 IRB 347 (§3.01(b)).
38. IRC §168(e)(2)(B).
39. Rev. Proc. 2019-08, 2019-03 IRB 347 (§3.02).
40. Rev. Proc. 2019-08, 2019-03 IRB 347 (§4).
41. IRC §168(g)(2)(C).
42. *New rules and limitations for depreciation and expensing under the Tax Cuts and Jobs Act*. Jun. 28, 2019. IRS. [www.irs.gov/newsroom/new-rules-and-limitations-for-depreciation-and-expensing-under-the-tax-cuts-and-jobs-act] Accessed on Jul. 8, 2019.
43. Treas. Reg. §1.168(b)-1(a)(2).
44. IRC §168(e)(2)(A).

For tax years beginning after December 31, 2017, the ADS recovery period is 30 years for residential real property (as stated earlier) and 40 years for nonresidential real property.[45] QIP concerns nonresidential real property (as stated earlier). Depreciation deductions for QIP are determined in the same manner as the property being improved.[46] Therefore, the ADS recovery period for QIP is 40 years.[47]

Similarly, an **electing farm business** must use the ADS for MACRS property with a recovery period of **10 years or more** (under the general depreciation system (GDS))**.** For this purpose, a farming business means the trade or business of farming and includes certain agricultural/horticultural cooperatives, operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.[48]

ADS recovery periods for MACRS farm property with a GDS recovery period of 10 years[49] are as follows.[50]

| Farm Property | GDS Recovery Period | ADS Recovery Period |
|---|---|---|
| Single-purpose agricultural or horticultural structures | 10 years | 15 years |
| Trees or vines bearing fruit or nuts | 10 years | 20 years |

The treatment of property subject to the ADS depends upon whether this is existing or newly acquired property, as discussed next.

**Existing Property.** For the year of election, electing businesses determine the depreciation deduction for existing property using the rules provided by Treas. Reg. §1.168(i)-4(d). These rules consider factors such as the adjusted basis of the property, the applicable convention, and short tax years of less than 12 months.

**Note.** This change from GDS to ADS is **not** considered a change in accounting method.[51] Bonus depreciation previously claimed on existing property is not redetermined.[52]

**Newly Acquired Property.** Depreciation of newly acquired property is determined in accordance with the ADS for its placed-in-service year and the subsequent tax years. Such property is not eligible for bonus depreciation.[53]

**Note.** Taxpayers who fail to calculate depreciation under the ADS on property subject to the ADS have adopted an impermissible accounting method. Correcting this requires the taxpayer to request a change in method of accounting using Form 3115, *Application for Change in Accounting Method.*[54]

45. IRC §168(g)(2)(C).
46. IRC §168(i)(6).
47. IRC §168(g)(2)(C).
48. IRC §163(j)(7)(C).
49. IRC §§168(e)(3)(D)(i) and (ii).
50. IRS Pub. 946, *How To Depreciate Property*; IRS Pub. 225, *Farmer's Tax Guide*.
51. Treas. Reg. §1.168(i)-4(f).
52. Treas. Reg. §1.168(k)-1(f)(6)(iv)(A).
53. IRC §168(k)(2)(D).
54. See Rev. Proc. 2019-08, 2019-03 IRB 347, §4.02(3) for more information on changing the accounting method.

## QUALIFIED EQUITY GRANTS[55]



The TCJA introduced a new provision regarding the taxation of qualified stock options (QSOs) and restricted stock units (RSUs) granted to qualified employees of privately held corporations. Specifically, this provision permits **deferral of tax** on these QSOs for up to five years.

IRS Notice 2018-97 provides taxpayers with **initial** guidance on the following issues.

1. Application of the requirement that QSOs be made to not less than 80% of all employees who provide services to the corporation in the United States[56]
2. Federal income and employment tax withholding requirements on deferred income related to the QSOs
3. The circumstances when an employer can preclude their employees from making an IRC §83(i) election with respect to stock received upon exercise of the QSO or settlement of the RSU

Further guidance from the IRS on §83(i) is expected.

## NET OPERATING AND EXCESS BUSINESS LOSSES

This section discusses changes made to net operating losses (NOLs) by the TCJA as well as application of the newly introduced excess business loss (EBL) rules. Correlation of EBLs with the passive activity and excess farm loss rules is discussed, as well as the application of EBLs to partners and S corporation shareholders.

### Net Operating Losses[57]

An NOL arises when a taxpayer's business deductions exceed its gross income. Before the TCJA, an NOL could generally be carried back two years and carried forward 20 years, and it could offset 100% of income.[58]

For tax years **ending after 2017**, the TCJA provides an unlimited carryforward period and generally eliminates NOL carrybacks.[59] **This provision is permanent.**

The TCJA also introduced a new limitation such that NOLs arising in tax years **beginning after 2017** may only reduce **80%** of taxable income in carryback and carryforward years.[60] In applying this limitation, the NOL deduction is limited to the **lesser** of:[61]

- The aggregate of NOL carryforwards and carrybacks to the tax year, or
- 80% of taxable income computed for the tax year without regard to the NOL deduction allowed for the tax year.

Pursuant to the ordering rules, an NOL is first carried back to the earliest year for which carryback is possible. Any unused portion of that NOL is then carried forward to the next possible year until it is fully utilized.[62] Therefore, NOLs from tax years beginning **before** 2018 that offset 100% of taxable income **take precedence** over NOLs from **subsequent** tax years that only offset 80% of taxable income.

---

55. TCJA §13603; IRC §83(i); IRS Notice 2018-97, 2018-52 IRB 1062.
56. IRC §83(i)(2)(C)(i)(II).
57. TCJA §13302.
58. IRC §§172(a) and (b) prior to amendment by the TCJA.
59. IRC §172(b) after amendment by the TCJA.
60. IRC §172(a) after amendment by the TCJA.
61. Ibid.
62. Treas. Reg. §1.172-4.

**Example 1.** Greg, a calendar-year taxpayer, has a $2,000 NOL carryover from 2017 and a $60,000 NOL carryover from 2018. In 2019, Greg has $40,000 of taxable income before considering NOL carryovers.

After considering NOL carryovers, Greg has 2019 taxable income of $6,000 and a $28,000 NOL carryover of his remaining 2018 NOL to subsequent years, which is calculated as follows.

| | |
|---|---|
| 2019 taxable income **before** NOL carryovers | $40,000 |
| Less: NOL from 2017, which is the **lesser of:** | (2,000) |
| • $2,000 NOL carryover, **or** | |
| • $40,000 (100% of 2019 taxable income before NOL carryovers) | |
| Less: NOL from 2018, which is the **lesser of:** | (32,000) |
| • $60,000 NOL, **or** | |
| • $32,000 (2019 taxable income before NOL carryovers of $40,000 × 80%) | |
| 2019 taxable income after NOL carryovers | $ 6,000 |
| 2018 NOL carryover to 2020 ($60,000 2018 NOL − $32,000 utilized in 2019) | $28,000 |

**Farming Losses.**[63] An NOL carryback period was retained for the **portion** of an NOL that arises from a farming business (farming loss). However, this carryback period for farming losses is reduced from five years to **two years** for tax years ending **after** December 31, 2017. Taxpayers continue to have the option of carrying forward these losses by electing out of the carryback period.

When an NOL includes a farming loss, the remaining portion of the NOL is taken into account **before** the farming loss.

**Example 2.** Ava, a calendar-year taxpayer, is the sole shareholder of Ava Farming, which is an S corporation. In 2019, Ava has a $100,000 NOL, of which $70,000 pertains to her farming business.

Ava carries back her $70,000 farming loss from 2019 to 2017, where it is fully utilized. The law does not permit carryback of the $30,000 remaining NOL (i.e., $100,000 NOL − $70,000 farming loss carried back to 2017). Therefore, Ava carries this forward to 2020.

If Ava had elected to forgo the farming loss carryback, then the entire $100,000 NOL would have carried over to 2020, and Ava would have utilized the $30,000 nonfarm portion first.

**Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: New Legislation — Business Concerns, discusses NOLs for fiscal year filers, casualty and property insurance company NOLs, and NOL computation.

**Note.** The TCJA changes to NOLs are **permanent provisions,** unlike the EBL provisions (discussed next) which are temporary (i.e., applying only in the TCJA period).

63. IRC §172(b)(1)(B).

## Excess Business Losses[64]



The TCJA introduced a new loss limitation for noncorporate taxpayers. As a result, such taxpayers cannot deduct EBLs during the TCJA period. For tax years beginning in 2019, an EBL is defined as the **excess** (if any) of:

1. A taxpayer's aggregate deductions from trades or businesses, **over**
2. The sum of:
   - **a.** The taxpayer's aggregate trade or business income and gains, **plus**
   - **b.** $255,000 ($510,000 for married filing jointly (MFJ) taxpayers).[65]

The taxpayer's aggregate deductions from trades or businesses are determined without regard to whether such deductions are disallowed for the tax year by the EBL limitation.

> **Note.** The threshold amounts are adjusted annually for inflation for tax years during the TCJA period.[66] For tax years beginning in 2018, the thresholds were $500,000 for MFJ taxpayers and $250,000 for all other taxpayers.

A taxpayer's EBL is carried forward and treated as part of their NOL carryforward in subsequent tax years.[67]

During the TCJA period, the limit on excess farm losses of noncorporate taxpayers **does not apply.**[68]

> **Note.** At the time this chapter was published, IRS guidance on EBLs mainly consisted of Form 461, *Limitation on Business Losses* (which follows), and the accompanying instructions.

64. TCJA §11012; IRC §461(l).
65. Rev. Proc. 2018-57, 2018-49 IRB 827.
66. IRC §461(l)(3)(B).
67. IRC §461(l)(2).
68. IRC §461(l)(1)(A).

Form **461**

Department of the Treasury
Internal Revenue Service

## Limitation on Business Losses

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form461* for instructions and the latest information.

OMB No. 1545-2283
2018
Attachment Sequence No. **461**

| Name(s) shown on return | Identifying number |
|---|---|
| | |

**Part I** **Total Income/Loss Items**
See instructions if you are filing a tax return other than Form 1040.

| | | | |
|---|---|---|---|
| 1 | Enter amount from Form 1040, line 1 | 1 | |
| 2 | Enter amount from Schedule 1 (Form 1040), line 12 | 2 | |
| 3 | Enter amount from Schedule 1 (Form 1040), line 13 | 3 | |
| 4 | Enter amount from Schedule 1 (Form 1040), line 14 | 4 | |
| 5 | Enter amount from Schedule 1 (Form 1040), line 17 | 5 | |
| 6 | Enter amount from Schedule 1 (Form 1040), line 18 | 6 | |
| 7 | Enter amount from Schedule 1 (Form 1040), line 19 | 7 | |
| 8 | Enter other income, gain, or losses from a trade or business not reported on lines 1 through 7 | 8 | |
| 9 | Combine lines 1 through 8 | 9 | |

**Part II** **Adjustment for Amounts Not Attributable to Trade or Business**
See instructions if you are filing a tax return other than Form 1040.

| | | | |
|---|---|---|---|
| 10 | Enter any income or gain reported on lines 1 through 8 that is not attributable to a trade or business | 10 | |
| 11 | Enter any losses or deductions reported on lines 1 through 8 that are not attributable to a trade or business. See instructions | 11 | |
| 12 | Subtract line 11 from line 10 | 12 | |

**Part III** **Limitation on Losses**

| | | | |
|---|---|---|---|
| 13 | If line 12 is a negative number, enter it here as a positive number. If line 12 is a positive number, enter it here as a negative number | 13 | |
| 14 | Add lines 9 and 13 | 14 | |
| 15 | Enter $250,000 (or $500,000 if married filing jointly) | 15 | |
| 16 | Add lines 14 and 15. If less than zero, enter the amount from line 16 as a positive number on Schedule 1 (Form 1040), line 21. See instructions if you are filing a tax return other than a Form 1040. If zero or greater, do not attach this form to your tax return | 16 | |

**For Paperwork Reduction Act Notice, see the separate instructions.** Cat. No. 16654I Form **461** (2018)

Form 461 consists of three parts. In part I, taxpayers enter certain income/loss items to determine their total income/loss. Specific income/loss items listed in part I are identified in the following table.

| Form Reference | Description of Income/Loss Item |
|---|---|
| Form 1040, line 1 | Wages, salaries, tips, etc. |
| Schedule 1 (Form 1040), line 12 | Business income or (loss) from Schedule C, *Profit or Loss From Business* |
| Schedule 1 (Form 1040), line 13 | Capital gain or (loss) from Schedule D, *Capital Gains and Losses* |
| Schedule 1 (Form 1040), line 14 | Other gains or (losses) from Form 4797, *Sales of Business Property* |
| Schedule 1 (Form 1040), line 17 | Rental real estate, royalties, partnerships, S corporations, trusts, etc. from Schedule E, *Supplemental Income and Loss* |
| Schedule 1 (Form 1040), line 18 | Farm income or (loss) from Schedule F, *Profit or Loss From Farming* |
| Schedule 1 (Form 1040), line 19 | Unemployment compensation |

In part II, taxpayers adjust for income/loss items not attributable to a **trade or business.** In part III, taxpayers apply the previously described formula for calculating the EBL.

IRC §461(l)(5) authorizes the IRS to issue additional reporting requirements regarding EBLs. However, at the time this material was published, the IRS has yet to issue proposed regulations under §461(l). A definition of "trade or business" is not provided in the statute. In the instructions to Form 461, the IRS provides the following information regarding what constitutes a trade or business.

> *An activity qualifies as a trade or business if your primary purpose for engaging in the activity is for income or profit and **you are involved in the activity** with continuity and regularity. The facts and circumstances of each case determine if an activity is a trade or business. The regularity of activities and transactions and the production of income are important elements. You do not need to actually make a profit to be in a trade or business as long as you have a profit motive. However, you do need to make ongoing efforts to further the interests of your business.*

**Note.** In a recent letter to the IRS,[69] the American Institute of CPAs (AICPA) requested the IRS replace the bolded text from the instructions (see quoted material above) with "the activity is conducted." The AICPA's reason for this request was that the taxpayer's regular and continuous involvement in the activity was **not** one of the tests for a trade or business (e.g., a passive investor in a partnership may be in a trade or business provided the business is conducted with regularity and continuity). At the time of writing, the IRS has not responded publicly to this request.

Further information on what constitutes a trade or business for purposes of the EBL rules is posted on the IRS's website.[70] According to this information, trade or business income/loss **can** include, but is not limited to, the following sources.

- Schedule F and Schedule C activities
- The activity of being an employee
- An activity reported on Form 4835, *Farm Rental Income and Expenses*
- Business activities reported on Schedule E
- Business gains and losses reported on Form 4797, *Sales of Business Property*, and Form 8949, *Sales and Other Dispositions of Capital Assets*
- Trade or business income and losses from pass-through entities
- Farming losses from casualties or because of disease or drought

**Employee Wages.**[71] Interestingly, the IRS's indication that employee wages **can** constitute trade or business income conflicts with the legislators' intent regarding the determination of the EBL limitation. According to the TCJA explanation provided by the Joint Committee on Taxation, the trade or business of performing services as an employee is **not** considered in determining an EBL. However, this explanation also indicates that "a technical correction may be necessary to carry out this intent."

---

69. *Recommendation for the 2018 Instructions for Form 461 – Limitation on Business Losses*. Nellen, Annette. Apr. 3, 2019. AICPA. [www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20190403-aicpa-comments-on-form-461-instructions.pdf] Accessed on Jul. 10, 2019.

70. *Excess business losses*. Jun. 28, 2019. IRS. [www.irs.gov/newsroom/excess-business-losses] Accessed on Jul. 10, 2019.

71. *General Explanation of Public Law No. 115-97 (JCS-1-18)*. Dec. 2018. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5152] Accessed on Jul. 10, 2019; *New limitation on excess business losses*. Vercelli, Lydia. May 1, 2019. The Tax Adviser. [www.thetaxadviser.com/issues/2019/may/new-limitation-excess-business-losses.html] Accessed on Jul. 10, 2019.

The next example illustrates the effect that employee wages and filing status can have upon the determination of an EBL.

**Example 3.** Anne and Ben are a married couple. In 2019, Anne has $250,000 of wages and Ben has a $600,000 loss from his sole proprietorship. The couple has no other trade or business income.

If the couple files **separately,** then Ben has a $345,000 EBL ($600,000 business loss – ($0 business income + $255,000 threshold)), which carries over as part of Ben's NOL to subsequent years.

If the couple files **jointly,** then there is no EBL ($600,000 business loss – ($250,000 wages + $510,000 threshold)). This is because Ben's business loss does not exceed the sum of Anne's wages and the applicable threshold (if the IRS continues to treat wages as business income for EBL purposes).

However, if the legislators' intent prevails and wages are not treated as business income, then the couple would have a $90,000 EBL ($600,000 business loss – ($0 business income + $510,000 threshold)) when filing jointly.

**Partners and S Corporation Shareholders.**[72] EBLs are determined at the partner/shareholder level. Consequently, partners/shareholders take into account their share of the entity's income, gain, deduction, or loss attributable to the entity's trades or businesses.

Based on IRS guidance currently available, business gains and losses reported on Forms 4797 and 8949, including those from pass-through entities, can be trade or business income/loss for purposes of the EBL limitation. This includes a partner's/shareholder's share of an entity's gain or loss from the sale of its business assets.[73]

However, absent a more precise definition of trade or business income, it is unclear whether this includes gain or loss from the sale of a shareholder's S corporation stock.[74]

***Loss Ordering Rules.*** The following limitations apply to ordinary losses reported on a partner's or S corporation shareholder's Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.,* in the order listed.[75]

1. Stock and debt basis limitations (IRC §§704(d) and 1366(d))
2. At-risk limitations (IRC §465)
3. Passive activity loss limitations (IRC §469)

**Note.** For more information about the three loss limitations that apply to partners and S corporation shareholders, see the 2019 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: Schedule K-1.

The EBL limitation is then applied after the passive activity loss limitations.[76]

A passive activity is one that involves the conduct of a trade or business in which the taxpayer does not materially participate.[77] Generally, passive losses are only allowable to the extent of passive income, with any remaining loss carried over to subsequent years.[78] However, individual taxpayers with adjusted gross income (AGI) of $100,000 or less ($50,000 or less for certain married filing separately (MFS) taxpayers) who own and **actively participate** in the management of rental real estate may offset up to $25,000 of losses from the activity against other income in a tax year.[79] Individual taxpayers cannot meet the active participation requirement unless they own at least 10% of the rental real estate activity.[80]

72. IRC §461(l)(4).

73. *Excess business losses*. Jun. 28, 2019. IRS. [www.irs.gov/newsroom/excess-business-losses] Accessed on Jul. 10, 2019.

74. *New limitation on excess business losses*. Vercelli, Lydia. May 1, 2019. The Tax Adviser. [www.thetaxadviser.com/issues/2019/may/new-limitation-excess-business-losses.html] Accessed on Jul. 10, 2019.

75. *S Corporation Stock and Debt Basis*. May 13, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/s-corporation-stock-and-debt-basis] Accessed on Jul. 19, 2019.

76. IRC §461(l)(6).

77. IRC §469(c).

78. IRC §§469(a) and (b).

79. IRC §469(i).

80. IRC §469(i)(6).

The following example illustrates the interplay of the EBL and passive loss rules.

**Example 4.** Ellen, a single taxpayer, is a 10% shareholder of Gurnee Enterprises, which is an S corporation. Gurnee Enterprises' sole activity is real estate rentals, which is considered a business. Ellen actively participates in the management of the corporations' rental properties. In 2019, Ellen has income of $100,000 from activities that are not trades or businesses. However, this excludes Ellen's $300,000 share of Gurnee Enterprise's 2019 loss.

Assuming Ellen's business loss is not limited by the stock and debt basis and at-risk limitations, it is nevertheless subject to the passive activity loss limitation. Thus, Ellen's entire $300,000 loss from Gurnee Enterprises is passive.

Her AGI does not exceed $100,000; therefore, she can deduct $25,000 of this loss on her 2019 tax return. The remaining $275,000 passive loss ($300,000 rental loss – $25,000 utilized in 2019) is carried over to subsequent years. Applying the EBL formula (previously described), Ellen appears to have an EBL of $45,000 ($300,000 business loss – ($0 business income + $255,000 threshold)). However, because only $25,000 of Ellen's $300,000 business loss is deductible in 2019 and this is less than the $255,000 applicable EBL threshold, Ellen does **not** have an EBL for 2019.

**Hedge Fund Investments.**[81] When applying the EBL rules to hedge fund investments, it is important to determine whether the fund is engaged in a trade or business activity. According to the IRS, a trader in securities who buys and sells securities for their own account is engaged in a trade or business if **all** the following conditions are met.[82]

1. They must seek to profit from daily market movements in the prices of securities and not from dividends, interest, or capital appreciation
2. Their activity must be substantial
3. They must carry on the activity with continuity and regularity

Specific facts and circumstances that are considered by the IRS in determining if an activity is a securities trading business include the following.[83]

- Typical holding periods for securities bought and sold
- The frequency and dollar amount of trades during the year
- The amount of time devoted to the activity

**Note.** Only the portion of a hedge fund's activity that is from a trade or business activity is considered in determining a taxpayer's EBL. For hedge funds structured as pass-through entities, it is the responsibility of the entity return preparer to determine the ultimate owners' allocable portion of business income/loss from the trading activity.

81. *New limitation on excess business losses*. Vercelli, Lydia. May 1, 2019. The Tax Adviser. [www.thetaxadviser.com/issues/2019/may/new-limitation-excess-business-losses.html] Accessed on Jul. 10, 2019.

82. *Topic Number 429 - Traders in Securities (Information for Form 1040 Filers)*. Jul. 18, 2019. IRS. [www.irs.gov/taxtopics/tc429] Accessed on Jul. 19, 2019.

83. Ibid.

## IRS SAFE HARBOR FOR LUXURY AUTO DEPRECIATION DEDUCTIONS[84]

Following passage of the TCJA, 100% bonus depreciation is available for certain business assets, including business automobiles.[85] However, when bonus depreciation or §179 expensing is claimed, there is an $18,000 cap on the amount of depreciation that can be claimed on a passenger automobile placed in service in 2018 (and acquired **after** September 27, 2017).[86] Consequently, depreciation deductions that are disallowed by this cap (often referred to as the "luxury auto limitation") are deferred and recovered after the end of the vehicle's recovery period at **$5,760** per year.[87] The 2018 depreciation limitation for an automobile placed in service in 2018 but acquired **before** September 28, 2017 is $16,400.[88] The IRS intends to furnish guidance on the applicable first-year depreciation limits for passenger automobiles placed in service **after** 2018.[89]

The IRS issued Rev. Proc. 2019-13, whereby taxpayers **claiming bonus depreciation** who have unadjusted depreciable basis exceeding the first-year depreciation cap can use a safe harbor method of accounting rather than be forced to wait until after the end of the vehicle's recovery period to recover their remaining adjusted basis.

This revenue procedure is effective on February 13, 2019, and applies to a passenger automobile (other than a leased vehicle) which meets the following conditions.

1. Is acquired and placed in service by the taxpayer after September 27, 2017
2. Is property qualifying for bonus depreciation
3. Has an unadjusted depreciable basis[90] exceeding the first-year depreciation limitation
4. For which the taxpayer did not elect §179 expensing for the cost or any portion of the cost

To take advantage of the safe harbor method of accounting offered by this revenue procedure for property placed in service in 2018, taxpayers must abide by the following requirements.

1. The taxpayer must use the applicable optional depreciation table for computing the depreciation deductions for the automobile. (See Appendix A in IRS Pub. 946, *How To Depreciate Property*, for the applicable optional depreciation tables.)
2. The taxpayer deducts the first-year depreciation maximum amount in 2018 (i.e., $18,000 for an automobile acquired after September 27, 2017, and $16,400 for an automobile acquired before then).
3. For tax years after the year placed in service, the taxpayer computes depreciation on the remaining adjusted depreciable basis (i.e., the depreciable basis less the first-year depreciation) using the applicable percentage from the table provided later.
4. In the first tax year succeeding the end of the recovery period, the depreciation deduction is the **lesser** of the remaining adjusted depreciable basis or $5,760.[91]
5. In the first tax year succeeding the year placed in service that the automobile is not predominantly used in a qualified business,[92] the accounting safe harbor ceases to apply in that year and any subsequent tax year.

---

84. Rev. Proc. 2019-13, 2019-09 IRB 744.
85. TCJA §13201.
86. This is a total of $10,000 under IRC §280F(a)(1)(A)(i) plus $8,000 under IRC §168(k)(2)(F)(i); Rev. Proc. 2018-25, 2018-18 IRB 543.
87. IRC §280F(a)(1)(B) as amended by the TCJA §13202.
88. Rev. Proc. 2018-25, 2018-18 IRB 543.
89. Under IRC §280F(a)(1); Rev. Proc. 2019-13, 2019-09 IRB 744 (§4.03(2)).
90. See Treas. Reg. §1.168(b)-1(a)(3).
91. IRC §280F(a)(1)(B).
92. As defined in IRC §§280F(d)(6)(B) and (C).

**Depreciation Deductions for a Passenger Automobile Acquired after September 27, 2017, and Placed in Service in 2018**

| Tax Year | Annual Depreciation Limitations Under Table 2 of Rev. Proc. 2018-25 | Percentage Depreciation Deduction Applicable to the Adjusted Basis |
|---|---|---|
| 2018 | $18,000 | N/A |
| 2019 | 16,000 | 32% |
| 2020 | 9,600 | 19.2% |
| 2021 | 5,760 | 11.52% |
| 2022 | 5,760 | 11.52% |
| 2023 | 5,760 | 5.76% |

The following example illustrates how the unadjusted basis for a passenger automobile is recovered when the safe harbor accounting method is **not** used.

**Example 5.** In 2018, Shelly, a calendar-year taxpayer, acquires and places in service a passenger automobile (which is not a sport utility vehicle (SUV)) in her sole proprietorship business activity. The automobile cost $65,000, which is also its unadjusted basis. It is qualified property for which 100% bonus depreciation is allowable. Shelly decides not to claim the §179 deduction for this vehicle and does not use the Rev. Proc. 2019-13 accounting method safe harbor.

Shelly cannot fully expense the vehicle with 100% bonus depreciation in 2018 because of the application of the first-year depreciation limitation. Therefore, she claims an $18,000 depreciation deduction for the vehicle in 2018. The $47,000 remaining adjusted basis of the vehicle ($65,000 cost basis − $18,000 depreciation deduction) is recovered at a maximum of $5,760 per year starting in 2024 (i.e., the year after the last year of the recovery period), as shown in the following table.

| Tax Year | Maximum Annual Depreciation Limitations[a] | | Percentage Depreciation Deduction |
|---|---|---|---|
| 2018 | $18,000 | Lesser of $65,000 unadjusted basis **or** the $18,000 first year depreciation limit = | $18,000 |
| 2019 | N/A | | N/A |
| 2020 | N/A | | N/A |
| 2021 | N/A | | N/A |
| 2022 | N/A | | N/A |
| 2023 | N/A | | N/A |
| 2024 | 5,760 | Lesser of $47,000 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2025 | 5,760 | Lesser of $41,240 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2026 | 5,760 | Lesser of $35,480 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2027 | 5,760 | Lesser of $29,720 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2028 | 5,760 | Lesser of $23,960 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2029 | 5,760 | Lesser of $18,200 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2030 | 5,760 | Lesser of $12,440 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2031 | 5,760 | Lesser of $6,680 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2032 | 5,760 | Lesser of $920 remaining adjusted basis **or** the $5,760 annual limit = | 920 |
| Total | | | $65,000 |

[a] First-year depreciation under IRC §280F(a)(1)(A)(i) is increased by $8,000 under §168(k)(2)(F)(i)). For depreciation in subsequent years, see IRC §280F(a)(1)(B).

The next example shows how the unadjusted basis of a passenger automobile is recovered when the Rev. Proc. 2019-13 accounting method safe harbor is adopted.

**Example 6.** Use the same facts as **Example 5,** except Shelly uses the Rev. Proc. 2019-13 safe harbor. Shelly's first-year depreciation deduction for 2018 is still $18,000. However, the $47,000 remaining adjusted basis of the vehicle can be recovered more quickly, as shown in the following table.

| Tax Year | Maximum Annual Depreciation Limitations [a] | | Percentage Depreciation Deduction |
|---|---|---|---|
| 2018 | $18,000 | | $18,000 |
| 2019 | 16,000 | $47,000 × 32% = | 15,040 |
| 2020 | 9,600 | $47,000 × 19.2% = | 9,024 |
| 2021 | 5,760 | $47,000 × 11.52% = | 5,414 |
| 2022 | 5,760 | $47,000 × 11.52% = | 5,414 |
| 2023 | 5,760 | $47,000 × 5.76% = | 2,707 |
| 2024 | 5,760 | Lesser of $9,401 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2025 | 5,760 | Lesser of $3,641 remaining adjusted basis **or** the $5,760 annual limit = | 3,641 |
| Total | | | $65,000 |

[a] From 2018 to 2023, the annual depreciation limits are from Table 2 of Rev. Proc. 2018-25. Thereafter, the IRC §280F(a)(1)(B) limit applies.

Instead of depreciating business assets, a taxpayer can elect to treat some or all of the asset's cost as an expense under §179 that is recovered in the tax year that the asset is placed in service.[93] IRC §179 expensing applies to most tangible IRC §1245 property (including vehicles) bought for use in a taxpayer's business.[94] However, there is an **annual dollar limitation,** which is the maximum §179 deduction a business can claim in a tax year.[95] There is also an **investment limitation,** which is the maximum amount a business can invest in property qualifying for the §179 deduction without affecting the dollar limitation.[96] For 2019, the annual dollar limitation is $1.02 million and the investment limitation is $2.55 million.[97] There is also a §179 expensing limit for SUVs, which is $25,500 per SUV for 2019.[98]

The next example explores the effect of a §179 expense election on the accounting method safe harbor.

**Example 7.** Use the same facts as **Example 5,** except Shelly expenses the cost of the vehicle in 2018 under §179. She did not elect out of bonus depreciation.

For 2018, Shelly claims a §179 expense of $18,000 (because this is the maximum amount permissible under §280F(a)(1)(A)(i), increased by $8,000 under §168(k)(2)(F)(i)). However, the §179 expense election means the vehicle no longer falls within the scope of the Rev. Proc. 2019-13 safe harbor. The result is the same as **Example 5,** with the remaining $47,000 adjusted basis recovered at a maximum of $5,760 per year beginning in 2024.

**Caution.** Electing any §179 deduction on a vehicle removes the vehicle from the Rev. Proc 2019-13 safe harbor.

93. IRC §179(a).
94. IRC §179(d)(1).
95. IRC §179(b)(1).
96. IRC §179(b)(2).
97. Rev. Proc. 2018-57, 2018-49 IRB 827.
98. IRC §179(b)(5); Rev. Proc. 2018-57, 2018-49 IRB 827.

The next example shows how the unadjusted basis of a passenger automobile is recovered when a taxpayer uses §168(k)(7) to elect out of bonus depreciation and addresses the applicability of the accounting method safe harbor in this situation. There is also a noteworthy difference in calculating depreciation deductions when GDS is used. As stated earlier, the adjusted basis is used for determining depreciation deductions in years after the property is placed in service when bonus depreciation applies (i.e., depreciable basis less the first-year depreciation). However, for GDS, this adjustment is not made, so each year depreciation deductions are calculated on the original basis of the property in accordance with IRC §167(c).

**Example 8.** Use the same facts as **Example 5,** except Shelly elects out of bonus depreciation and instead depreciates the vehicle using the GDS under §168(a).

Because bonus depreciation does not apply, the vehicle no longer falls under the scope of the accounting method safe harbor. Consequently, GDS depreciation is calculated and the §280F(a) limitations are applied as follows.

| Tax Year | Maximum Annual Depreciation Limitations [a] | | Percentage Depreciation Deduction [b] |
|---|---|---|---|
| 2018 | $10,000 | Lesser of $13,000 ($65,000 unadjusted basis × 20%) **or** the $10,000 annual limit = | $10,000 |
| 2019 | 16,000 | Lesser of $20,800 ($65,000 unadjusted basis × 32%) **or** the $16,000 annual limit = | 16,000 |
| 2020 | 9,600 | Lesser of $12,480 ($65,000 unadjusted basis × 19.2%) **or** the $9,600 annual limit = | 9,600 |
| 2021 | 5,760 | Lesser of $7,488 ($65,000 unadjusted basis × 11.52%) **or** the $5,760 annual limit = | 5,760 |
| 2022 | 5,760 | Lesser of $7,488 ($65,000 unadjusted basis × 11.52%) **or** the $5,760 annual limit = | 5,760 |
| 2023 | 5,760 | Lesser of $3,744 ($65,000 unadjusted basis × 5.76%) **or** the $5,760 annual limit = | 3,744 |
| 2024 | 5,760 | Lesser of $14,136 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2025 | 5,760 | Lesser of $8,376 remaining adjusted basis **or** the $5,760 annual limit = | 5,760 |
| 2026 | 5,760 | Lesser of $2,616 remaining adjusted basis **or** the $5,760 annual limit = | 2,616 |
| Total | | | $65,000 |

[a] Under IRC §280F(a).

[b] IRS Pub. 946, Table A-1.

## DOMESTIC PRODUCTION ACTIVITIES DEDUCTION[99]

### Old Law

The domestic production activities deduction (DPAD) was allowed for tax years beginning before 2018. This deduction was 9% of the lesser of the taxpayer's:[100]

1. Qualified production activities income for the tax year, or
2. Taxable income (determined without regard to the DPAD) for the tax year.

> **Note.** Businesses qualifying for the DPAD including pass-through entities are further discussed in the 2012 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 3: Small Business Issues.

99. Former IRC §199, which was stricken by the TCJA.

100. Former IRC §199(a), which was stricken by the TCJA.

**Taxable Social Security Benefit Amount.** The amount of a taxpayer's social security benefit that is taxable depends on the taxpayer's modified adjusted gross income (MAGI).[101] For tax years beginning before 2018, the DPAD deduction was **not** allowed in determining MAGI.[102]

## New Law

The TCJA repealed the DPAD effective for tax years beginning **after** December 31, 2017.[103] Generally, **calendar-year** taxpayers should not claim a DPAD for 2018. However, **fiscal-year** taxpayers with a yearend falling in 2018 could still claim a DPAD. Accordingly, on November 21, 2018, the IRS issued a directive stating that the following taxpayers can claim the DPAD in 2018 or later years.[104]

1. Taxpayers with a tax year that began **before** January 1, 2018
2. Shareholders or partners who are allocated a DPAD by an S corporation or partnership for a tax year beginning **before** January 1, 2018
3. Beneficiaries who are allocated a DPAD by an estate or trust for a tax year beginning **before** January 1, 2018
4. Patrons who are allocated a DPAD by an agricultural or horticultural cooperative for a tax year beginning **before** January 1, 2018

**Note.** This directive is aimed at providing IRS Large Business and International (LB&I) division examiners with guidance on handling amended returns or claims for refund connected with the DPAD under their jurisdiction. It is not an official pronouncement of the law and cannot be used, cited, or relied upon as such.

The LB&I division serves C corporations, S corporations, and partnerships with assets greater than $10 million.[105] It is unclear whether the IRS will allow other taxpayers (i.e., those who are not served by the LB&I division) who meet the preceding conditions to claim the DPAD.

The IRS's position stated in the directive is reiterated in the instructions to the 2018 Form 8903, *Domestic Production Activities Deduction*, which indicates that the DPAD can only be claimed in 2018 or later years by the four categories of taxpayers outlined in the directive.

Therefore, based on this directive, the IRS should allow 2018 calendar-year individual taxpayers to claim the DPAD allocated to them by a relevant pass-through entity (as described in the directive) in a fiscal yearend falling in 2018.

**Taxable Social Security Benefit Amount.** Besides repealing the DPAD, the TCJA made conforming amendments that are **also** effective for tax years beginning **after** December 31, 2017.[106] One of these amendments concerns the determination of taxable social security benefits.[107] Specifically, the amendment eliminates the DPAD as an adjustment in determining MAGI for this purpose.[108] Therefore, whereas the DPAD was **not** allowed in determining MAGI in pre-2018 tax years, in post-2017 tax years it is **allowed.**

---

101. IRC §86.
102. IRC §86(b)(2).
103. PL 115-97, §13305.
104. LB&I Directive 04-1118-016 (Nov. 21, 2018).
105. *Large Business and International Division At-a-Glance.* Mar. 19, 2019. IRS. [www.irs.gov/businesses/international-businesses/large-business-and-international-division-at-a-glance] Accessed on Aug. 6, 2019.
106. PL 115-97, §13305(c).
107. PL 115-97, §13305(b)(1).
108. IRC §86(b)(2)(A).

However, this change in the law is **not** properly reflected in the 2018 IRS worksheet for calculating taxable social security benefits. The relevant section of the IRS worksheet from the 2018 Form 1040 instructions is reproduced below.

**Social Security Benefits Worksheet—Lines 5a and 5b** *Keep for Your Records*

***Before you begin:***
- ✓ Figure any write-in adjustments to be entered on the dotted line next to Schedule 1, line 36 (see the instructions for Schedule 1, line 36).
- ✓ If you are married filing separately and you lived apart from your spouse for all of 2018, enter "D" to the right of the word "benefits" on line 5a. If you don't, you may get a math error notice from the IRS.
- ✓ Be sure you have read the ***Exception*** in the line 5a and 5b instructions to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.

**1.** Enter the total amount from **box 5** of **all** your **Forms SSA-1099** and **Forms RRB-1099.** Also, enter this amount on Form 1040, line 5a . . . . . **1.** ________

**2.** Multiply line 1 by 50% (0.50) . . . . . **2.** ________

**3.** Combine the amounts from Form 1040, lines 1, 2b, 3b, 4b, and Schedule 1, line 22 . . . . . **3.** ________

**4.** Enter the amount, if any, from Form 1040, line 2a . . . . . **4.** ________

**5.** Combine lines 2, 3, and 4 . . . . . **5.** ________

**6.** Enter the total of the amounts from Schedule 1, lines 23 through 32, plus any write-in adjustments you entered on the dotted line next to Schedule 1, line 36 other than any amounts identified as "DPAD" . . . . . **6.** ________

**7.** Is the amount on line 6 less than the amount on line 5?

☐ **No.** STOP None of your social security benefits are taxable. Enter -0- on Form 1040, line 5b.

btract line 6 from line 5 . . . . .

**Observation.** When implementing this change for 2018, several tax preparation software providers implemented the methodology used in the 2018 IRS worksheets.

Consequently, it was reported by tax practitioners that affected taxpayers received 2018 tax refunds from the IRS due to recalculating taxable social security benefits to allow the DPAD in computing the taxpayer's MAGI. This is in accordance with IRC §86(b)(2)(A) as amended by the TCJA. However, such recalculation would not be correct for DPAD coming from an agricultural or horticultural cooperative, as discussed next.

**Transition Rule for Qualified Payments to Patrons of Cooperatives.** The TCJA repeal of the DPAD was subsequently modified by the Consolidated Appropriations Act, 2018.[109] As a result, the DPAD repeal does not apply to payments qualifying for the DPAD received from a specified agricultural or horticultural cooperative in a taxpayer's tax year beginning **after** December 31, 2017, for the cooperative's tax year beginning **before** January 1, 2018. Therefore, the conforming amendment made to IRC §86(b)(2)(A) by the TCJA does **not** apply to these payments and the DPAD pertaining to these payments is consequently **not** allowable in determining a taxpayer's MAGI for calculating taxable social security benefits.

**Note.** The impact of the DPAD on calculating taxable social security benefits is further discussed in the 2019 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 6: Agricultural Issues and Rural Investments.

---

109. PL 115-141, Div. T, §101(c) (Mar. 23, 2018).

## QUALIFIED OPPORTUNITY ZONE FUNDS[110]

The TCJA[111] introduced incentives for investments in qualified opportunity zones. IRC §1400Z-1 allows for a **temporary deferral** of eligible capital gains[112] reinvested in a qualified opportunity zone fund (QOZF).

### Qualified Opportunity Zone Defined[113]

A "qualified opportunity zone" is defined as a population census tract that is a low-income community designated as a qualified opportunity zone. IRS Notice 2018-48 contains a list of all population census tracts designated by the Treasury as qualified opportunity zones.

The deferral of **capital gains** occurs when a taxpayer invests their capital gains in a QOZF.[114] A QOZF is any investment vehicle that is organized as a corporation or partnership for the purpose of investing in qualified opportunity zone property that holds at least 90% of the entity's assets in qualified opportunity zone property (defined later).[115]

### Qualified Opportunity Zone Funds[116]

Capital gains reinvested **within 180 days** into a QOZF receive a **temporary deferral** from inclusion in taxable income. The deferred gain must be recognized on the **earlier** of the date on which the opportunity zone investment is disposed of or December 31, 2026.

To avoid taxation on the capital gain from the sale of an asset, an investor needs to reinvest the **capital gain** into a QOZF **within 180 days of the date of disposition of the asset**. The investor then receives stock from a corporation or a partnership interest in the QOZF. These entities must then invest in qualified opportunity zone property (discussed later).

Capital gains reinvested in a QOZF receive a **stepped-up basis.** The taxpayer's basis in the investment is increased by **10%** of the amount of gain deferred if the taxpayer holds the QOZF investment for at least **five years** and by **an additional 5%** of the deferred gain if the taxpayer's holding period is at least **seven years. Therefore, the taxpayer can potentially exclude up to 15% of the original gain from taxation** if they hold the investment at least seven years.

For any QOZF investment held by the taxpayer **for at least 10 years,** the basis of such property is equal to the FMV of such investment on the date the investment is sold or exchanged.[117]

**Qualified Opportunity Zone Property.**[118] The term **qualified opportunity zone property** is defined as property that is one of the following.

- Qualified opportunity zone stock
- Qualified opportunity zone partnership interest
- Qualified opportunity zone business property

---

110. IRC §§1400Z-1 and 1400Z-2.
111. PL115-97.
112. Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(2).
113. IRC §1400Z-1(a)
114. IRC §1400Z-2(a)(1).
115. IRC §§1400Z-2(d)(1) and (2).
116. IRC §1400Z-2.
117. IRC §1400Z-2(c)
118. IRC §1400Z-2(d)(1).

**Qualified opportunity zone stock** is defined as stock in a domestic corporation if the stock is acquired by the QOZF after December 31, 2017, at its original issue from the corporation solely in exchange for cash. When the stock in the corporation is issued, the corporation must be a qualified opportunity zone business. In the case of a new corporation, the corporation must have been organized for purposes of being a qualified opportunity zone business.[119]

A **qualified opportunity zone partnership interest** is defined as any capital or profits interest in a domestic partnership if the interest in the partnership is acquired by the QOZF after December 31, 2017, from the partnership solely in exchange for cash. When the partnership interest is issued, the partnership must be a qualified opportunity zone business. For a new partnership, the partnership must have been organized for purposes of being a qualified opportunity zone business. The partnership must remain qualified as a qualified opportunity zone business during substantially all of the QOZF's holding period for the interest.[120]

**Qualified opportunity zone business property** is tangible property used in the trade or business of a QOZF if the property:

- Was acquired by purchase after December 31, 2017;
- The **original use** of the property commences with the QOZF **or** the QOZF substantially improves the property; and
- During substantially all of the QOZF's holding period for the property, substantially all of the use of the property was in a qualified opportunity zone.[121]

**180-Day Period.** The 180-day period with respect to any eligible gain generally begins the day on which the gain would have been recognized for federal income tax purposes if the taxpayer had not deferred it under the QOZF program.[122]

The proposed regulations provide helpful examples that illustrate when the 180-day period begins.[123]

| Type of Gain | 180-Day Period Start Date |
|---|---|
| Individual stock sale | On the trade date |
| Capital gain dividends received by regulated investment company (RIC) and real estate investment trust (REIT) shareholders | On the date the dividend is paid |
| Undistributed capital gain received by RIC and REIT shareholders | Last day of RIC or REIT's tax year |

The proposed regulations permit a partnership to elect to defer gain at the partnership level. If the partnership **does not elect to defer gain,** the **partner may do so.** The following rules explain when the 180-day period begins.[124]

- The partner's 180-day period generally begins on the **last day of the partnership's tax year** in which the partner's allocable share of the partnership's eligible gain is taken into account.
- If a partnership does not elect to defer all of its eligible gain, the partner may elect to defer the gain. The partner may choose to begin their own 180-day period on the same date as the start of the partnership's 180-day period.

119. IRC §1400Z-2(d)(2)(B).
120. IRC §1400Z-2(d)(2)(C).
121. IRC §1400Z-2(d)(2)(D).
122. IRC §1400Z-2(a)(1)(A).
123. Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(4).
124. Prop. Treas. Reg. §1.1400Z-2(a)-1(c)(1).

The preceding rules for partnerships and partners also apply to other pass-through entities and their members, such as S corporations and their shareholders, as well as estates and trusts and their beneficiaries.[125]

Additionally, an investor may reelect to defer gain on a complete disposition of their QOZF interest if they reinvest in another QOZF within the new 180-day period.[126]

If a taxpayer holds investment interests with identical rights in a QOZF that were acquired on different days and the taxpayer disposes of less than all of these interests, the first-in, first-out (FIFO) method must be used to identify which interests were disposed of. If, after application of the FIFO method, a taxpayer is treated as having disposed of less than all of the investment interests that the taxpayer acquired on one day and if the interests acquired on that day vary with respect to certain characteristics, then a proportionate allocation must be made to determine which interests were disposed of (pro-rata method).[127]

**Note.** For information on application of the pro-rata method, see Prop. Treas. Reg. §1.1400Z-2(a)-1.

However, if the taxpayer holds the investment until **December 31, 2026, the gain must be recognized** and taxes paid on the deferred gain, even if the taxpayer is still holding the property.[128] The taxpayer's basis is subject to the increases that the taxpayer may have received after the fifth and seventh years,[129] as discussed earlier. If the investment is held for at least 10 years, any additional gain derived from the QOZF is permanently excluded from taxation.[130]

**Making the Election.** A taxpayer must make an election to defer part or all of the gain that was invested in a QOZF. The taxpayer makes the election on Form 8949, *Sales and Other Dispositions of Capital Assets*. The taxpayer reports the deferral of the eligible gain on part I or part II of Form 8949 (depending on whether the gain is short- or long-term). In column (a) of Form 8949, the taxpayer enters only the QOZF's employer identification number (EIN). In column (b), the taxpayer enters the date they invested in the QOZF. To make the election, enter code Z in column (f), and the deferred gain amount is entered as a negative number in column (g).

**Note.** The following example includes a Form 8949 and Schedule D that illustrates the proper reporting of the gain and the deferral election. For more information about making the election, see the instructions to Form 8949.

125. Prop. Treas. Reg. §1.1400Z-2(a)-1(c)(3).

126. Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(4).

127. Prop. Treas. Reg. §§1.1400Z-2(a)-1(b)(4) and (b)(6).

128. IRC §1400Z-2(b)(1)(B).

129. IRC §1400Z-2(b)(2)(B).

130. IRC §1400Z-2(c).

**Example 9.** On June 30, 2018, Dan sells GoBapple common stock for $225,000. He bought the stock on May 1, 2000, for $25,000. Therefore, he realizes a $200,000 capital gain. He invests the $200,000 gain into a QOZF within 180 days.

If Dan had not reinvested his gain in a QOZF in 2018, he would have owed $30,000 in taxes on his capital gain (assuming he is subject to a 15% long-term capital gains rate in 2018). By making the QOZF investment, he can defer paying tax on any part of the gain until 2026.

After Dan holds the QOZF investment seven years, he receives a 15% step-up in basis (10% after five years, and an additional 5% step-up after seven years). Therefore, Dan's stepped-up basis in the gain after seven years is $30,000 ($200,000 × 15%).

On December 31, 2026, Dan **must** recognize the deferred gain from 2019. The original gain was $200,000; however, because of the previous step-ups after five and seven years, his taxable gain is now $170,000 ($200,000 gain – $30,000 stepped-up basis). If the 15% long-term capital gain rate still applies, his tax due from this deferral will be $25,500 ($170,000 × 15%). This is $4,500 less than the $30,000 tax on capital gains he would have owed in 2019. In addition, he was able to delay paying the tax for several years (2018 to 2026).

Dan sells his QOZF investment on May 1, 2030, for $575,000. His appreciation on the investment is $375,000 ($575,000 – $200,000 invested). This appreciation is tax-free because he invested in the QOZF **for at least 10 years.**

Dan's timeline for his investment is summarized in the following table.

| | |
|---|---|
| June 30, 2018 | $200,000 gain realized |
| December 31, 2018 | Gain reinvested into a QOZF (180th day) |
| December 31, 2023 | 10% basis increase ($200,000 × 10% = $20,000) (after 5 years) |
| December 31, 2025 | Additional 5% basis increase ($200,000 × 5% = $10,000) (after 7 years) |
| December 31, 2026 | Mandatory deferred gain recognition (($200,000 gain invested − $30,000 step-ups) × 15% capital gain rate = $25,500) |
| May 1, 2030 | Dan sells his investment for $575,000. No tax is due on the $375,000 of appreciation on the $200,000 gain invested in the QOZF. |

Relevant portions of Dan's 2018 Form 8949 and Schedule D follow.

**Note.** The last date to reinvest gain and receive the maximum step-ups in basis is December 31, 2019, because the investment must be held seven years to receive both the 10% and 5% step-ups. The last date a taxpayer can invest any gain and receive at least some step-up is December 31, 2021, because December 31, 2026, is five years after that date. In this situation, the taxpayer would receive only a 10% step-up. In addition, the taxpayer can continue to defer recognition of the full FMV of their gain until December 31, 2047.[131]

**Caution. Example 9** produces a positive outcome for the taxpayer. This may not always be the case when investing in a QOZF. Taxpayers should consult their financial advisor.

131. Prop. Treas. Reg. §1.1400Z-2(c)-1.

## For Example 9

Form 8949 (2018) Attachment Sequence No. 12A Page 2

| Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side | Social security number or taxpayer identification number |
|---|---|
| Dan Taxpayer | 765-43-2109 |

*Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.*

**Part II** **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

**Note:** You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

**You *must* check Box D, E, *or* F below. Check only one box.** If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☒ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☐ **(F)** Long-term transactions not reported to you on Form 1099-B

| 1 (a) Description of property (Example: 100 sh. XYZ Co.) | (b) Date acquired (Mo., day, yr.) | (c) Date sold or disposed of (Mo., day, yr.) | (d) Proceeds (sales price) (see instructions) | (e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions | Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions. (f) Code(s) from instructions | (g) Amount of adjustment | (h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g) |
|---|---|---|---|---|---|---|---|
| 2000 sh GoBapple | 05-01-00 | 06-30-18 | 225,000 | 25,000 | | | 200,000 |
| 12-3456789 | 12-31-18 | | | | Z | (200,000) | (200,000) |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| **2 Totals.** Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked) ▶ | | | 225,000 | 25,000 | | (200,000) | |

**Note:** If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Form **8949** (2018)

## For Example 9



**SCHEDULE D (Form 1040)**

Department of the Treasury Internal Revenue Service (99)

# Capital Gains and Losses

▶ Attach to Form 1040 or Form 1040NR.
▶ Go to *www.irs.gov/ScheduleD* for instructions and the latest information.
▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

OMB No. 1545-0074

2018

Attachment Sequence No. 12

Name(s) shown on return: Dan Taxpayer

Your social security number: 765-43-2109

**Part I** **Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less** (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|---|---|---|---|---|
| **1a** Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b . | | | | |
| **1b** Totals for all transactions reported on Form(s) 8949 with **Box A** checked . . . . . . . . . . . . . . | | | | |
| **2** Totals for all transactions reported on Form(s) 8949 with **Box B** checked . . . . . . . . . . . . . . | | | | |
| **3** Totals for all transactions reported on Form(s) 8949 with **Box C** checked . . . . . . . . . . . . . . | | | | |

| | | |
|---|---|---|
| **4** Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . | 4 | |
| **5** Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 5 | |
| **6** Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions . . . . . . . . . . . . . . . . . . . . . . . . | 6 | ( ) |
| **7** **Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back . . . . . . | 7 | |

**Part II** **Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year** (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|---|---|---|---|---|
| **8a** Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b . | | | | |
| **8b** Totals for all transactions reported on Form(s) 8949 with **Box D** checked . . . . . . . . . . . . . . | 225,000 | 25,000 | (200,000) | |
| **9** Totals for all transactions reported on Form(s) 8949 with **Box E** checked . . . . . . . . . . . . . . | | | | |
| **10** Totals for all transactions reported on Form(s) 8949 with **Box F** checked. . . . . . . . . . . . . . | | | | |

| | | |
|---|---|---|
| **11** Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . . . . . . . . . . . . . . . . . . . | 11 | |
| **12** Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 | 12 | |
| **13** Capital gain distributions. See the instructions . . . . . . . . . . . . . . . . . . . . | 13 | |
| **14** Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions . . . . . . . . . . . . . . . . . . . . . . . . | 14 | ( ) |
| **15** **Net long-term capital gain or (loss).** Combine lines 8a through 14 in column (h). Then go to Part III on the back . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 15 | |

**For Paperwork Reduction Act Notice, see your tax return instructions.** Cat. No. 11338H **Schedule D (Form 1040) 2018**

## Establishing and Certifying A QOZF

As an alternative to investing in an established QOZF, a taxpayer can establish their own QOZF. To do so, they must certify that the entity is organized to invest in qualified opportunity zone property.

A corporation or partnership uses Form 8996, *Qualified Opportunity Fund,* (which follows) to certify that it is organized to invest in qualified opportunity zone property. In addition, the entity files Form 8996 **annually** to report that the QOZF meets the investment standard of IRC §1400Z-2 or to calculate the penalty if it fails to meet the investment standard. Form 8996 must be attached to the corporate or partnership return indicating the entity was established for the purpose of investing in a QOZF.[132]

> **Caution.** In order to become compliant (and to remain compliant) with the rules for establishing a QOZF, specific guidelines must be adhered to. Failure to follow the guidelines can result in the disqualification of the QOZF. Before attempting to establish a QOZF, taxpayers are advised to seek competent legal counsel well versed in this new area of tax law.

Form **8996**
(December 2018)
Department of the Treasury
Internal Revenue Service

**Qualified Opportunity Fund**

**► Go to *www.irs.gov/Form8996* for the latest information.**
**► Attach to your tax return. See instructions.**

OMB No. 1545-0123
Attachment Sequence No. **996**

Name | **Employer identification number**

**Part I** **General Information and Certification**

**1** Type of taxpayer: ☐ Corporation ☐ Partnership

**2** Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)?

☐ **No. STOP.** Do not file this form with your tax return.

☐ **Yes.** Go to line 3.

**3** Is this the first period the taxpayer is a Qualified Opportunity Fund?

☐ **Yes.** By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and the description of the qualified opportunity zone business. See instructions.

☐ **No.** Go to Part II.

**4** If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund. ►

**Part II** **Investment Standard Calculation**

| | | | |
|---|---|---|---|
| **5** | Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes" | **5** | |
| **6** | Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes" | **6** | |
| **7** | Divide line 5 by line 6 | **7** | . |
| **8** | Total qualified opportunity zone property held by the taxpayer on the last day of the taxpayer's tax year | **8** | |
| **9** | Total assets held by the taxpayer on the last day of the taxpayer's tax year | **9** | |
| **10** | Divide line 8 by line 9 | **10** | . |

**Part III** **Qualified Opportunity Fund Average and Penalty**

| | | | |
|---|---|---|---|
| **11** | Add lines 7 and 10 | **11** | . |
| **12** | Divide line 11 by 2.0. See instructions if Part I, line 3 is "Yes" | **12** | . |
| **13** | Is line 12 equal to or more than 0.90?<br>☐ **Yes.** Enter -0- on this line and file this form with your tax return.<br>☐ **No.** The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return | **13** | |

**For Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 37820G Form **8996** (12-2018)

132. Instructions to Form 8996.

Form 8996 (12-2018) Page **2**

**Part IV** **Line 13 Penalty**

If you checked "No" in Part III, line 13, complete Part IV to figure the penalty. Enter the number from line 8 below on Part III, line 13. See instructions if Part I, line 3 is "Yes."

| | **(a)** Month 1 | **(b)** Month 2 | **(c)** Month 3 | **(d)** Month 4 | **(e)** Month 5 |
|---|---|---|---|---|---|
| **1** Total assets on the last day of the month | | | | | |
| **2** Multiply line 1 by 0.90 | | | | | |
| **3** Total qualified opportunity zone property on the last day of the month | | | | | |
| **4** Subtract line 3 from line 2. If zero or less, enter -0- | | | | | |
| **5** Underpayment rate | | | | | |
| **6** Multiply line 4 by line 5 | | | | | |
| **7** Divide line 6 by 12.0. Round up to two decimal places. See instructions if Part I, line 3 is "Yes" | | | | | |

| | **(f)** Month 6 | **(g)** Month 7 | **(h)** Month 8 | **(i)** Month 9 | **(j)** Month 10 | **(k)** Month 11 | **(l)** Month 12 |
|---|---|---|---|---|---|---|---|
| **1** | | | | | | | |
| **2** | | | | | | | |
| **3** | | | | | | | |
| **4** | | | | | | | |
| **5** | | | | | | | |
| **6** | | | | | | | |
| **7** | | | | | | | |

**8** **Penalty.** Add columns (a) through (l) of line 7. Enter the total here and on Part III, line 13 . . . . . $

Form **8996** (12-2018)

## IRS Questions and Answers[133]

The IRS provides assistance for taxpayers who want more information about QOZFs. Following are some questions and answers from the IRS website.

**Q. What is an Opportunity Zone?**

**A.** An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the IRS.

**Q. How were Opportunity Zones created?**

**A.** Opportunity Zones were added to the tax code by the Tax Cuts and Jobs Act on December 22, 2017.

**Q. Have Opportunity Zones been around a long time?**

**A. No,** they are new. The first set of Opportunity Zones, covering parts of 18 states, were designated on April 9, 2018. Opportunity Zones have now been designated covering parts of all 50 states, the District of Columbia and five U.S. territories.

**Q. What is the purpose of Opportunity Zones?**

**A.** Opportunity Zones are an economic development tool—that is, they are designed to spur economic development and job creation in distressed communities.

133. *Opportunity Zones Frequently Asked Questions.* Jul. 15, 2019. IRS. [www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions] Accessed on Jul. 23, 2019.

**Q. How do Opportunity Zones spur economic development?**

**A.** Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains invested in a Qualified Opportunity Fund (QOF) until the earlier of the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. If the QOF investment is held for longer than five years, there is a 10% exclusion of the deferred gain. If held for more than seven years, the 10% becomes 15%. Second, if the investor holds the investment in the Opportunity Fund for at least 10 years, the investor is eligible for an increase in basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.

**Q. What is a Qualified Opportunity Fund?**

**A.** A QOF is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in a Qualified Opportunity Zone.

**Q. Do I need to live in an Opportunity Zone to take advantage of the tax benefits?**

**A. No.** An investor can get the tax benefits, even if they do not live, work, or have a business in an Opportunity Zone. All the investor needs to do is invest a recognized gain in a QOF and elect to defer the tax on that gain.

**Q. I am interested in knowing where the Opportunity Zones are located. Is there a list of Opportunity Zones available?**

**A. Yes.** The list of designated Qualified Opportunity Zones can be found at www.cdfifund.gov/Pages/Opportunity-Zones.aspx and in IRS Notice 2018-48. Further a visual map of the census tracts designated as Qualified Opportunity Zones may also be found at Opportunity Zones Resources.

**Q. I am interested in forming a QOF. Is there a list of Opportunity Zones available in which the Fund can invest?**

**A. Yes.** The list of designated Qualified Opportunity Zones in which a Fund may invest to meet its investment requirements can be found in IRS Notice 2018-48.

**Q. How does a corporation or partnership become certified as a QOF?**

**A.** To become a QOF, an eligible corporation or partnership self-certifies by filing Form 8996, *Qualified Opportunity Fund,* with its federal income tax return. The return with Form 8996 must be filed timely, taking extensions into account.

**Q. Can a limited liability company (LLC) be an Opportunity Fund?**

**A. Yes.** An LLC that chooses to be treated either as a partnership or corporation for federal tax purposes can organize as a QOF.

**Q.** I sold some stock for a gain in 2018, and, during the 180-day period beginning on the date of the sale, I invested the amount of the gain in a QOF. Can I defer paying tax on that gain?

**A. Yes,** you may elect to defer the tax on the amount of the gain invested in a QOF. Therefore, if you only invest part of your gain in a QOF(s), you can elect to defer tax on only the part of the gain which was invested.

**Q. How do I elect to defer my gain on the 2018 sale of the stock?**

**A.** You may make an election to defer the gain, in whole or in part, when filing your 2018 federal income tax return. That is, you may make the election on the return on which the tax on that gain would be due if you do not defer it.

**Q. I sold some stock on December 15, 2017, and, during the required 180-day period, I invested the amount of the gain in a QOF. Can I elect to defer tax on that gain?**

**A. Yes.** You make the election on your 2017 return. Attach Form 8949, reporting information about the sale of your stock.

**Q. How can I get more information about Opportunity Zones?**

**A.** The Treasury Department and the IRS will provide further details, including additional legal guidance, on this new tax benefit. More information will be available at Treasury.gov and IRS.gov.

**Q. Can I defer §1231 capital gain net income for a taxable year under the Opportunity Zone rules?**

**A. Yes.** If a taxpayer's §1231 gains for any taxable year exceed the §1231 losses for that year, the net gain is long-term capital gain. A taxpayer can elect to defer some or all of this capital gain under §1400Z-2 by making an investment of a corresponding amount in a QOF during the 180-day period that begins on the last day of the taxpayer's taxable year.

**Q. Can I transfer property other than cash as an investment to a QOF?**

**A. Yes.** A taxpayer can transfer property other than cash as an investment to a QOF. However, a transfer of non-cash property may result in only part of the investment being eligible for Opportunity Zone tax benefits, so that not all the taxpayer's capital gain is able to be deferred. See Prop. Treas. Reg. §§1.1400Z2(a)-1(b)(9) & (10).

**Q. When I transfer property to a QOF, does my holding period of the property also transfer to my QOF eligible investment?**

**A. No.** The Opportunity Zones tax incentives provisions determine a taxpayer's holding period in a qualifying investment in a QOF without regard to the holding period of the cash or other property transferred to the QOF.

**Q. I deferred gain based on an investment in a QOF, and now that QOF has dissolved before the end of my deferral period. What happens to my deferred gain?**

**A.** When the QOF dissolved, the deferral period ended, and you must include the deferred gain when you file your return, reporting the gain on Form 8949.

**Q. I deferred a gain based on an investment in a QOF, and now I gave the investment to my child before the deferral period had ended. Is there anything that I need to do?**

**A. Yes.** The deferral period ended when you gave away the QOF investment. You must include the deferred gain when you file your return, reporting the gain on Form 8949.

**Q. When is tangible property "original use" tangible property?**

**A.** Tangible property is original use on the date first placed in service in the qualified opportunity zone for purposes of depreciation or amortization. Used tangible property satisfies the original use requirement if the property has not been previously placed in service in the qualified opportunity zone.

**Q. Can inventory in transit be "qualified opportunity zone business property?"**

**A. Yes.** Inventory of a QOF, including raw materials, does not fail to be "used in a qualified opportunity zone" solely because the inventory is in transit from a vendor to the QOF or from the QOF to a customer.

## REGULATED INVESTMENT COMPANIES[134]

TD 9851 contains regulations that provide guidance to corporations that wish to qualify as regulated investment companies (RICs) under IRC §851. A key focus of these regulations is clarification of investment income that is considered for the IRC §851(b) 90% gross income test (a requirement to be treated as an RIC).

## CENTRALIZED PARTNERSHIP AUDIT REGIME[135]

TD 9844 contains final regulations that provide guidance on implementing the centralized partnership audit regime (IRC §§6221 through 6241) introduced by the Bipartisan Budget Act of 2015,[136] and amended by the Protecting Americans from Tax Hikes Act of 2015,[137] and the Tax Technical Corrections Act of 2018.[138]

Prior to the introduction of the centralized partnership audit regime, the IRS assessed adjustments of partnership items at the partner level. However, for tax years beginning after December 31, 2017, the default position of this new audit regime is for the IRS to assess and collect any understatement of tax, interest, and penalties at the **partnership** level.

Specific guidance is provided in these regulations on the following issues.

- Scope of the centralized partnership audit regime
- Requirement for consistent reporting
- Calculation and modification of imputed underpayments
- The push out election under IRC §6226
- Administrative adjustment requests
- Notices, assessment, penalties, and interest
- Judicial review of partnership adjustments
- Period of limitations
- Definitions and special rules

## TRUNCATED IDENTIFICATION NUMBERS ON FORMS W-2[139]

On July 3, 2019, the IRS issued final regulations under IRC §§6051 and 6052 permitting employers to **voluntarily truncate** employees' social security numbers (SSNs) on the employees' copies of Form W-2, *Wage and Tax Statement* (i.e., by substituting the employee's SSN with a truncated taxpayer identification number (TTIN)). The intent of these regulations and previously issued regulations under IRC §6109 is to aid an employers' efforts to **protect** employees from identity theft.

Effective for Forms W-2 and other applicable reporting forms filed or furnished after December 31, 2020,[140] employers have the **option** of using TTINs instead of employees' SSNs on the employee's copies of Form W-2.[141]

134. TD 9851, 2019-14 IRB 917.
135. TD 9844, 2019-11 IRB 781.
136. PL 114-74, §1101.
137. PL 114-113, Div. Q.
138. PL 115-141, Div. U.
139. 84 Fed. Reg. 31,717 (Jul. 3, 2019).
140. Treas. Regs. §§31.6051-3(f) and 301.6109-4(c).
141. Treas. Reg. §301.6109-4(b)(1).

A TTIN is an individual's SSN, individual taxpayer identification number (ITIN), adoption taxpayer identification number, or EIN in which the first five digits of the 9-digit number are replaced with Xs or asterisks. The TTIN takes the same format as the identifying number it replaces (e.g., XXX-XX-1234 when replacing an SSN, or XX-XXX1234 when replacing an EIN).[142]

However, a TTIN **cannot** be used in the following circumstances.[143]

- When prohibited by statute, regulation, or other IRS guidance
- When use of a TTIN is not specifically permitted
- For any form or other document required to be filed with the IRS or the Social Security Administration (e.g., an employer may not truncate the employee's SSN on the copy of the W-2 filed with the Social Security Administration)[144]
- In order to truncate the taxpayer's own taxpayer identification number (TIN) (e.g., an employer may not truncate its own EIN on Forms W-2 given to employees)[145]

Use of a TTIN will not result in application of any penalty for failure to include a correct taxpayer identifying number on the employee's copy of Form W-2.[146]

**Caution.** Employers must confirm whether states where the employer files permit use of TTINs on W-2s issued to employees for state income tax purposes.

## RESPONSIBLE PARTY REQUESTING EIN MUST HAVE SSN/ITIN[147]

An EIN is a unique 9-digit tax identification number assigned to sole proprietors, corporations, partnerships, estates, trusts, employee retirement plans, and other entities. These entities use the EIN for tax filing and reporting purposes.

After May 13, 2019, **only individuals** with TINs may apply for an EIN as the **responsible party.** The application is made using the paper Form SS-4, *Application for Employer Identification Number,* or through the online EIN application at **uofi.tax/19b2x3** [www.irs.gov/businesses/small-businesses-self-employed/employer-id-numbers]. This change prohibits entities from obtaining additional EINs by using their own EINs.

Generally, the responsible party is the person who ultimately owns or controls the entity or who exercises ultimate effective control over the entity.[148] When more than one person meets this definition, the entity can choose the responsible party.

The TIN of the responsible party can be either an SSN or an ITIN.

**Note.** Tax professionals can continue to act as third-party designees for entities and complete paper/online EIN applications on behalf of their clients.

---

142. Treas. Reg. §301.6109-4(a).

143. Treas. Reg. §301.6109-4(b)(2).

144. Treas. Reg. §31.6051-2.

145. Treas. Reg. §301.6109-4(b)(3)(i).

146. Treas. Reg. §301.6109-4(b)(1).

147. IRS News Rel. IR-2019-58 (Mar. 27, 2019).

148. Form SS-4 Instructions.

## SELF-EMPLOYED HEALTH INSURANCE DEDUCTION[149]

Health and accident insurance premiums paid on behalf of a greater-than-2% S corporation shareholder-employee are deductible by the corporation.

The S corporation must report the premiums as wages on the shareholder-employee's Form W-2, box 1. However, these premiums are not subject to social security, Medicare, or unemployment taxes if they are made to or on behalf of an employee under a plan or system that makes provision for all or a class of employees (or employees and their dependents). Generally, the shareholder-employee is also eligible for the IRC §162(l) above-the-line deduction in arriving at adjusted gross income. The shareholder enters the deduction on Form 1040, Schedule 1, *Additional Income and Adjustments to Income*) if the medical care coverage was established by the S corporation and the shareholder met the other requirements for the deduction.[150]

**Caution.** A shareholder cannot claim the above-the-line deduction if the shareholder or their spouse was eligible to participate in any subsidized health care plan.

A recent advisory from the IRS Office of Chief Counsel (OCC) concluded that family members employed by an S corporation who are **deemed** to be 2% shareholders of the S corporation can also claim the self-employed health insurance deduction under §162(l) if they otherwise qualify.[151] Key to this OCC decision was the observation that a 2% shareholder includes someone who either owns or is **considered to own** (as defined in IRC §318) more than 2% of the S corporation's stock.[152] A taxpayer is considered to own stock that is owned, directly or indirectly, by the following family members of the taxpayer.[153]

- Spouse (other than a spouse legally separated from the taxpayer under a decree of divorce or separate maintenance)
- Children
- Grandchildren
- Parents

The following example illustrates application of this stock ownership attribution rule.

**Example 10.** Grant Fithian is the sole owner of Fithian Corporation, which is organized as an S corporation. Grant decides to provide medical insurance through his corporation to his unmarried adult children who are employees of the corporation.

Fithian Corporation issues Forms W-2 to the affected family members reporting the payment of these medical insurance premiums as wages in box 1.

Although none of the recipients own stock in Fithian Corporation, they are deemed to be 2% shareholders of the corporation because of their father's share ownership. Therefore, each recipient can claim the self-employed health insurance deduction under §162(l) if they otherwise qualify.

149. *S Corporation Compensation and Medical Insurance Issues*. May 10, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/s-corporation-compensation-and-medical-insurance-issues] Accessed on Jul. 15, 2019.

150. IRC §162(l); 2018 Instructions for Form 1040.

151. CCA 201912001 (Mar. 22, 2019).

152. IRC §1372(b).

153. IRC §318(a)(1).

# TAX BASIS REPORTING FOR PARTNERSHIPS AND S CORPORATIONS



## PARTNERSHIPS[154]

If a partnership does **not** use tax basis reporting for partners' capital accounts,[155] the partnership has additional tax reporting duties for partners with tax basis **negative** capital accounts (i.e., the partner's capital account if calculated using tax principles). Accordingly, the partnership must report the amount of the partner's tax basis capital account at the beginning and end of the year on Schedule K-1 (Form 1065), line 20, using code "AH."

A similar requirement applies to taxpayers who file Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*. Schedules K-1 issued with Form 8865 are subject to the same tax basis reporting requirements.

A tax basis negative capital account occurs in the following situations.

- A partnership allocates tax deductions or losses or makes distributions to a partner that exceed the partner's tax basis equity in the partnership.
- A partner contributes debt-encumbered property to a partnership and the debt exceeds the property's adjusted tax basis to the partnership.

> **Note.** Detailed guidance for calculating a partner's tax basis capital account is available at **uofi.tax/19b2x1** [www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions].

### Safe Harbor[156]

An elective safe harbor is available to partnerships. Under this safe harbor, a partner's tax basis negative capital account is the excess, if any, of the partner's share of partnership liabilities under IRC §752 over the partner's outside basis.

### De Minimis Exception

A partnership that satisfies the following four conditions does not have to report tax basis negative capital account information. This is because such partnerships are not required to complete Schedule K-1 (Form 1065), part II, item L, regarding partner capital account information.[157]

1. The partnership's total receipts for the tax year were less than $250,000.
2. The partnership's total assets at the end of the tax year were less than $1 million.
3. Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.
4. The partnership is not filing and is not required to file Schedule M-3, *Net Income (Loss) Reconciliation for Certain Partnerships.*

154. Instructions for Schedule K-1 (Form 1065); *Form 1065 Frequently Asked Questions*. Apr. 5, 2019. IRS. [www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions] Accessed on Jul. 12, 2019.

155. See Schedule K-1 (Form 1065), Part II, Item L.

156. See FAQ 6 of *Form 1065 Frequently Asked Questions*. Apr. 5, 2019. IRS. [www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions] Accessed on Jul. 12, 2019.

157. See Form 1065, Schedule B, line 4.

### Tax Penalty Relief[158]

For tax years beginning **after** December 31, 2017, and **before** January 1, 2019, the IRS waived penalties for failure to include tax basis negative capital account information if the Schedule K-1 or other applicable form or statement meets the following requirements.

- Is timely filed with the IRS (including extensions)
- Is timely furnished to the appropriate partner (if applicable)
- Contains all other required information

To obtain this penalty waiver the preparer of the partnership return (or other responsible person) must file a statement with the IRS reporting the following information for each partner with a negative tax basis capital account.

- The partnership's name and EIN, if any, and reference identification number, if any
- The partner's name, address, and taxpayer identification number
- The amount of the partner's tax basis capital account at the beginning and end of the partnership's tax year

This statement must be marked "Filed Under Notice 2019-20" and filed with the IRS no later than **one year after the original due date (not including extensions)** of the partnership tax return. The statement must be sent to the following address.

**1973 North Rulon White Blvd.**
**Ogden, UT 84404-7843**
**MS 4700**
**Attn: Ogden PTE**

No other tax forms, amended forms, or statements must be filed to obtain the waiver.

The waiver applies to the following penalties.

- Failure to furnish a partner Schedule K-1 (Form 1065)[159]
- Failure to file a Schedule K-1 (Form 1065) with a partnership return[160]
- Failure to furnish a Schedule K-1 with respect to certain partnerships (Form 8865)[161]
- Any other penalty that arises solely as a result of failing to include negative tax basis capital account information

**Note.** Rev. Proc. 2019-32 provides a 6-month extension to file superseding Forms 1065 and Schedules K-1 for partnerships subject to the centralized audit regime.[162] A taxpayer filing a superseding return must indicate the return is such by selecting the superseded return checkbox in the software or the IRS will reject the return as a duplicate filing.[163]

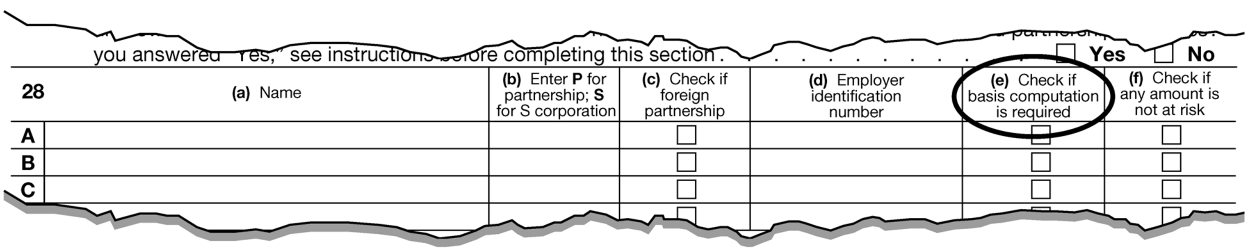
To qualify for this filing extension under Rev. Proc. 2019-32, a partnership must have filed its tax return by the original due date and also file a superseding Form 1065 no later than six months after the nonextended due date. The superseding Form 1065 (including corresponding Schedules K-1) must be filed in the same manner as the original return and the words "SUPERSEDING FORM 1065 PURSUANT TO REVENUE PROCEDURE 2019-32" must be written on the top of the superseding Form 1065.

158. IRS Notice 2019-20, 2019-14 IRB 927.
159. IRC §6722.
160. IRC §6698.
161. IRC §6038.
162. Rev. Proc. 2019-32, 2019-33 IRB 659.
163. *Amended and Superseding Corporate Returns.* Nov. 29, 2018. IRS. [www.irs.gov/businesses/corporations/amended-and-superseding-corporate-returns] Accessed on Sep. 9, 2019.

## S CORPORATIONS[164]

S corporation shareholders must check the corresponding box on Schedule E (Form 1040), *Supplemental Income and Loss,* line 28, column (e) and attach a computation to their tax return detailing their S corporation basis if any of the following apply.

- The shareholder reports a loss from the S corporation.
- The shareholder receives a distribution from the S corporation.
- The shareholder disposes of S corporation stock.
- The shareholder receives a loan repayment from the S corporation.


you answered "Yes," see instructions before completing this section . . . . . . . . . . ☐ Yes ☐ No

| 28 | (a) Name | (b) Enter P for partnership; S for S corporation | (c) Check if foreign partnership | (d) Employer identification number | (e) Check if basis computation is required | (f) Check if any amount is not at risk |
|---|---|---|---|---|---|---|
| A | | | ☐ | | ☐ | ☐ |
| B | | | ☐ | | ☐ | ☐ |
| C | | | ☐ | | ☐ | ☐ |

## FINAL REGULATIONS ON HEALTH REIMBURSEMENT ARRANGEMENTS[165]

Effective January 1, 2020, employers may put aside pre-tax funds into a health reimbursement arrangement (HRA), which can be used by an employee to **pay for premiums** and other out-of-pocket costs for an individual health insurance policy (known as individual coverage HRAs or ICHRAs), if certain conditions are met. **Recently released final regulations reverse previous Affordable Care Act (ACA)[166] guidance that prohibited an employer from reimbursing individual health insurance premiums except in limited situations.**

> **Observation.** The final regulations give an employer the option to **not** offer a traditional group health plan and instead contribute a specific amount into an ICHRA on an annual basis. The employee could then use the ICHRA funds to purchase any individual health insurance policy the employee desires through the government Marketplace or through private carriers.

On June 13, 2019, the U.S. Departments of Treasury, Labor, and Health and Human Services (hereinafter referred to as the Departments) issued final regulations regarding HRAs and other account-based group health plans, along with model attestations, notices, and frequently asked questions.

**The final regulations are effective August 19, 2019, and are applicable for plan years beginning on or after January 1, 2020.[167]**

---

164. *Clarification on line 28, column (e), of Schedule E (Form 1040).* Feb. 6, 2019. IRS. [www.irs.gov/forms-pubs/clarification-on-line-28-column-e-of-schedule-e-form-1040] Accessed on Jul. 12, 2019; 2018 Schedule E (Form 1040).

165. TD 9867, 2019-28 IRB 98.

166. PL 111-148 (Mar. 23, 2010).

167. TD 9867, 2019-28 IRB 98.

## BACKGROUND

The final regulations are in response to President Trump's Executive Order No. 13813, *Promoting Healthcare Choice and Competition Across the United States*.[168] The executive order directed the Departments to consider issuing sweeping new healthcare guidance in a stated effort to lower premium costs and increase choice in the individual health insurance market. One of the executive order's initiatives was expanding the use and availability of HRAs.

The final regulations create **two new methods** by which employees may use HRA dollars in conjunction with health insurance purchased on the individual market.[169]

1. The first method permits the use of HRA funds to purchase individual health insurance coverage or Medicare (thereby creating opportunities for ICHRAs).
2. The second method creates a limited-dollar HRA that employees may use to pay for most out-of-pocket medical expenses (excepted benefit HRAs or EBHRAs).

A detailed discussion of each of these methods follows.

## INDIVIDUAL COVERAGE HRAs[170]

### Integration Rules[171]

Guidance previously issued by the Departments in 2013 provided that an HRA (or other employer-sponsored arrangement designed to pay for health coverage purchased in the individual market) for active employees had to be integrated with another group health plan to satisfy the ACA's market reform requirements. The stated legal rationale for this earlier guidance was that a stand-alone HRA or other similar arrangement for active employees would fail to satisfy two of the ACA's market reform provisions: the prohibition against annual dollar limits on essential health benefits and the requirement to provide certain preventive services without cost-sharing.[172]

The final regulations permit an ICHRA to be integrated with certain qualifying individual health plan coverage or Medicare in order to satisfy the market reforms. In order to be integrated with individual market coverage/Medicare, the final regulations provide that the ICHRA must meet the following conditions.[173]

1. **Require that all individuals covered by the HRA be enrolled in individual health insurance or Medicare coverage.**[174] In order to be integrated with individual market health insurance coverage, any participant (regardless of whether they are a current or former employee) and dependent who can receive reimbursements from the ICHRA **must** be enrolled in individual market health insurance or Medicare coverage for each month that they are covered by the ICHRA. Substantiation of enrollment in such coverage is required (as discussed later).[175]

---

168. 82 Fed. Reg. 48,385 (Oct. 12, 2017).

169. *FAQs on New Health Coverage Options for Employers and Employees*. Jun. 13, 2019. Department of the Treasury, Department of Labor, Department of Health and Human Services. [www.irs.gov/pub/irs-utl/health_reimbursement_arrangements_faqs.pdf] Accessed on Jul. 29, 2019.

170. IRS Notice 2018-88, 2018-49 IRB 817.

171. IRS Notice 2013-54, 2013-40 IRB 287.

172. TD 9867, 2019-28 IRB 98, 100.

173. Treas. Reg. §§54.9802-4(c) and (e).

174. Treas. Reg. §54.9802-4(c)(1).

175. Ibid; Treas. Reg. §54.9815-2711(d)(5).

2. **The employer cannot offer both an HRA integrated with individual health insurance coverage and a traditional group health plan to the same class of employees.**[176] Generally, an employer may not offer an ICHRA to a class of employees if the employer offers a traditional group health plan to the same class of employees. A traditional group health plan is defined as any group health plan **except** an account-based health plan and a plan that consists solely of excepted benefits. However, employers are permitted to create classes within their workforce such as full-time, part-time, salaried, non-salaried, etc. If the employer offers an ICHRA to an employee in a given class, it must offer the ICHRA on the same terms to all employees in that class. However, it could offer a traditional group health plan to employees in a different class. If an employer is considering developing classes of employees for purposes of offering an ICHRA, it should be aware that the final regulations add minimum class size requirements for certain classes, in an attempt to prevent adverse selection in the individual market. The minimum class size depends on the size of the employer.

3. **Same-terms requirement.**[177] Subject to three notable exceptions discussed below (in addition to other exceptions), employers offering an ICHRA to a class of employees must offer the ICHRA on the same terms and conditions to all employees within the same class. Interestingly, the Departments prohibit discrimination against participants and beneficiaries based on a health factor by offering a more generous ICHRA to individuals based on an adverse health factor.[178]

   Amounts that are not used to reimburse medical care expenses for any plan year that are made available to participants in later plan years are disregarded for purposes of determining whether an HRA is offered on the same terms. However, the method for determining whether participants have access to unused amounts in future years and the methodology and formula for determining the amounts of unused funds which they may access in future years must be the same for all participants in a class of employees.[179]

   An HRA does not fail to be treated as provided on the same terms if the plan sponsor offers participants in a class of employees a choice between an individual coverage HRA that is compatible with a health savings account (HSA) and an ICHRA that is not HSA-compatible. However, both types of HRAs must be offered to all participants in the class of employees on the same terms.[180]

   a. **Exception for age.**[181] The final regulations permit an employer to increase the maximum amount available to a participant under an ICHRA based on an increase in a participant's age. The final regulations make clear, however, that the same increase must apply to all similarly aged participants in the same class of employees. While employers may offer additional ICHRA money to older participants, the maximum dollar amount made available to the oldest participant in a plan may not exceed three times the amount made available to the youngest participant in the plan.

   b. **Exception for number of dependents.**[182] The maximum dollar amount available under an ICHRA may also increase as the number of the participant's dependents covered under the ICHRA increases. The increase must be made on a uniform basis within the class.

---

176. Treas. Reg. §§54.9802-4(c)(2) and (d).
177. Treas. Reg. §54.9802-4(c)(3).
178. Treas. Reg. §54.9802-1(a).
179. Treas. Reg. §54.9802-4(c)(3)(ii).
180. Treas. Reg. §54.9802-4(c)(3)(vi).
181. Treas. Reg. §54.9802-4(c)(3)(iii)(B).
182. Treas. Reg. §54.9802-4(c)(3)(iii)(A).

c. **Exception for former employees.**[183] An ICHRA is treated as offered on the same terms even if the employer offers the ICHRA to some, but not all, former employees within a class. To the extent an ICHRA is offered to former employees, however, it must be offered to the former employees on the same terms as it is offered to all other active employees in that class. The preamble to the regulations reiterates that employers may continue to offer retiree-only HRAs that are not subject to these integration rules.[184]

4. **Opt-out provisions.**[185] For any month for which an individual is covered by an ICHRA, the individual is **not** eligible for a premium tax credit (PTC) for that same month. For that reason, the final regulations provide that employers who offer ICHRAs must allow participants to opt out of, and waive future reimbursements from, the ICHRA annually and on termination of employment.[186]

5. **Substantiation of individual health insurance coverage and Medicare.**[187] An ICHRA must implement and follow reasonable procedures to verify that all participants and dependents covered by the ICHRA are enrolled in individual health insurance coverage. For these purposes, reasonable procedures may consist of obtaining documentation from a third party or an attestation by the participant. Notably, the final regulations provide that new verification is required prior to the reimbursement of **any** expense.

   The Departments provide model attestations for participants to provide to the sponsor of the ICHRA.[188] The model attestations can be found at **uofi.tax/19b2x2** [www.irs.gov/pub/irs-utl/health_reimbursement_arrangements_faqs.pdf].

## Notice Requirements[189]

Because the offer of an HRA could render an employee ineligible for a PTC,[190] an **employer must provide written notice to eligible employees at least 90 days before** the beginning of each plan year of the effect of an ICHRA on the employee's eligibility for a PTC.

For participants who are not eligible for the ICHRA at the beginning of the plan year (such as new hires), the final regulations provide that the notice must be given no later than the date on which the participant is first eligible to participate in the ICHRA.

There are specific content requirements for the notice relating to the terms of the ICHRA and the participant's rights. Along with the final regulations, the Departments provided a model notice that ICHRAs may provide to employees to satisfy the notice requirements. The model notice can be found at **uofi.tax/19b2x2** [www.irs.gov/pub/irs-utl/health_reimbursement_arrangements_faqs.pdf].

## Individual Health Insurance Coverage and ERISA Plan Status[191]

In the final regulations, the Department of Labor (DOL) reiterates that an HRA itself is a group health plan that is subject to Employee Retirement Income Security Act (ERISA). However, the final regulations except from the scope of ERISA compliance individual insurance coverage integrated with the ICHRA when certain conditions are met.

---

183. Treas. Reg. §54.9802-4(c)(3)(iv).
184. TD 9867, IRB 2019-28 IRB 98, 119.
185. Treas. Reg. §54.9802-4(c)(4); TD 9867, 2019-28 IRB 98, 221.
186. IRC §36B(c)(4)(B).
187. 26 CFR §1.36B-2(c)(3)(vii)(A).
188. TD 9867, 2019-28 IRB 98, 198.
189. Treas. Reg. §54.9802-4(c)(6).
190. TD 9867, 2019-28 IRB 98, 181.
191. TD 9867, 2019-28 IRB 98, 165.

Significantly, the final regulations allow an employee to use a salary reduction arrangement under a cafeteria plan to pay the portion of the premium for individual market insurance coverage. This is permitted if the insurance was not purchased from an Exchange and not covered by the ICHRA. Thus, employers offering an ICHRA or qualified small employer HRA (QSEHRA) can also offer a related cafeteria plan that their employees may use to pay their share of the premiums on a pre-tax basis.[192]

> **Note.** For more information about QSEHRAs, see the 2019 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 3: Small Business Issues.

**Specific Safe Harbor Criteria.**[193] Under the DOL's safe harbor, the HRA must meet the following conditions.

1. The purchase of any individual health insurance coverage must be completely **voluntary** for employees and beneficiaries.
2. The sponsor of the ICHRA cannot select or endorse any particular issuer or insurance coverage.
3. Premium reimbursements must be limited to qualifying individual health insurance coverage that does not consist solely of excepted benefits (defined later).
4. The sponsor cannot receive consideration in the form of cash or otherwise in connection with the employee's selection or renewal of health insurance coverage.
5. Each plan participant must be notified annually that the individual health insurance coverage is not subject to title I of ERISA.

### Employer Mandate Compliance and ICHRAs

The final regulations do not provide specific rules regarding how an employer can satisfy the ACA's employer shared responsibility requirements by providing an ICHRA. The preamble to the regulations states that Treasury and IRS intend to propose safe harbors or other methods intended to reduce burdens and provide more predictability regarding the application of IRC §4980H.[194]

> **Note.** The employer shared responsibility requirement is often called the "employer mandate." For information about this ACA provision, see the 2019 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 3: Small Business Issues.

The preamble notes that although individuals offered ICHRAs integrated with Medicare are not eligible for a PTC[195] and thus do not need to know whether the ICHRA is affordable, employers still need to know whether the ICHRA is affordable for such individuals for employer mandate purposes.[196]

---

192. *FAQs on New Health Coverage Options for Employers and Employees*. Jun. 13, 2019. Department of the Treasury, Department of Labor, Department of Health and Human Services. [www.irs.gov/pub/irs-utl/health_reimbursement_arrangements_faqs.pdf] Accessed on Jul. 29, 2019.

193. TD 9867, 2019-28 IRB 98, 223.

194. TD 9867, 2019-28 IRB 98, 135.

195. TD 9867, 2019-28 IRB 98, 161.

196. IRC §36B(c)(2)(C); 26 CFR §§1.36B-2(c)(3)(v)(A)(1) and (2).

### Individual Market Special Enrollment Periods

The final regulations create a new individual market special enrollment period for employees and their dependents if they newly gain access to an ICHRA or a QSEHRA.[197] A similar requirement applies to employees/dependents who were previously offered, or enrolled in, the ICHRA/QSEHRA, as long as they were not covered by the ICHRA/QSHERA on the day immediately prior to the "triggering event."[198]

Examples of "triggering events" include, but are not limited to, the following.[199]

- Losing minimum essential coverage
- Enrolling in any non-calendar year group health plan or individual health insurance coverage
- Losing pregnancy-related coverage
- Losing medical coverage as described under §1902(a)(10)(C) of the Social Security Act
- Gaining a dependent or becoming a dependent through marriage, birth, adoption, placement for adoption, placement in foster care, or through a child support order
- Becoming newly eligible for enrollment in a qualified health plan through the exchange
- Becoming newly eligible or ineligible for advance payments of the PTC
- Gaining access to new qualified health plans as a result of a permanent move
- Unintentional, inadvertent, or erroneous enrollment or nonenrollment in a qualified health plan as the result of error, misrepresentation, misconduct, or inaction by a person conducting enrollment activities

**Note.** For more information about triggering events and a complete list of such events, see 45 CFR §155.420(d).

### Premium Tax Credit Eligibility and ICHRAs[200]

An individual who is eligible for an ICHRA is not eligible for a PTC for a month if the individual is enrolled in the ICHRA for the month, or the individual opts out of the ICHRA for the month, but the ICHRA is considered "affordable."[201] Under the final regulations, any ICHRA considered affordable automatically satisfies the "minimum value" requirement.[202]

The Departments state that by November 1, 2019, the Department of Health and Human Services (HHS) will provide resources to assist individuals offered an ICHRA with determining their eligibility for a PTC.[203]

## EXCEPTED BENEFIT HRA (EBHRA)[204]

The final regulations allow for the use of a stand-alone HRA that an employer can offer to active employees without regard to whether they are enrolled in other health coverage. This HRA is an excepted benefit under the Health Insurance Portability and Accountability Act of 1996 (HIPAA).[205]

---

197. Treas. Reg. §54.9802-4(c)(6)(J).
198. 45 CFR §155.420(d).
199. Ibid.
200. IRC §36B and 26 CFR §1.36B-2(c)(3)(i).
201. IRC §36B(c)(2)(C)(iii) and Treas. Regs. §§1.36B-2(c)(3)(vii)(A) and 1.36B-3(c).
202. Treas. Reg. §1.36B-2(c)(3)(i)(B).
203. TD 9867, 2019-28 IRB 98, 135.
204. TD 9867, 2019-28 IRB 98, 149.
205. PL 104-191.

### What are Excepted Benefits?[206]



An excepted benefit is a type of health coverage that does not provide comprehensive health coverage with the essential health benefits prescribed under the ACA.

EBHRA reimbursements may include the following.

- Limited scope dental and vision insurance
- COBRA continuation coverage
- Short-term limited duration insurance
- Cost sharing (co-pays and deductible)
- Long-term care coverage

The following requirements must be satisfied in order for an HRA to qualify as an EBHRA.[207]

1. **Otherwise not an integral part of the plan.**[208] In order to satisfy this requirement, the employer must offer the participant other group health plan coverage that is not limited to excepted benefits and that is not an HRA or other account-based group health plan.
2. **Limited in amount.**[209] The amount of new employer contributions each year cannot exceed **$1,800** (indexed for inflation after December 31, 2020). If the terms of the HRA allow unused amounts to be made available to participants and their dependents in later plan years, the amount of any carryover is disregarded for determining if benefit amounts are limited. Furthermore, if the plan sponsor provides more than one HRA or other account-based group health plan to the participant for the same time period, the amounts made available under all such plans are **aggregated** to determine whether the benefits are limited in amount. HRAs or other account-based group health plans that reimburse only excepted benefits are **not** included in determining whether the benefits are limited in amount.
3. **Prohibition on reimbursement of premiums for certain types of coverage.**[210] The EBHRA or other account-based group health plan must not reimburse premiums for individual health insurance coverage, group health plan coverage (other than COBRA continuation coverage or other continuation coverage), or Medicare Part A, B, C, or D, except that the HRA or other account-based group health plan may reimburse premiums for such coverage that consists solely of excepted benefits.
4. **Uniform availability.**[211] The EBHRA must be made available on a uniform basis to all similarly situated employees. A plan may treat participants as distinct groups of similarly situated individuals if the distinction between or among the groups of participants is based on a bona fide employment-based classification consistent with the employer's usual business practice.
5. **Notice.**[212] The rules regarding the time, manner, and content for summary plan descriptions (including a description of conditions pertaining to eligibility to receive benefits; annual or lifetime caps or other limits on benefits under the plan; and a description or summary of the benefits) applicable to plans subject to ERISA, as amended, can be found at 29 CFR §§2520.102-3(j)(2) and (3) and 29 CFR §2520.104b-2(a).[213]

---

206. 29 CFR §2590.732(c); *FAQs on New Health Coverage Options for Employers and Employees*. Jun. 13, 2019. Department of the Treasury, Department of Labor, Department of Health and Human Services. [www.irs.gov/pub/irs-utl/health_reimbursement_arrangements_faqs.pdf] Accessed on Jul. 29, 2019.

207. Treas. Reg. §54.9831-1(c)(3)(viii).

208. Treas. Reg. §54.9831-1(c)(3)(viii)(A).

209. Treas. Reg. §54.9831-1(c)(3)(viii)(B).

210. Treas. Reg. §54.9831-1(c)(3)(viii)(C).

211. Treas. Regs.§§54.9831-1(c)(3)(viii)(D) and 54.9802-1(d).

212. Treas. Reg. §54.9831-1(c)(3)(viii)(E).

213. 29 CFR §§2520.102-3(j)(2) and (3) and 29 CFR §2520.104b-2(a).

## UPDATED TAX FORMS — INDIVIDUALS

This section concerns recent IRS forms and guidance that affect individual taxpayers.

### NEW W-4 FORM[214]

On August 8, 2019, the IRS issued a draft of the 2020 Form W-4, *Employee's Withholding Certificate.* The draft form follows.

Form **W-4**
Department of the Treasury
Internal Revenue Service

**Employee's Withholding Certificate**

▶ **Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.**
▶ **Give Form W-4 to your employer.**
▶ **Your withholding is subject to review by the IRS.**

OMB No. 1545-0074
**2020**



**Step 1: Enter Personal Information**

(a) First name and middle initial | Last name | (b) Social security number

Address

City or town, state, and ZIP code

▶ **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

(c) ☐ **Single or Married filing separately**
☐ **Married filing jointly** (or Qualifying widow(er))
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

**Complete Steps 2 through 4 ONLY if they apply to you.** To see if you are exempt from withholding or if you have concerns about your privacy, see page 2. Everyone must complete Step 5. See instructions on page 2.

**Step 2: Multiple Jobs or Spouse Works**

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

**(a)** Use the estimator at *www.irs.gov/W4App* for most accurate withholding; **or**

**(b)** Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

**(c)** If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . . ▶ ☐

**CAUTION:** If you have privacy concerns, choose **(a)** or **(b).** If you and/or your spouse have income from self-employment, including as an independent contractor, choose **(a).**

**Complete Steps 3 through 4(b) on Form W-4 for only one of these jobs.** Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3 through 4(b) on the Form W-4 for the highest paying job.)

**Step 3: Claim Dependents**

If your income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ▶ $

Multiply the number of other dependents by $500 . . . . ▶ $

Add the amounts above and enter the total here . . . . . . . . . . . . . . . . **3** $

**Step 4 (optional): Other Adjustments**

**(a) Other income.** If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income. You should not include income from any jobs . . **4(a)** $

**(b) Deductions.** If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . . . . . . . . . . . . . . . . . . . **4(b)** $

**(c) Extra withholding.** Enter any additional tax you want withheld each **pay period** . **4(c)** $

**Step 5: Sign Here**

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

▶ **Employee's signature** (This form is not valid unless you sign it.) ▶ **Date**

**Employers Only** | Employer's name and address | First date of employment | Employer identification number (EIN)

**For Privacy Act and Paperwork Reduction Act Notice, see page 3.** Cat. No. 10220Q Form **W-4** (2020)

---

214. IRS News Rel. IR-2019-98 (May 31, 2019); *FAQs on the draft 2020 Form W-4*. Aug. 14, 2019. IRS. [www.irs.gov/newsroom/faqs-on-the-early-release-of-the-2020-form-w-4] Accessed on Aug. 26, 2019.

> **Note.** In 2020, employers can continue to compute tax withholding based on the information from the employee's most recently submitted Form W-4. Therefore, employees need not resubmit Form W-4 using the redesigned version unless there is a change in their circumstances affecting their tax withholding that they need to communicate to their employer.

The aim of the draft form is to increase the accuracy of tax withholding. Because personal exemptions were suspended during the TCJA period,[215] basing tax withholding on withholding exemptions is no longer justified. Therefore, the draft 2020 form takes a different approach.

The form is divided into five sections (referred to on the form as steps). In step 1, taxpayers provide personal information to identify themselves and select their filing status. If they claim the standard deduction and have no other taxable income or credits/deductions, then they only have to complete steps 1 and 5. However, taxpayers with multiple jobs and/or a working spouse should complete step 2. Taxpayers who are claiming dependents should complete step 3. Taxpayers with other income or deductions should complete step 4. Thus, where appropriate, completion of steps 2, 3, and 4 helps taxpayers improve the accuracy of their tax withholding.

The same set of withholding tables apply to both the old and new Forms W-4.

Instructions regarding the use of the new Form W-4 by nonresident aliens will be provided in the 2020 IRS Pub. 15-T, *Federal Income Tax Withholding Methods.* Nonresident aliens should use IRS Pub. 15-T in conjunction with the instructions provided in IRS Notice 1392.

## NEW FORM 1040-SR FOR SENIORS[216]

The Bipartisan Budget Act of 2018 (BBA) instructed the IRS to make a new form available for use by taxpayers who have attained age 65 by the end of the tax year. Accordingly, the IRS developed Form 1040-SR, *U.S. Tax Return for Seniors.* The IRS released the first draft form on July 11, 2019, which follows. As of the date this chapter was published, the IRS had not released the form instructions.

215. PL 115-97, §11041.

216. Bipartisan Budget Act of 2018, PL 115-123 §41106.

Form **1040-SR** Department of the Treasury—Internal Revenue Service (99)
**U.S. Tax Return for Seniors** **2019** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.



**Filing Status** Check only one box.
☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS)
☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

| Your first name and middle initial | Last name | Your social security number |
|---|---|---|
| If joint return, spouse's first name and middle initial | Last name | Spouse's social security number |
| Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | **Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse |
| City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). | | |
| Foreign country name / Foreign province/state/county / Foreign postal code | | If more than four dependents, see inst. and ✓ here ▶ ☐ |

**Standard Deduction** **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

**Age/Blindness** **You:** ☐ Were born before January 2, 1955 ☐ Are blind
**Spouse:** ☐ Was born before January 2, 1955 ☐ Is blind

**Dependents** (see instructions):

| (1) First name | Last name | (2) Social security number | (3) Relationship to you | (4) ✓ if qualifies for (see inst.): Child tax credit | Credit for other dependents |
|---|---|---|---|---|---|
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |

Attach Schedule B if required.

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | Wages, salaries, tips, etc. Attach Form(s) W-2 | | | | 1 | |
| 2a | Tax-exempt interest | 2a | | b Taxable interest | 2b | |
| 3a | Qualified dividends | 3a | | b Ordinary dividends | 3b | |
| 4a | IRA distributions | 4a | | b Taxable amount | 4b | |
| c | Pensions and annuities | 4c | | d Taxable amount | 4d | |
| 5a | Social security benefits | 5a | | b Taxable amount | 5b | |
| 6 | Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐ | | | | 6 | |
| 7a | Other income from Schedule 1, line 9 | | | | 7a | |
| b | Add lines 1, 2b, 3b, 4b, 4d, 5b, 6, and 7a. This is your **total income** ▶ | | | | 7b | |
| 8a | Adjustments to income from Schedule 1, line 22 | | | | 8a | |
| b | Subtract line 8a from line 7b. This is your **adjusted gross income** ▶ | | | | 8b | |
| 9 | **Standard deduction or itemized deductions** (from Schedule A) | 9 | | | | |
| 10 | Qualified business income deduction. Attach Form 8995 or Form 8995-A | 10 | | | | |
| 11a | Add lines 9 and 10 | | | | 11a | |
| b | **Taxable income.** Subtract line 11a from line 8b | | | | 11b | |

**Standard Deduction** See *Standard Deduction Chart* below.

**Standard Deduction Chart**

Don't use this chart if someone can claim you (or your spouse if filing jointly) as a dependent, your spouse itemizes on a separate return, or you were a dual-status alien. Instead, see instructions.

Add the number of boxes checked in the "Age/Blindness" section of *Standard Deduction* ▶

| IF your filing status is. . . | AND the number of boxes checked is. . . | THEN your standard deduction is. . . | IF your filing status is. . . | AND the number of boxes checked is. . . | THEN your standard deduction is. . . |
|---|---|---|---|---|---|
| Single | 0 | $12,200 | Head of household | 0 | $18,350 |
| | 1 | 13,850 | | 1 | 20,000 |
| | 2 | 15,500 | | 2 | 21,650 |
| Married filing jointly or Qualifying widow(er) | 0 | 24,400 | Married filing separately | 0 | 12,200 |
| | 1 | 25,700 | | 1 | 13,500 |
| | 2 | 27,000 | | 2 | 14,800 |
| | 3 | 28,300 | | 3 | 16,100 |
| | 4 | 29,600 | | 4 | 17,400 |

**For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 71930F Form **1040-SR** (2019)

| | | | | |
|---|---|---|---|---|
| **12a** | **Tax** (see instructions). Check if any from: 1 ☐ Form(s) 8814 2 ☐ Form 4972 3 ☐ ______ | **12a** | | |
| **b** | Add Schedule 2, line 3, and line 12a and enter the total . . . . . . . . . ▶ | | **12b** | |
| **13a** | Child tax credit or credit for other dependents . . . . . | **13a** | | |
| **b** | Add Schedule 3, line 7, and line 13a and enter the total . . . . . . . . . ▶ | | **13b** | |
| **14** | Subtract line 13b from line 12b. If zero or less, enter -0- . . . . . . . . . | | **14** | |
| **15** | Other taxes, including self-employment tax, from Schedule 2, line 10 . . . . | | **15** | |
| **16** | Add lines 14 and 15. This is your **total tax** . . . . . . . . . . . . . . ▶ | | **16** | |
| **17** | Federal income tax withheld from Forms W-2 and 1099 . . . . . . . . . | | **17** | |
| **18** | Other payments and refundable credits: | | | |
| **a** | Earned income credit (EIC) . . . . . . . . . . . . . . | **18a** | | |
| **b** | Additional child tax credit. Attach Schedule 8812 . . . . | **18b** | | |
| **c** | American opportunity credit from Form 8863, line 8 . . . | **18c** | | |
| **d** | Schedule 3, line 14 . . . . . . . . . . . . . . . . . | **18d** | | |
| **e** | Add lines 18a through 18d. These are your **total other payments and refundable credits** ▶ | | **18e** | |
| **19** | Add lines 17 and 18e. These are your **total payments** . . . . . . . . . ▶ | | **19** | |

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

## Refund

| | | | | |
|---|---|---|---|---|
| **20** | If line 19 is more than line 16, subtract line 16 from line 19. This is the amount you **overpaid** | | **20** | |
| **21a** | Amount of line 20 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐ | | **21a** | |
| **b** | Routing number ▶ **c** Type: ☐ Checking ☐ Savings | | | |
| **d** | Account number | | | |
| **22** | Amount of line 20 you want **applied to your 2020 estimated tax** ▶ | **22** | | |

Direct deposit? ▶ See instructions. ▶

## Amount You Owe

| | | | | |
|---|---|---|---|---|
| **23** | **Amount you owe.** Subtract line 19 from line 16. For details on how to pay, see instructions ▶ | | **23** | |
| **24** | Estimated tax penalty (see instructions) . . . . . . . ▶ | **24** | | |

## Third Party Designee

(Other than paid preparer)

Do you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions. ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

## Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

| | | | |
|---|---|---|---|
| Your signature | Date | Your occupation | If the IRS sent you an Identity Protection PIN, enter it here (see inst.) |
| Spouse's signature. If a joint return, **both** must sign. | Date | Spouse's occupation | If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) |
| Phone no. | Email address | | |

## Paid Preparer Use Only

| | | | | |
|---|---|---|---|---|
| Preparer's name | Preparer's signature | Date | PTIN | Check if: ☐ 3rd Party Designee ☐ Self-employed |
| Firm's name ▶ | | | Phone no. | |
| Firm's address ▶ | | | Firm's EIN ▶ | |

Go to *www.irs.gov/Form1040SR* for instructions and the latest information. Form **1040-SR** (2019)

The BBA directed the IRS to make Form 1040-SR "as similar as practicable" to Form 1040-EZ, *Income Tax Return for Single and Joint Filers With No Dependents.* Form 1040-EZ was eliminated by the TCJA.

### Using Form 1040-SR

As stated earlier, in order to use Form 1040-SR, the taxpayer must be 65 or older by the end of the tax year for which they are filing a return. For example, taxpayers who turn 65 on December 31, 2019, can use Form 1040-SR for the 2019 tax year, and taxpayers who are 65 at any time in 2020 can use the form for the 2020 tax year.

**No Limit on Income.** According to the BBA, the Form 1040-SR can be used by a taxpayer regardless of the amount of **any** item of taxable income or the **total amount** of taxable income for the tax year.

**Tax Deductions.** Although the BBA directed the IRS to make Form 1040-SR "as similar as practicable" to Form 1040-EZ, the draft Form 1040-SR allows taxpayers to claim either the standard deduction or itemized deductions (see Form 1040-SR, line 9).

**Observation.** At the time of writing, committee reports for the BBA were unavailable so it is unclear whether it was the legislators' intent to **require** users of Form 1040-SR to claim the standard deduction (as was the case for Form 1040-EZ).

**Tax Credits.** Users of Form 1040-SR can claim both refundable and nonrefundable tax credits (see lines 13b and 18 of the draft Form 1040-SR.

## NEW 2019 FORM 1040

On July 11, 2019, the IRS released a draft 2019 Form 1040, which is longer than the 2018 version. In addition, the number of schedules that taxpayers may need to attach to the Form 1040 was reduced from six to three.

The draft Form 1040 and Schedules 1–3 follow.

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2019** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

**Filing Status** Check only one box.
☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

| Your first name and middle initial | Last name | **Your social security number** |
|---|---|---|
| If joint return, spouse's first name and middle initial | Last name | **Spouse's social security number** |

| Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | **Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ **You** ☐ **Spouse** |
|---|---|---|
| City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). | | |

| Foreign country name | Foreign province/state/county | Foreign postal code | If more than four dependents, see instructions and ✓ here ▶ ☐ |
|---|---|---|---|



**Standard Deduction** **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

**Age/Blindness** **You:** ☐ Were born before January 2, 1955 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1955 ☐ Is blind

**Dependents** (see instructions):

| **(1)** First name | Last name | **(2)** Social security number | **(3)** Relationship to you | **(4)** ✓ if qualifies for (see instructions): Child tax credit | Credit for other dependents |
|---|---|---|---|---|---|
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |
| | | | | ☐ | ☐ |

**Standard Deduction for—**
- Single or Married filing separately, $12,200
- Married filing jointly or Qualifying widow(er), $24,400
- Head of household, $18,350
- If you checked any box under *Standard Deduction,* see instructions.

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | Wages, salaries, tips, etc. Attach Form(s) W-2 | | | | 1 | |
| 2a | Tax-exempt interest | 2a | | **b** Taxable interest. Attach Sch. B if required | 2b | |
| 3a | Qualified dividends | 3a | | **b** Ordinary dividends. Attach Sch. B if required | 3b | |
| 4a | IRA distributions | 4a | | **b** Taxable amount | 4b | |
| c | Pensions and annuities | 4c | | **d** Taxable amount | 4d | |
| 5a | Social security benefits | 5a | | **b** Taxable amount | 5b | |
| 6 | Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐ | | | | 6 | |
| 7a | Other income from Schedule 1, line 9 | | | | 7a | |
| b | Add lines 1, 2b, 3b, 4b, 4d, 5b, 6, and 7a. This is your **total income** ▶ | | | | 7b | |
| 8a | Adjustments to income from Schedule 1, line 22 | | | | 8a | |
| b | Subtract line 8a from line 7b. This is your **adjusted gross income** ▶ | | | | 8b | |
| 9 | **Standard deduction or itemized deductions** (from Schedule A) | 9 | | | | |
| 10 | Qualified business income deduction. Attach Form 8995 or Form 8995-A | 10 | | | | |
| 11a | Add lines 9 and 10 | | | | 11a | |
| b | **Taxable income.** Subtract line 11a from line 8b | | | | 11b | |

**For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 11320B Form **1040** (2019)

| | | | | |
|---|---|---|---|---|
| 12a | **Tax** (see inst.) Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐ | 12a | | |
| b | Add Schedule 2, line 3, and line 12a and enter the total ▶ | | 12b | |
| 13a | Child tax credit or credit for other dependents | 13a | | |
| b | Add Schedule 3, line 7, and line 13a and enter the total ▶ | | 13b | |
| 14 | Subtract line 13b from line 12b. If zero or less, enter -0- | | 14 | |
| 15 | Other taxes, including self-employment tax, from Schedule 2, line 10 | | 15 | |
| 16 | Add lines 14 and 15. This is your **total tax** ▶ | | 16 | |
| 17 | Federal income tax withheld from Forms W-2 and 1099 | | 17 | |
| 18 | Other payments and refundable credits: | | | |
| a | Earned income credit (EIC) | 18a | | |
| b | Additional child tax credit. Attach Schedule 8812 | 18b | | |
| c | American opportunity credit from Form 8863, line 8 | 18c | | |
| d | Schedule 3, line 14 | 18d | | |
| e | Add lines 18a through 18d. These are your **total other payments and refundable credits** ▶ | | 18e | |
| 19 | Add lines 17 and 18e. These are your **total payments** ▶ | | 19 | |

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

## Refund

Direct deposit? See instructions.

| | | | | |
|---|---|---|---|---|
| 20 | If line 19 is more than line 16, subtract line 16 from line 19. This is the amount you **overpaid** | | 20 | |
| 21a | Amount of line 20 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐ | | 21a | |
| ▶ b | Routing number ▶ c Type: ☐ Checking ☐ Savings | | | |
| ▶ d | Account number | | | |
| 22 | Amount of line 20 you want **applied to your 2020 estimated tax** ▶ | 22 | | |

## Amount You Owe

| | | | | |
|---|---|---|---|---|
| 23 | **Amount you owe.** Subtract line 19 from line 16. For details on how to pay, see instructions ▶ | | 23 | |
| 24 | Estimated tax penalty (see instructions) ▶ | 24 | | |

## Third Party Designee

(Other than paid preparer)

Do you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions. ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

## Sign Here

Joint return? See instructions. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

| | | | |
|---|---|---|---|
| Your signature | Date | Your occupation | If the IRS sent you an Identity Protection PIN, enter it here (see inst.) |
| Spouse's signature. If a joint return, **both** must sign. | Date | Spouse's occupation | If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) |
| Phone no. | Email address | | |

## Paid Preparer Use Only

| | | | | |
|---|---|---|---|---|
| Preparer's name | Preparer's signature | Date | PTIN | Check if: ☐ 3rd Party Designee ☐ Self-employed |
| Firm's name ▶ | | Phone no. | | |
| Firm's address ▶ | | | Firm's EIN ▶ | |

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2019)

2

**SCHEDULE 1**
**(Form 1040 or 1040-SR)**
Department of the Treasury
Internal Revenue Service

# Additional Income and Adjustments to Income

▶ Attach to Form 1040 or 1040-SR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. **01**

Name(s) shown on Form 1040 or 1040-SR | **Your social security number**

DRAFT AS OF July 11, 2019 DO NOT FILE

| | | | |
|---|---|---|---|
| **Part I** | **Additional Income** | | |
| 1 | Taxable refunds, credits, or offsets of state and local income taxes | 1 | |
| 2a | Alimony received | 2a | |
| b | Date of original divorce or separation agreement (see instructions) ▶ | | |
| 3 | Business income or (loss). Attach Schedule C | 3 | |
| 4 | Other gains or (losses). Attach Form 4797 | 4 | |
| 5 | Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E | 5 | |
| 6 | Farm income or (loss). Attach Schedule F | 6 | |
| 7 | Unemployment compensation | 7 | |
| 8 | Other income. List type and amount ▶ | 8 | |
| 9 | Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a | 9 | |
| **Part II** | **Adjustments to Income** | | |
| 10 | Educator expenses | 10 | |
| 11 | Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 | 11 | |
| 12 | Health savings account deduction. Attach Form 8889 | 12 | |
| 13 | Moving expenses for members of the Armed Forces. Attach Form 3903 | 13 | |
| 14 | Deductible part of self-employment tax. Attach Schedule SE | 14 | |
| 15 | Self-employed SEP, SIMPLE, and qualified plans | 15 | |
| 16 | Self-employed health insurance deduction | 16 | |
| 17 | Penalty on early withdrawal of savings | 17 | |
| 18a | Alimony paid | 18a | |
| b | Recipient's SSN ▶ | | |
| c | Date of original divorce or separation agreement (see instructions) ▶ | | |
| 19 | IRA deduction | 19 | |
| 20 | Student loan interest deduction | 20 | |
| 21 | Reserved for future use | 21 | |
| 22 | Add lines 10 through 21. These are your **adjustments to income.** Enter here and on Form 1040 or 1040-SR, line 8a | 22 | |

**For Paperwork Reduction Act Notice, see your tax return instructions.** Cat. No. 71479F **Schedule 1 (Form 1040 or 1040-SR) 2019**

**SCHEDULE 2**
**(Form 1040 or 1040-SR)**
Department of the Treasury
Internal Revenue Service

# Additional Taxes

▶ Attach to Form 1040 or 1040-SR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. **02**

Name(s) shown on Form 1040 or 1040-SR | **Your social security number**

DRAFT AS OF July 11, 2019 DO NOT FILE

| | | | |
|---|---|---|---|
| **Part I** | **Tax** | | |
| 1 | Alternative minimum tax. Attach Form 6251 | 1 | |
| 2 | Excess advance premium tax credit repayment. Attach Form 8962 | 2 | |
| 3 | Add lines 1 and 2. Enter here and include on Form 1040 or 1040-SR, line 12b | 3 | |
| **Part II** | **Other Taxes** | | |
| 4 | Self-employment tax. Attach Schedule SE | 4 | |
| 5 | Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919 | 5 | |
| 6 | Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required | 6 | |
| 7a | Household employment taxes. Attach Schedule H | 7a | |
| b | Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required | 7b | |
| 8 | Taxes from: a ☐ Form 8959 b ☐ Form 8960 c ☐ Instructions; enter code(s) | 8 | |
| 9 | Section 965 net tax liability installment from Form 965-A [9] | | |
| 10 | Add lines 4 through 8. These are your **total other taxes.** Enter here and on Form 1040 or 1040-SR, line 15 | 10 | |

**For Paperwork Reduction Act Notice, see your tax return instructions.** Cat. No. 71478U **Schedule 2 (Form 1040 or 1040-SR) 2019**

| SCHEDULE 3 (Form 1040 or 1040-SR) Department of the Treasury Internal Revenue Service | **Additional Credits and Payments** ▶ Attach to Form 1040 or 1040-SR. ▶ Go to *www.irs.gov/Form1040* for instructions and the latest information. | OMB No. 1545-0074 2019 Attachment Sequence No. 03 |
|---|---|---|
| Name(s) shown on Form 1040 or 1040-SR | | **Your social security number** |



| | | | |
|---|---|---|---|
| **Part I** | **Nonrefundable Credits** | | |
| 1 | Foreign tax credit. Attach Form 1116 if required | 1 | |
| 2 | Credit for child and dependent care expenses. Attach Form 2441 | 2 | |
| 3 | Education credits from Form 8863, line 19 | 3 | |
| 4 | Retirement savings contributions credit. Attach Form 8880 | 4 | |
| 5 | Residential energy credit. Attach Form 5695 | 5 | |
| 6 | Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐ ______ | 6 | |
| 7 | Add lines 1 through 6. Enter here and include on Form 1040 or 1040-SR, line 13b | 7 | |
| **Part II** | **Other Payments and Refundable Credits** | | |
| 8 | 2019 estimated tax payments and amount applied from 2018 return | 8 | |
| 9 | Net premium tax credit. Attach Form 8962 | 9 | |
| 10 | Amount paid with request for extension to file (see instructions) | 10 | |
| 11 | Excess social security and tier 1 RRTA tax withheld | 11 | |
| 12 | Credit for federal tax on fuels. Attach Form 4136 | 12 | |
| 13 | Credits from Form: **a** ☐ 2439 **b** ☐ Reserved **c** ☐ 8885 **d** ☐ ______ | 13 | |
| 14 | Add lines 8 through 13. Enter here and on Form 1040 or 1040-SR, line 18d | 14 | |

**For Paperwork Reduction Act Notice, see your tax return instructions.** Cat. No. 71480G **Schedule 3 (Form 1040 or 1040-SR) 2019**

# TCJA UPDATE — INDIVIDUAL

## IRS PUBLICATION ON TAX REFORM

IRS Pub. 5307, *Tax Reform Basics for Individuals and Families,* provides a summary of the TCJA provisions affecting individual taxpayers and their families. The information provided ranges from tax rate changes and their effects on tax withholding calculations to changes in tax deductions and credits. Although it is a useful reference guide, this publication does not supersede or replace IRS tax forms, instructions, and other official guidance concerning the TCJA.

## CREDIT FOR OTHER DEPENDENTS[217]

Besides modifying the child tax credit (CTC), the TCJA also introduced a new tax credit for other dependents (referred to in this material as "other dependents credit," or ODC).[218] This nonrefundable tax credit is $500 for **each** of a taxpayer's dependents other than qualifying children and applies during the **TCJA period.**

### Who Qualifies?

Generally, the ODC can only be claimed for a taxpayer's qualifying dependents other than their children, **except** that it can also be claimed for a qualifying child who does not have an SSN.[219] Apart from this exception, the ODC cannot be claimed for a qualifying child of the taxpayer or any other taxpayer.[220] This is because, during the TCJA period, a taxpayer can claim the CTC for a qualifying child other than one who does not have an SSN.[221]

> **Note.** In all cases, the qualifying dependent for purposes of the ODC **must be** a citizen, national, or resident of the United States unlike the CTC, which can be claimed for qualifying children who are residents of Canada or Mexico.[222]

217. IRC §24(h)(4).
218. PL 115-97, §11022.
219. IRC §§24(h)(4)(A) and (C) and 152.
220. IRC §152(d)(1)(D).
221. IRC §§24(a), (c), and (h)(7).
222. IRC §24(h)(4)(B).

Although the personal exemption is suspended during the TCJA period,[223] the following requirements for claiming a personal exemption for a dependent also apply to the ODC.[224]

1. Relationship requirement
2. Support test
3. Gross income requirement

**Relationship Requirement.** The qualifying **relative** must bear one of the following relationships to the taxpayer.[225]

- A child or grandchild
- A sibling or stepsibling
- A father, mother, or ancestor of either
- A stepparent
- A niece or nephew
- An aunt or uncle
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
- An individual (other than a spouse) who lived with the taxpayer for the tax year and is a member of the taxpayer's household

**Support Test.** The taxpayer claiming the ODC must provide more than 50% of the qualifying relative's support during the year.[226]

**Gross Income Requirement.** The qualifying relative's gross income for the year must be less than the personal exemption amount.[227] Because the personal exemption is zero during the TCJA period, the IRS clarified that the personal exemption amount is **treated as** $4,150 (adjusted for inflation) during this period.[228] For 2019, the qualifying relative's gross income must be **less than $4,200.**[229]

> **Note.** There is no gross income requirement for a qualifying child.[230]

### Determining the Credit

**Overall Limit on Nonrefundable Credits.** The ODC is subject to the overall limit on nonrefundable credits, which is a taxpayer's regular tax liability reduced by the allowable foreign tax credit (FTC) and increased by the taxpayer's alternative minimum tax (AMT) liability.[231] For example, a taxpayer with $300 of regular tax liability and $10 of FTC and zero AMT could claim a maximum ODC of $290 ($300 regular tax – $10 FTC).

---

223. TCJA §11041.
224. IRC §152(d).
225. IRC §152(d)(2).
226. Ibid.
227. IRC §152(d)(1)(B).
228. IRS Notice 2018-70, 2018-38 IRB 441.
229. Rev. Proc. 2018-57, 2018-49 IRB 827.
230. IRC §152(c).
231. IRC §26(a).

**Limitation Based on Modified Adjusted Gross Income.**[232] The ODC is not available to higher income taxpayers.[233] Like the CTC, the ODC is reduced (but not below zero) by $50 for each $1,000 (or fraction thereof) by which the taxpayer's MAGI exceeds the applicable threshold amount. For this purpose, MAGI is a taxpayer's AGI with the addback of certain foreign/U.S. possessions earned income exclusions under IRC §§911, 931, and 933. The amount of the threshold depends on the taxpayer's filing status. The applicable threshold amounts are **not** subject to inflation adjustments; therefore, the amounts that apply to **every** tax year in the TCJA period are as follows.[234]

| Filing Status | Lower Threshold | Upper Threshold [a] |
|---|---|---|
| MFJ | $400,000 | $409,001 |
| MFS | 200,000 | 209,001 |
| Other | 200,000 | 209,001 |

[a] MAGI at which the ODC is fully phased out.

The following example illustrates the ODC qualification requirements and phase-out.

**Example 11.** Patrizia Verdi is a single U.S. citizen. In 2019, Patrizia has a MAGI of $205,053 and would like to claim the ODC for her grandmother Margherita who is an Italian citizen and U.S. permanent resident. Margherita received $4,175 of income in 2019 and Patrizia provided 80% of her financial support.

Because Margherita is appropriately related to Patrizia, is a U.S. permanent resident, received more than 50% of her support from Patrizia, and had less than $4,200 of income, Patrizia can claim the ODC for Margherita. However, the maximum ODC that Patrizia can claim for Margherita in 2019 is limited to $200, which is calculated as follows.

**$205,053 MAGI − $200,000 lower threshold = $5,053**

**$5,053 ÷ $1,000 = 5.05, rounded up to 6**

**6 × $50 reduction per $1,000 of MAGI in excess of threshold = $300 total reduction in ODC**

**$500 maximum ODC − $300 reduction = $200 ODC**

**Caution.** Tax practitioners must exercise due diligence when claiming the ODC and complete the relevant sections of Form 8867, *Paid Preparer's Due Diligence Checklist*. Due diligence and the exposure to the due diligence penalty[235] is discussed in the next section.

## HEAD OF HOUSEHOLD DUE DILIGENCE

Following passage of the TCJA, the IRC §6695(g) due diligence penalty (DDP) applies to tax preparers who fail to exercise due diligence in determining a taxpayer's eligibility for the head of household (HoH) filing status or in claiming the ODC.[236] These changes apply to tax years beginning after December 31, 2017.[237]

232. IRC §24(b).

233. *Child Tax Credit and Credit for Other Dependents at a Glance*. Nov. 14, 2018. IRS. [www.irs.gov/credits-deductions/child-tax-credit-and-credit-for-other-dependents-at-a-glance] Accessed on Jun. 10, 2019.

234. IRC §24(h)(3).

235. IRC §6695(g).

236. TCJA §11001(b).

237. TCJA §11001(c).

For 2019 tax returns or claims for refund filed in 2020, the DDP is $530.[238] Tax preparers are charged this penalty for **each** instance of failure to exercise due diligence on a tax return.[239] Therefore, multiple DDPs can be assessed for a preparer claiming HoH status, the ODC, and/or one or more refundable tax credits on a client's tax return.

## IRS Regulations[240]

On November 26, 2018, regulations were published regarding the due diligence a tax preparer must perform when preparing a tax return claiming HoH status, the ODC, and/or a refundable tax credit. These regulations detail the **knowledge and documentation** requirements necessary to demonstrate that a preparer acted diligently in this regard.

**Knowledge Requirements.** There are two knowledge requirements in the regulations that the tax preparer must meet.[241]

1. The tax preparer must **not** know, or have reason to know, that any information used in determining the taxpayer's eligibility for HoH status claimed on the return or claim for refund is incorrect.
2. The tax preparer may not ignore the implications of information furnished to them, or known by them, and must make reasonable inquiries if a reasonable and well-informed tax preparer knowledgeable in the law would conclude that the information furnished to them appears to be incorrect, inconsistent, or incomplete.

The wording of these requirements is similar to wording in Circular 230, particularly regarding the second requirement.[242] In the preamble to the final regulations, the IRS indicates that the language used in the knowledge requirements mirrors the pre-existing language in Circular 230 to avoid confusing tax preparers and decreasing overall clarity.[243]

***Pre-Existing Knowledge.*** In response to a commenter on the proposed regulations, the IRS clarified that pre-existing knowledge acquired by a tax preparer outside the context of their tax preparation practice does **not** meet these knowledge requirements.[244] A new example was added to the final regulations emphasizing this exclusion.[245]

> **Example 12.** Sue is an enrolled agent. Each year, she prepares the tax return for her nephew, Brock. Sue knows that Brock's children live with him for 2019; however, based upon Treas. Reg §1.6695-2, she must still request and retain copies of documents used to determine HoH status, the CTC, or the American opportunity credit.

**Documentation Requirements.** Tax preparers claiming HoH status on a tax return are subject to the following documentation requirements.

1. Contemporaneous records
2. Due diligence checklist
3. Record retention

***Contemporaneous Records.***[246] When making inquiries to establish a taxpayer's eligibility for HoH status, a tax preparer must **contemporaneously** document in their paper or electronic files the inquiries made and the responses received.

---

238. Rev. Proc. 2018-57, 2018-49 IRB 827.

239. IRC §6695(g).

240. TD 9842, 2018-48 IRB 783.

241. Treas. Reg. §1.6695-2(b)(3)(i).

242. See Circular 230, §10.34(d).

243. TD 9842, 2018-48 IRB 783, 784.

244. Ibid.

245. Treas. Reg. §1.6695-2(b)(3)(ii)(F).

246. Treas. Reg. §1.6695-2(b)(3)(i).

***Paid Preparer's Due Diligence Checklist.***[247] A tax return preparer demonstrates satisfaction of due diligence requirements by completing Form 8867 (or other prescribed form) and including it in the taxpayer's tax return. Completion of the form must be based on information received from the taxpayer or otherwise reasonably obtained or known by the tax preparer (other than excluded pre-existing knowledge).

Multiple Forms 8867 may be required for one tax return (e.g., a nonsigning tax preparer determines HoH and ODC eligibility and a signing tax preparer determines eligibility for refundable tax credits).

***Record Retention Requirements.***[248] Tax preparers must **retain** the following records in paper or electronic format.

1. A copy of the completed and filed Form 8867
2. Copies of any taxpayer documents relied upon to determine eligibility for HoH filing status
3. Records showing how, when, and from whom the information used to prepare Form 8867 was obtained
4. A record of any additional questions asked regarding eligibility for HoH filing status and the taxpayer's answers

These records must be kept for three years from the **latest** of:

- The due date of the tax return (not including extensions),
- The date the return was filed (if e-filed by the tax preparer),
- The date the return was presented to the taxpayer for signature (if **not** e-filed by the tax preparer), and
- The date the portion of the return was submitted to the signing tax return preparer (in the case of a nonsigning tax return preparer).

The following example illustrates application of the new tax preparer due diligence requirements when claiming HoH status on a tax return.

**Example 13.** Catherine Thomson has been preparing John Hansen's individual tax return for several years. In 2017, John, a single taxpayer and a university employee, informed Catherine that he paid 60% of the cost of keeping up a home that was his elderly father's main home for all of 2017. After establishing that John's father qualified as his dependent, Catherine prepared John's 2017 tax return using HoH status and claiming John's father as a dependent.

In February 2019, John emailed his 2018 tax information to Catherine along with a note that he wished to continue using HoH filing status and claiming his father as a dependent. To comply with the new due diligence rules, Catherine asked John to verify that his father was still his dependent and that he could continue to claim HoH filing status in 2018. Then Catherine documented how and when she contacted John along with the answers John provided in response to her inquiries. Although John provided no supporting documentation, he confirmed that this was available if required.

Catherine prepared and e-filed John's 2018 tax return on March 10, 2019, using the HoH filing status and claiming the ODC for John's father. Included in John's 2018 tax return was Form 8867, which Catherine completed as follows.

247. Treas. Reg. §1.6695-2(b)(1); Instructions for Form 8867.

248. Instructions for Form 8867.

## For Example 13



Form **8867**

Department of the Treasury
Internal Revenue Service

# Paid Preparer's Due Diligence Checklist

*Earned Income Credit (EIC), American Opportunity Tax Credit (AOTC), Child Tax Credit (CTC) (including the Additional Child Tax Credit (ACTC) and Credit for Other Dependents (ODC)), and Head of Household (HOH) Filing Status*

**▶ To be completed by preparer and filed with Form 1040, 1040NR, 1040SS, or 1040PR.**

**▶ Go to *www.irs.gov/Form8867* for instructions and the latest information.**

OMB No. 1545-0074
2018
Attachment Sequence No. **70**

| Taxpayer name(s) shown on return | Taxpayer identification number |
|---|---|
| John Hansen | 123-45-6789 |

Enter preparer's name and PTIN
Catherine Thomson P01234567

**Part I** **Due Diligence Requirements**

| Please check the appropriate box for the credit(s) and/or HOH filing status claimed on this return and complete the related Parts I–V for the benefit(s), and/or HOH filing status claimed (check all that apply). | EIC | CTC/ ACTC/ODC | AOTC | HOH |
|---|---|---|---|---|
| | ☐ | ☒ | ☐ | ☒ |

| | | | | |
|---|---|---|---|---|
| **1** | Did you complete the return based on information for tax year 2018 provided by the taxpayer or reasonably obtained by you? . . . . . . . . . . . | ☒ **Yes** | ☐ **No** | |
| **2** | If credits are claimed on the return, did you complete the applicable EIC and/ or CTC/ACTC/ODC worksheets found in the Form 1040, 1040SS, 1040PR, 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? . . . . . . | ☒ **Yes** | ☐ **No** | ☐ **N/A** |
| **3** | Did you satisfy the knowledge requirement? To meet the knowledge requirement, you must do both of the following.<br>• Interview the taxpayer, ask questions, and document the taxpayer's responses to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status.<br>• Review information to determine that the taxpayer is eligible to claim the credit(s) and/or HOH filing status and the amount of any credit(s) claimed. | ☒ **Yes** | ☐ **No** | |
| **4** | Did any information provided by the taxpayer or a third party for use in preparing the return, or information reasonably known to you, appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b. If "No," go to question 5.) . . . . . . . . . . . . . . . . . . . | ☐ **Yes** | ☒ **No** | |
| **a** | Did you make reasonable inquiries to determine the correct, complete, and consistent information? . . . . . . . . . . . . . . . . . . . | ☐ **Yes** | ☐ **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.) . . . . . . . . . . . . . . . . . . . . . . . . | ☐ **Yes** | ☐ **No** | |
| **5** | Did you satisfy the record retention requirement? To meet the record retention requirement, you must keep a copy of your documentation referenced in 4b, a copy of this Form 8867, a copy of any applicable worksheet(s), a record of how, when, and from whom the information used to prepare Form 8867 and any applicable worksheet(s) was obtained, and a copy of any document(s) provided by the taxpayer that you relied on to determine eligibility for the credit(s) and/or HOH filing status or to compute the amount of the credit(s) . . . . . . . . . . . . . . . . . . . | ☒ **Yes** | ☐ **No** | |
| | 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 the credit(s) and/or HOH filing status and the amount of any credit(s) claimed on the return if his/her return is selected for audit? . . . . . . . . . . . . . . . . . . . . . . . . | ☒ **Yes** | ☐ **No** | |
| **7** | Did you ask the taxpayer if any of these credits were disallowed or reduced in a previous year? . . . . . . . . . . . . . . . . . . .<br>(If credits were disallowed or reduced, go to question 7a; if not, go to question 8.) | ☐ **Yes** | ☐ **No** | ☒ **N/A** |
| **a** | Did you complete the required recertification Form 8862? . . . . . . . | ☐ **Yes** | ☐ **No** | ☒ **N/A** |
| **8** | If the taxpayer is reporting self-employment income, did you ask questions to prepare a complete and correct Form 1040, Schedule C? . . . . . . . | ☐ **Yes** | ☐ **No** | ☒ **N/A** |

**For Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 26142H Form **8867** (2018)

## For Example 13

Form 8867 (2018) Page **2**

**Part II** **Due Diligence Questions for Returns Claiming EIC** (If the return does not claim EIC, go to Part III.)

| | EIC | CTC/ ACTC/ODC | AOTC | HOH |
|---|---|---|---|---|
| **9a** 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, or to claim the EIC if the taxpayer has no qualifying child? (Skip 9b and 9c if the taxpayer is claiming the EIC and does not have a qualifying child.) | ☐ **Yes** ☐ **No** | | | |
| **b** Did you ask the taxpayer if the child lived with the taxpayer for over half of the year, even if the taxpayer has supported the child the entire year? | ☐ **Yes** ☐ **No** | | | |
| **c** Did you explain to the taxpayer the rules about claiming the EIC when a child is the qualifying child of more than one person (tiebreaker rules)? | ☐ **Yes** ☐ **No** ☐ **N/A** | | | |

**Part III** **Due Diligence Questions for Returns Claiming CTC/ACTC/ODC** (If the return does not claim CTC, ACTC, or ODC, go to Part IV.)

| | EIC | CTC/ ACTC/ODC | AOTC | HOH |
|---|---|---|---|---|
| **10** Have you determined that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national, or resident of the United States? | | ☒ **Yes** ☐ **No** | | |
| **11** Did you explain to the taxpayer that he/she may not claim the CTC/ACTC if the taxpayer has not lived with the child for over half of the year, even if the taxpayer has supported the child, unless the child's custodial parent has released a claim to exemption for the child? | | ☐ **Yes** ☐ **No** ☒ **N/A** | | |
| **12** Did you explain to the taxpayer the rules about claiming the CTC/ACTC/ODC for a child of divorced or separated parents (or parents who live apart), including any requirement to attach a Form 8332 or similar statement to the return? | | ☐ **Yes** ☐ **No** ☒ **N/A** | | |

**Part IV** **Due Diligence Questions for Returns Claiming AOTC** (If the return does not claim AOTC, go to Part V.)

| | EIC | CTC/ ACTC/ODC | AOTC | HOH |
|---|---|---|---|---|
| **13** Did the taxpayer provide the required substantiation for the credit, including a Form 1098-T and/or receipts for the qualified tuition and related expenses for the claimed AOTC? | | | ☐ **Yes** ☐ **No** | |

**Part V** **Due Diligence Questions for Claiming HOH** (If the return does not claim HOH filing status, go to Part VI.)

| | EIC | CTC/ ACTC/ODC | AOTC | HOH |
|---|---|---|---|---|
| **14** Have you determined that the taxpayer was unmarried or considered unmarried on the last day of the tax year and provided more than half of the cost of keeping up a home for the year for a qualifying person? | | | | ☒ **Yes** ☐ **No** |

**Part VI** **Eligibility Certification**

► **You will have complied with all due diligence requirements for claiming the applicable credit(s) and/or HOH filing status on the return of the taxpayer identified above if you:**

A. 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/or HOH filing status and to determine the amount of the credit(s) claimed;

B. Complete this Form 8867 truthfully and accurately and complete the actions described in this checklist for any applicable credit(s) claimed and HOH filing status, if claimed;

C. Submit Form 8867 in the manner required; **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 credit(s) claimed;
3. Copies of any documents provided by the taxpayer on which you relied to determine eligibility for the credit(s) and/or HOH filing status;
4. A record of how, when, and from whom the information used to prepare this form and the applicable worksheet(s) was obtained; and
5. A record of any additional questions you may have asked to determine eligibility to claim the credit(s), and/or HOH filing status and the amount(s) of any credit(s) claimed and the taxpayer's answers.

► **If you have not complied with all due diligence requirements, you may have to pay a $520 penalty for each failure to comply related to a claim of an applicable credit or HOH filing status.**

| | |
|---|---|
| **15** Do you certify that all of the answers on this Form 8867 are, to the best of your knowledge, true, correct, and complete? | ☒ **Yes** ☐ **No** |

Form **8867** (2018)

Finally, Catherine made arrangements to keep the following 2018 records until **April 17, 2022** (i.e., three years from the April 17, 2019 due date of John's 2018 tax return).

1. A copy of the completed and filed Form 8867
2. Documentation of how and when she obtained the information from John to prepare the Form 8867
3. A record of the questions she asked John regarding his eligibility for HoH filing status, along with John's responses

### Practitioner Planning Tip

Tax preparers do not need to obtain documentary evidence from their clients in support of the HoH filing status (e.g., receipts substantiating financial support of a qualified dependent). It is enough that the client confirms that such documentation is available.

## ISSUES ARISING FROM THE SALT LIMITATION

The TCJA's introduction of the state and local taxes (SALT) limit added complexity to the preparation of individual tax returns. State workarounds using charitable contributions, state tax refund taxability, the interaction with the business use of home deduction,[249] and the impact on the net investment income tax (NIIT) are discussed next.

### Practitioner Planning Tip

Because of the restrictiveness of the SALT limitation, it is more important than ever to determine how each item of property is used and where real property taxes can be deducted. For example, real estate taxes pertaining to an investment property are not subject to the SALT limit. Therefore, they can either be deducted or capitalized subject to the requirements of IRC §266.

### Contributions in Exchange for State or Local Tax Credits

Due to the introduction of the $10,000 limit ($5,000 for MFS taxpayers) on the deduction of state and local taxes during the TCJA period,[250] some states (e.g., New York and New Jersey) created workarounds allowing state tax credits for contributions made to a state-created charitable fund in lieu of paying real property taxes directly.[251] In response, the IRS issued proposed regulations on August 23, 2018, which provide rules regarding payments or property transfers to an **eligible charitable organization** in return for a corresponding state or local tax credit.

249. IRC §280A.

250. TCJA §11042; IRC §164(b)(6).

251. *Treasury deals final blow to SALT cap workarounds in high-tax states*. Davison, Laura. Jun. 11, 2019. Accounting Today. [www.accountingtoday.com/articles/treasury-deals-final-blow-to-salt-cap-workarounds-in-high-tax-states] Accessed on Jun. 12, 2019.

These proposed regulations were followed by final regulations published in the Federal Register on June 13, 2019.[252] Generally, there are no major differences between the proposed and final regulations. However, on June 11, 2019, the IRS issued a notice of a **proposed** safe harbor permitting an IRC §164 deduction for the portion of a charitable contribution deduction disallowed by these regulations.[253] This proposed safe harbor can significantly affect certain taxpayers (as discussed later).

**Effective Date.** These changes (including the proposed safe harbor mentioned later) apply to amounts paid or property transferred by individuals **after** August 27, 2018.[254]

**Eligible Charitable Organization.** An eligible charitable organization receiving such a contribution is any organization eligible to receive deductible contributions and to establish tax credits under IRC §170(c).[255]

**State or Local Tax Definition.** For purposes of these regulations, a state or local tax means a tax imposed by a state, a possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia.[256]

**State Tax Credit Limitation.** As a result of these regulations, individual taxpayers must generally reduce their federal charitable contribution deduction by the amount of any state or local tax **credit** they receive or expect to receive.[257] For this purpose, the amount of such credit is the maximum credit allowable for the charitable contribution.[258] Therefore, absent the proposed safe harbor described later, **no tax deduction is allowed** for the disallowed portion of the charitable contribution.

***De Minimis Exception.*** A de minimis exception to the general limitation is provided. Under this exception, a taxpayer does not reduce their charitable contribution deduction when the **total** amount of the state and local tax credits received or expected to be received does not exceed 15% of the payment or the FMV of the property transferred.[259]

> **Example 14.** On November 28, 2018, Tyler donated an automobile with an FMV of $2,500 to an eligible organization and received a local real estate tax credit of $300. Because Tyler's local real estate tax credit is not more than 15% of the automobile's FMV (i.e., $2,500 × 15% = $375), his 2018 federal charitable contribution deduction for the donation of the automobile is unaffected.

***Proposed Safe Harbor for Disallowed Deductions.***[260] To mitigate the impact of the §170 regulations, the IRS intends to publish a proposed regulation amending Treas. Reg. §1.164-3 to provide a safe harbor for certain individuals who make cash contributions to a charitable entity in return for a state or local tax credit.

Consequently, this safe harbor allows an individual who itemizes deductions to claim an IRC §164 SALT deduction for charitable contributions disallowed by the **state tax credit limitation.** This treatment as a §164 state or local tax payment is allowed in the tax year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for either that tax year or the preceding tax year. The portion of the tax payment not so applied is carried forward and treated as a §164 state or local tax payment in the tax year or years when it is used to offset the individual's state or local tax liability.

252. TD 9864, 2019-27 IRB 6.

253. IRS Notice 2019-12, 2019-27 IRB 57.

254. Treas. Reg. §1.170A-1(h)(3)(viii); IRS Notice 2019-12, 2019-27 IRB 57.

255. Treas. Reg. §1.170A-1(h)(3)(i).

256. Treas. Reg. §1.170A-1(h)(3)(v).

257. Treas. Reg. §1.170A-1(h)(3)(i).

258. Treas. Reg. §1.170A-1(h)(3)(iv).

259. Treas. Reg. §1.170A-1(h)(3)(vi).

260. IRS Notice 2019-12, 2019-27 IRB 57.

Taxpayers can rely on the safe harbor provisions set forth in IRS Notice 2019-12 until the proposed regulation is issued.



**Note.** The proposed safe harbor does **not** apply to a transfer of **property.**

IRS Notice 2019-12 contains three examples applying this safe harbor upon which the following examples are based.

**Example 15.** On August 31, 2018, Stella made a $5,000 cash donation to an eligible organization and received a local real estate tax credit of $3,500 that she used to partially offset her 2018 local real estate tax liability of $4,000. Stella's allowable 2018 federal charitable contribution deduction is $1,500 ($5,000 charitable donation – $3,500 local real estate tax credit). In addition, Stella can claim a §164 SALT deduction on her 2018 tax return for the $3,500 disallowed charitable contribution deduction because the associated local real estate tax credit was applied against her 2018 local real estate tax liability.

**Example 16.** On September 15, 2018, Dan made a $10,000 cash donation to an eligible organization and received a state income tax credit of $10,000 that may be carried forward indefinitely. Dan's 2018 state income tax liability is $7,000.

Because the $10,000 contribution is entirely offset by the $10,000 state tax credit received, Dan has a zero charitable contribution deduction. Nevertheless, Dan can claim a $10,000 §164 SALT deduction for the disallowed contribution. However, this deduction is limited to $7,000 for 2018 (the maximum amount of state tax credit that Dan can offset against his 2018 state income tax liability). Dan can claim a state tax deduction for the $3,000 remainder in the future year(s) when this credit offsets his state income tax liability.

**State Tax Deduction Limitation.** If instead of a state or local tax credit, an individual taxpayer receives or expects to receive a state or local tax **deduction** that does not exceed the payment amount or FMV of the property transferred, then a charitable contribution deduction is allowed for the entire contribution.[261]

**Example 17.** On October 31, 2018, Anne made a $1,000 cash contribution to an eligible organization and is entitled to receive a state tax deduction for the same amount. Anne's $1,000 charitable contribution deduction is unaffected by the $1,000 state tax deduction that she is entitled to receive.

However, a taxpayer who receives or expects to receive a state or local tax deduction that exceeds the amount of the taxpayer's payment or the FMV of the property transferred (i.e., an excess state or local tax deduction) must reduce their charitable contribution deduction.

**Observation.** The IRS does not indicate how the charitable contribution deduction is reduced for taxpayers receiving an excess state or local tax deduction. However, it is likely that the charitable contribution deduction would be limited to the amount of the taxpayer's payment or the FMV of the property transferred.

**Application to Estates and Trusts.** The preceding state tax credit and deduction rules applicable to charitable contribution deductions made by individuals also apply to payments of gross income made by estates and trusts **after** August 27, 2018.[262]

### Taxability of 2018 State Tax Refunds

The introduction of the SALT limit by the TCJA potentially affects the taxability of SALT refunds. Recognizing this, the IRS issued Rev. Rul. 2019-11 to provide guidance on calculating the taxable portion of a SALT refund of taxes paid in a year when the SALT limit applied.[263]

261. Treas. Reg. §1.170A-1(h)(3)(ii).

262. Treas. Reg. §1.642(c)-3(g).

263. Rev. Rul. 2019-11, 2019-17 IRB 1041.

Gross income does not include the recovery of an amount that was deducted in a previous year to the extent that a tax benefit did not ensue (the "tax benefit rule").[264] In applying the tax benefit rule, Rev. Rul. 2019-11 includes the following formula for determining the taxable portion of a SALT refund.

A taxable SALT refund is the **lesser of:**

- Total itemized deductions taken in the prior year less applicable prior year itemized deductions if the proper amount of SALT paid, **or**
- Total itemized deductions taken in the prior year less applicable prior year standard deduction.

The second element of the formula is only applied if the taxpayer was not precluded from claiming the standard deduction in that prior year.

This formula applies equally to the recovery of any state or local tax, including income tax and real or personal property tax.

**Note.** References to the "proper amount of SALT" or "correct SALT paid" in the following examples concern the amount the taxpayer would have deducted if they only paid the actual state and local tax liability, with no refund and no balance due.[265]

The following examples illustrate application of the SALT rule. They are based on the examples contained in Rev. Rul. 2019-11. Facts common to each of these examples are as follows.

- The taxpayers are all single and itemize deductions in lieu of the $12,000 standard deduction for 2018.
- SALT payments do not relate to a trade, business, or investment activity.
- The taxpayers are not subject to the AMT and not entitled to any tax credit.
- The taxpayers use the cash method of accounting.

**Example 18.** In 2018, Amy, a single taxpayer, made payments of $3,000 local real property taxes and $6,000 state income taxes. Consequently, Amy's $9,000 total SALT payments were less than the $10,000 SALT limit. Amy's total 2018 itemized deductions were $15,000. In 2019, Amy received a $2,000 state income tax refund due to her overpayment of state income taxes in 2018. Therefore, Amy's correct SALT for 2018 is $7,000 ($9,000 paid – $2,000 refunded).

Applying the SALT formula in Rev. Rul. 2019-11, Amy's $2,000 tax refund is **fully taxable,** calculated as follows.

Her taxable SALT refund is the **lesser of:**

- $2,000 ($15,000 total itemized deductions – $13,000 itemized deductions if $7,000 correct SALT paid), **or**
- $3,000 ($15,000 total itemized deductions – $12,000 standard deduction).

264. IRC §111(a).

265. Rev. Rul. 2019-11, 2019-17 IRB 1041.

**Example 19.** In 2018, Ben, a single taxpayer, made payments of $5,000 local real property taxes and $7,000 state income taxes. Consequently, the deduction for Ben's $12,000 SALT payments ($5,000 real property taxes + $7,000 state income taxes) was capped at $10,000 due to application of the $10,000 SALT limit. Ben's total 2018 itemized deductions were $20,000. In 2019, Ben received a $2,000 state income tax refund due to his overpayment of state income taxes in 2018. Therefore, his correct SALT is $10,000 ($12,000 paid – $2,000 refunded)).

Applying the SALT formula, Ben's $2,000 tax refund is **not** taxable, as shown next.

His taxable SALT refund is the **lesser of:**

- $0 ($20,000 total itemized deductions – $20,000 itemized deductions if $10,000 correct SALT paid), **or**
- $8,000 ($20,000 total itemized deductions – $12,000 standard deduction).

**Note.** Ben's SALT refund was not taxable because even with the correct amount of SALT applied, the $10,000 SALT deduction (i.e., $5,000 real property taxes + $5,000 correct amount of state income taxes) remained unchanged due to the limitation.

**Example 20.** In 2018, Kay, a single taxpayer, made payments of $3,000 local real property taxes and $8,000 state income taxes. Consequently, the deduction for Kay's $11,000 SALT payments ($3,000 real property taxes + $8,000 state income taxes) was capped at $10,000 due to application of the SALT limit. Kay's total 2018 itemized deductions were $13,000. In 2019, Kay received a $1,750 state income tax refund due to her overpayment of state income taxes in 2018. Her correct SALT is $9,250 ($11,000 paid – $1,750 refunded)).

Applying the SALT formula, $750 of Kay's $1,750 tax refund is **taxable,** as shown next.

Her taxable SALT refund is the **lesser of:**

- $750 ($13,000 total itemized deductions – $12,250 itemized deductions if $9,250 correct SALT paid), **or**
- $1,000 ($13,000 total itemized deductions – $12,000 standard deduction).

**Example 21.** In 2018, Don, a single taxpayer, made payments of $5,000 local real property taxes and $6,500 state income taxes. Consequently, the deduction for Don's $11,500 SALT payments ($5,000 real property taxes + $6,500 state income taxes) was capped at $10,000 due to application of the SALT limit. Don's total 2018 itemized deductions were $12,500. In 2019, Don received a $2,500 state income tax refund due to his overpayment of state income taxes in 2018. His correct SALT is $9,000 ($11,500 paid – $2,500 refunded).

Applying the SALT formula, only $500 of Don's $2,500 tax refund is **taxable.**

His taxable SALT refund is the **lesser of:**

- $1,000 ($12,500 total itemized deductions – $11,500 itemized deductions if $9,000 correct SALT paid), **or**
- $500 ($12,500 total itemized deductions – $12,000 standard deduction).

**Observation.** If real estate and personal property taxes exceed the SALT limit, then a state income tax refund from that year is never taxable to the extent that it does not exceed the excess of the SALT paid over the SALT limit. This is because no tax benefit was derived from the taxes being refunded.

### Interaction with Business Use of Home Deduction

Another potential source of complexity caused by the SALT limit is the interplay between this limit and IRC §280A(b) amounts excepted from the general disallowance of expenses in connection with business use of a home.

Under §280A(a), no deduction is allowed for expenses relating to the business use of a home unless those expenses are allowed under another subsection of §280A. One of those subsections is §280A(b), which applies to expenses that **would have otherwise been allowable** as individual expenses (i.e., unrelated to a trade or business).

**IRS Chief Counsel Advice (CCA).** According to the IRS Office of Chief Counsel, application of the §280A(b) exception depends on the situation as described next.[266]

**§280A(b) Exception Applicable.** Usually, expenses related to certain business or rental uses of a dwelling unit are deductible under §280A(c), subject to the §280A(c)(5) gross income limitation, which is represented by the following formula.

| | |
|---|---|
| | Gross income from the trade, business, or rental |
| – | §280A(b) deductions |
| – | Deductions not incurred in connection with the dwelling unit used as a residence (e.g., advertising, office supplies) |
| | Gross income from which the taxpayer can deduct §280A(c) expenses |

However, if a taxpayer's total individual state and local taxes are **less** than the SALT limit, then, under §280A(b), the taxpayer can deduct state and local taxes relating to business use of their home up to the **difference between the state and local taxes otherwise deductible and the SALT limit.** The taxpayer deducts these §280A(b) taxes along with any other state and local taxes on Schedule A, lines 5a, 5b, or 5c.

The following formula for determining the maximum amount of SALT classifiable as a §280A(b) deduction is derived from the CCA. However, it does not apply to taxpayers claiming the standard deduction.

The maximum SALT deductible under §280A(b) is the **lesser of:**

- The rental portion of SALT, **or**
- The unused SALT limitation (the amount that the taxpayer's SALT expenses are under the SALT limit)

Determination of the maximum SALT deductible under §280A(b) is illustrated in the following examples, which are based on those contained in the CCA.

**Example 22.** Georgia Smith is a single filer. Her 2018 state and local taxes of $16,000 consist of $10,000 real estate taxes on her home and $6,000 of state income tax. In 2018, she rents out her home for 25% of the year. Consequently, the $10,000 real estate taxes are allocated $7,500 to personal use (deductible on Schedule A) and $2,500 to rental use of the home (deductible on Schedule E).

Applying the previously defined §280A(b) deduction formula, **none** of the $2,500 real estate taxes pertaining to the rental are §280A(b) expenses that are deductible on Schedule A, as shown next.

Her maximum SALT deductible under §280A(b) is the **lesser of:**

- $2,500 rental portion of SALT, **or**
- The unused SALT limitation of $0 (i.e., $10,000 SALT limit – $13,500 SALT)

Because her $13,500 of personal state and local taxes (i.e., $6,000 state income tax + $7,500 personal real estate taxes) exceed her $10,000 SALT limit, the $2,500 real estate taxes pertaining to the rental are §280A(c) expenses subject to the §280A(c)(5) gross income limitation reportable on Schedule E. Therefore, **none** of the $2,500 real estate taxes pertaining to the rental are §280A(b) expenses that are reported on Schedule A.

266. CCA 128002-18 (Dec. 7, 2018).

**Example 23.** Use the same facts as **Example 22,** except Georgia rents out her home 75% of the year and pays \$20,000 of mortgage interest on her home in 2018.

Georgia's \$10,000 real estate taxes are allocated \$2,500 to personal (deductible on Schedule A) and \$7,500 to rental use of the home (deductible on Schedule E). Georgia's \$8,500 personal state and local taxes (i.e., \$2,500 personal real estate taxes + \$6,000 state income tax) are less than her \$10,000 SALT limit. When the \$8,500 personal state and local taxes are added to her \$5,000 personal mortgage interest expense (\$20,000 × 25%), Georgia has total itemized deductions of \$13,500. Georgia's \$13,500 total itemized deductions exceed the \$12,000 standard deduction, so Georgia chooses to itemize.

Applying the previously defined §280A(b) deduction formula, \$1,500 of real estate taxes pertaining to the rental are §280A(b) expenses that are deductible on Schedule A, as shown next.

Her maximum SALT deductible under §280A(b) is the **lesser of:**

- \$7,500 rental portion of SALT, **or**
- The unused SALT limitation of \$1,500 (\$10,000 SALT limit – \$8,500 personal SALT)

Consequently, Georgia can take a \$1,500 §280A(b) deduction on Schedule A for real estate taxes currently attributable to the rental use. This is because these taxes would have been treated as personal state and local taxes if Georgia had not rented out her home. The remaining \$6,000 rental-related real estate taxes (\$7,500 – \$1,500 §280A(b) deduction) are §280A(c) expenses subject to the §280A(c)(5) gross income limitation.

### Practitioner Planning Tip

Deducting real estate taxes under §280A(b) may be preferable if a deduction would otherwise be limited by application of the §280A(c)(5) gross income limitation.

***§280A(b) Exception Not Applicable.*** State and local taxes relating to the business use of a taxpayer's home **are** not included as expenses under §280A(b) in the following situations.

- The taxpayer's total individual state and local taxes meet or exceed the SALT limit.
- The taxpayer chooses the standard deduction.

**Note.** State and local taxes relating to business use of a taxpayer's home could nevertheless be deductible under a different §280A exception (e.g., under §280A(c) subject to the §280A(c)(5) gross income limitation).

**Example 24.** Use the same facts as **Example 23,** except Georgia did not have a mortgage.

Georgia opts to take the \$12,000 standard deduction because this exceeds her \$8,500 itemized deductions. Therefore, no §280A(b) allocation is possible for real estate taxes that would have been deductible under §164 if Georgia had not rented out her home. Consequently, the \$7,500 real estate taxes attributable to the rental use are **all** §280A(c) deductions subject to the §280A(c)(5) gross income limitation.

### Net Investment Income Tax

Effective January 1, 2013, individuals (U.S. citizens and residents), estates, and trusts are subject to the NIIT.[267] For individual taxpayers, this tax is 3.8% of the **lesser of:**[268]

- **NII** for the tax year, **or**
- The excess (if any) of:
  - MAGI for the tax year, less
  - The threshold amount.

The applicable threshold amount depends on the taxpayer's filing status (i.e., $250,000 MFJ, $125,000 MFS, and $200,000 all other filing statuses).[269]

MAGI is the taxpayer's AGI with an adjustment for the foreign earned income exclusion.[270]

The determination of NII is discussed next, particularly the effect of the TCJA SALT limit on this calculation.

**Determining NII.** For the purposes of the NIIT, a taxpayer's gross investment income (GII) is the **sum** of the following items.[271]

1. Gross income from interest, dividends, annuities, royalties, and rents (other than amounts derived in the ordinary course of a trade or business)
2. Net capital gains (excluding most dispositions of property held in a trade or business)
3. Certain income and gains from trades or businesses (e.g., passive activities, investment trading, and commodities trading)

A taxpayer's NII is their GII reduced by deductions properly allocable thereto.[272]

**Note.** NII is increased by the recovery or refund during the year of a previously deducted item (see the IRS instructions for Form 8960, *Net Investment Income Tax — Individuals, Estates, and Trusts*).[273]

#### Practitioner Planning Tip

A portion of an NOL allowed in the year can also be claimed in determining NII (IRC §1411 NOL). Determination of the §1411 NOL is addressed in the IRS instructions for Form 8960.

267. PL 111-152, §1402(a)(4) (Mar. 30, 2010); IRC §1411.
268. IRC §1411(a).
269. IRC §1411(b).
270. IRC §1411(d).
271. IRC §1411(c).
272. Ibid.
273. Treas. Reg. §1.1411-4(g)(2).

Examples of deductions that are properly allocable to GII include the following.[274]

- Investment interest expense
- Investment advisory and brokerage fees
- Expenses related to rental and royalty income
- Tax preparation fees
- Fiduciary expenses (in the case of an estate or trust)
- Foreign income taxes
- State and local income taxes

**Note.** The deduction for miscellaneous itemized expenses subject to the 2%-of-AGI floor (e.g., investment advisory fees, brokerage fees, and tax preparation fees) is suspended during the TCJA period.[275]

During the TCJA period, foreign real property taxes are not deductible, and the SALT limit caps the deduction of state and local taxes.[276] However, foreign **income** taxes relating to a trade, business, or investment activity are not subject to this limit.[277]

***Allocation between NII and Excluded Income.***[278] When a deduction relates to both NII and excluded income, it must be allocated between them using any reasonable method. An example of a reasonable method is an allocation of the deduction based on the ratio of the amount of a taxpayer's GII to their AGI.

The calculation of NIIT during the TCJA period is illustrated in the following examples.

**Example 25.** In 2018, Bob, a single taxpayer, has $50,000 of GII included in his $250,000 MAGI. He also has $20,000 of state and local income taxes.

The portion of Bob's $20,000 of state and local income taxes allocable to his GII is $4,000 (($50,000 GII ÷ $250,000 MAGI) × $20,000).

Therefore, Bob has NII of $46,000 ($50,000 GII – $4,000 allocable deductions). His NIIT is $1,748, which is calculated as the **lesser of:**

- $46,000 NII × 3.8% = $1,748, **or**
- ($250,000 MAGI − $200,000 threshold) × 3.8% = $1,900

274. *Questions and Answers on the Net Investment Income Tax*. May 15, 2019. IRS. [www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax] Accessed on Jun. 19, 2019; Treas. Reg. §1.1411-4(f).

275. TCJA §11045.

276. TCJA §11042; IRC §164(b)(6).

277. IRC §164(b)(6)(B).

278. Treas. Reg. §1.1411-4(g)(1).

**Example 26.** Use the same facts as **Example 25,** except Bob's GII is $150,000.

The portion of Bob's $20,000 of state and local income taxes allocable to his GII is $12,000 (($150,000 GII ÷ $250,000 MAGI) × $20,000). However, Bob is subject to the SALT limit and therefore he can only deduct $10,000 of these taxes.

Therefore, Bob has NII of $140,000 ($150,000 GII – $10,000 allocable deductions). His NIIT is $1,900, which is calculated as the **lesser of:**

- $140,000 NII × 3.8% = $5,320, **or**
- ($250,000 MAGI − $200,000 threshold) × 3.8% = $1,900

**Example 27.** Use the same facts as **Example 26,** except Bob's GII includes foreign rental income (from a business activity), upon which he pays $1,000 foreign income tax in 2018.

Because the $1,000 foreign income tax paid is properly allocable to the foreign rental income included in his GII, Bob's NII is $139,000 ($140,000 NII as calculated in **Example 26** – $1,000 directly allocable foreign income taxes).

Therefore, Bob's NIIT is $1,900, which is calculated as the **lesser of:**

- $139,000 NII × 3.8% = $5,282, **or**
- ($250,000 MAGI − $200,000 threshold) × 3.8% = $1,900.

## ESTIMATED TAX PENALTY WAIVER

Individual taxpayers whose net tax (after credits) is $1,000 or more[279] and who fail to make the required annual payment for a tax year are generally subject to a penalty.[280] For this purpose, the required annual payment is generally the lesser of:[281]

1. 90% of the current year tax, or
2. 100% of the prior year tax (assuming the prior year was not a short tax year, and that the taxpayer filed a tax return for the prior year), unless AGI is over $150,000 ($75,000 for MFS). In this case, it is 110% of the prior year tax.[282]

However, the required annual payment differs for some taxpayers. For example, the current year tax requirement for qualified farmers and fishermen is 66.67% of the current year tax liability if paid by January 15.[283]

Certain taxpayers are exempted from the underestimation penalty (e.g., a U.S. citizen or resident who had zero tax liability in the prior tax year).[284]

Due to the many tax changes introduced by the TCJA and the difficulty that taxpayers had in ensuring that their 2018 tax withholdings/estimated tax payments were adequate, the IRS issued two waivers concerning the 2018 underestimation penalty, as discussed next.

---

279. IRC §6654(e)(1).
280. IRC §6654.
281. IRC §6654(d)(1)(B).
282. IRC §6654(d)(1)(C).
283. IRC §6654(i).
284. IRC §6654(e)(2).

### IRS Waivers for 2018 Tax Year



Under the first IRS waiver, the required annual payment under the current year tax requirement was reduced from 90% to 85% **for the 2018 tax year.**[285] Subsequently, this was superseded by a waiver reducing the required annual payment under the current year tax requirement to **80%** for the 2018 tax year.[286] This waiver only applies to the **2018** tax year.

**Claiming the Waiver on the Tax Return.**[287] Taxpayers claimed the waiver on Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*, which they could include with their 2018 tax return. If, after completing part I of Form 2210, it was determined that the waiver applied, taxpayers were instructed to check the waiver box (part II, box A), and include the statement "80% Waiver" next to this box. The form can be included with a paper or e-filed tax return.

> **Note.** Following issuance of waivers for 2018, the IRS clarified that it is automatically waiving the estimated tax penalty for taxpayers who already filed their 2018 tax returns without claiming the waiver. No action is required from taxpayers in this regard.[288] Affected taxpayers will receive a CP21 notice from the IRS granting this relief. Tax refund checks should follow approximately three weeks later.

**Farmer Waiver.**[289] Farm taxpayers were granted a waiver with respect to the estimated tax penalty for their 2018 federal income tax return if they filed and paid the tax due by April 15, 2019. To be eligible for the waiver, the farmer must have attached Form 2210-F, *Underpayment of Estimated Tax by Farmers and Fishermen,* to the return with part 1, box A checked.

## CREDIT FOR ELECTRIC VEHICLES PHASING OUT

A credit is available for new qualified plug-in electric drive motor vehicles sold for use in the United States after December 31, 2009.[290] A qualifying vehicle for this purpose must satisfy the following requirements.[291]

- Original use of the vehicle must begin with the taxpayer.
- It must be acquired for use or lease by the taxpayer and not for resale.
- It must have been made by a manufacturer and be treated as a motor vehicle for purposes of title II of the Clean Air Act.
- It must have a gross vehicle weight rating of less than 14,000 pounds.
- It must be propelled to a significant extent by an electric motor and have rechargeable battery capacity of at least four kilowatt hours.

A maximum credit of $2,500 is allowable for vehicles with rechargeable battery capacity of at least four kilowatt hours. This credit rises to $7,500 for higher capacity batteries.[292]

285. IRS Notice 2019-11, 2019-05 IRB 430.
286. IRS Notice 2019-25, 2019-15 IRB 942.
287. Ibid.
288. IRS News Rel. IR-2019-144 (Aug. 14, 2019).
289. IRS Notice 2019-17, 2019-12 IRB 907.
290. IRC §30D.
291. IRC §30D(d).
292. IRC §30D(b).

When a manufacturer has sold 200,000 qualifying vehicles for use or lease in the United States, the credit begins to phase out starting with the second subsequent calendar quarter.[293]

In accordance with section 5.05 of IRS Notice 2009-89, General Motors LLC (GM) provided notice that its cumulative sales of qualified vehicles reached the 200,000-vehicle limit during the calendar quarter ending December 31, 2018.[294] Consequently, starting April 1, 2019, the amount of allowable credit for newly purchased/leased qualified GM vehicles is as follows.[295]

| | Maximum Credit |
|---|---|
| Vehicles sold on or after April 1, 2019, and on or before September 30, 2019 | $3,750 ($7,500 × 50%) |
| Vehicles sold on or after October 1, 2019, and on or before March 31, 2020 | $1,875 ($7,500 × 25%) |
| Vehicles sold after April 1, 2020 | $0 |

## NEW IRS MEASURES TO PROTECT TAXPAYER DATA[296]

Recently, the IRS took the following measures in response to increasing identity theft by criminals using stolen taxpayer transcripts to claim tax refunds by filing fraudulent tax returns.

### TAX TRANSCRIPT DELIVERY CHANGES

Effective June 28, 2019, the IRS no longer **faxes** tax transcripts to taxpayers and third parties (including tax professionals). The termination of the fax service applies to both individual and business transcripts. Individual taxpayers and tax professionals still have the following options for obtaining tax transcripts.

#### Tax Transcript Options (Individual Taxpayers)

Tax transcript delivery options currently available to individual taxpayers are as follows.

- Online download (available at IRS.gov or via the IRS2Go app following taxpayer identity verification)
- By mail (request can be made online at IRS.gov or via the IRS2Go app, by calling 800-908-9946, or by submitting Form 4506-T, *Request for Transcript of Tax Return,* or Form 4506T-EZ, *Short Form Request for Individual Tax Return Transcript*)

#### Tax Transcript Options (Tax Professionals)

Tax transcript delivery options currently available to tax professionals are as follows.

- **Masked** individual and business taxpayer transcripts are available for online download through IRS e-Services' Transcript Delivery System (TDS)[297] or by calling the IRS (866-860-4259 Practitioner Priority Service),[298] faxing taxpayer authorization to the IRS assistor, and requesting delivery to the tax practitioner's e-Services secure mailbox
- **Unmasked** individual and business taxpayer transcripts are available for online download through IRS e-Services' TDS by calling the IRS practitioner priority service at 866-860-4259, faxing taxpayer authorization to the IRS assistor, and requesting delivery to the tax practitioner's e-Services secure mailbox.

293. IRC §30D(e).

294. IRS Notice 2019-22, 2019-14 IRB 931.

295. Ibid.

296. IRS News Rel. IR-2019-101 (Jun. 4, 2019).

297. *e-Services*. May 28, 2019. IRS. [www.irs.gov/e-services] Accessed on Jun. 24, 2019; *Transcript Delivery System (TDS)*. Nov. 1, 2018. IRS. [www.irs.gov/tax-professionals/transcript-delivery-system-tds] Accessed on Jun. 24, 2019.

298. *Practitioner Priority Service*®. May 2, 2019. IRS. [www.irs.gov/tax-professionals/practitioner-priority-service-r] Accessed on Jun. 24, 2019.

Masked tax transcripts partially conceal personally identifiable information while leaving financial entries intact. All data is fully visible in unmasked tax transcripts.[299]

Circular 230 practitioners (including attorneys, CPAs, and enrolled agents) are eligible to create an IRS e-Services account. Unenrolled tax practitioners must have an e-File application on file and be listed as delegated users to access TDS.

### Cessation of IRS Delivery of Tax Transcripts to Third Parties

Effective July 1, 2019, the IRS no longer provides tax return copies or taxpayers' tax transcripts to third parties. Accordingly, the IRS will revise Form 4506, *Request for Copy of Tax Return*, Form 4506-T, and Form 4506T-EZ, to remove the option of mailing a tax return copy or tax transcript to a third party.

Third parties (including lenders, colleges, and universities that require tax return copies or tax transcripts) have two options available to them. They can either request a tax return copy/tax transcript direct from the taxpayer or they can use the IRS's income verification express service (IVES). Third parties choosing IVES either contract with an existing IVES participant or apply to become an IVES participant.

This change does not affect use of the IRS data retrieval tool through the free application for federal student aid (FAFSA) process.

**Customer File Number.**[300] To further protect a taxpayer's identity, the IRS created a customer file number (CFN) tag to aid third parties in matching transcripts to taxpayers. Third parties can now assign a unique CFN, which is provided to the IRS and will populate on the transcript and help match it to the client/student.

## TAXPAYER FIRST ACT[301]

On July 1, 2019, President Trump signed into law the Taxpayer First Act (TFA). This legislation requires the IRS to become more customer-focused through the adoption of a "comprehensive customer service strategy."

In this section, the main provisions of the TFA are presented according to their implementation schedule, starting with those provisions effective upon the July 1, 2019 enactment date.

### TFA PROVISIONS EFFECTIVE JULY 1, 2019

### IRS Independent Office of Appeals[302]

Before enactment of the TFA, taxpayers disputing a proposed tax assessment or collection action could request a conference with the IRS Appeals Office. The appeals officer's role was to impartially review the disputed tax assessment/collection action, taking into consideration the positions of both the taxpayer and the IRS. The goal was to arrive at a fair resolution/settlement, thus avoiding court proceedings.[303]

299. *About the New Tax Transcript: FAQs*. Jun. 6, 2019. IRS. [www.irs.gov/individuals/about-the-new-tax-transcript-faqs] Accessed on Jun. 24, 2019.

300. Ibid.

301. PL 116-25 (Jul. 1, 2019); *Special study on Taxpayer First Act of 2019.* Jun. 17, 2019. Thomson Reuters Tax & Accounting. [tax.thomsonreuters.com/news/special-study-on-taxpayer-first-act-of-2019] Accessed on Jul. 19, 2019.

302. IRC §§7803, 7430(c)(2) and 6330(d)(3) as amended by TFA §1001.

303. *Topic No. 151 Your Appeal Rights*. Jul. 18, 2019. IRS. [www.irs.gov/taxtopics/tc151] Accessed on Jul. 19, 2019.

To correct any perception that the IRS appeals process was insufficiently independent, the TFA renamed the IRS Office of Appeals to the IRS **Independent** Office of Appeals.[304] The function of the renamed appeals office is to resolve federal tax disputes without litigation in a manner which:[305]

- Is fair and impartial to both the government and the taxpayer;
- Promotes consistent application, interpretation of, and voluntary compliance with federal tax laws; and
- Increases public confidence in the IRS's integrity and efficiency.

The TFA also codifies the following rules to better define and regulate the appeals process.

1. The appeals process must be generally available to **all** taxpayers.[306]
2. When the IRS **denies** a taxpayer's request to appeal a notice of deficiency, the IRS must provide detailed reasons for its denial and inform the taxpayer of the procedures for protesting this decision.[307] However, this rule does not apply to requests denied on the basis that the issue involved is a frivolous position (within the meaning of IRC §6702(c)).[308]

### Low-Income Exception for Offer-in-Compromise Payments[309]

The IRS may enter into an offer-in-compromise (OIC) agreement with a taxpayer to settle a tax debt for less than the taxpayer's actual liability.[310] For a lump-sum OIC, a taxpayer must pay an application fee and submit an initial payment,[311] although the IRS has the authority to waive these payments.[312]

Pursuant to the TFA, taxpayers whose AGI does not exceed 250% of the federal poverty level do not have to pay the application fee and make the initial payment with their OIC.[313]

### Volunteer Return Preparation Programs for Applicable Taxpayers[314]

Since 1969,[315] the IRS has sponsored tax assistance programs for lower-income taxpayers, disabled persons, elderly taxpayers, and individuals with limited grasp of the English language. IRS certified-volunteers with the volunteer income tax assistance (VITA) program and the tax counseling for the elderly (TCE) program provide free basic income tax return preparation, including electronic filing.[316]

304. IRC §7803(e)(1).
305. IRC §7803(e)(3).
306. IRC §7803(e)(4).
307. IRC §7803(e)(5)(A).
308. IRC §7803(e)(5)(D).
309. IRC §7122(c)(3) as added by TFA §1102.
310. IRC §7122(a).
311. IRC §7122(c)(1).
312. IRC §7122(c)(2)(C).
313. IRC §7122(c)(3) as added by TFA §1102.
314. IRC §7526A as added by TFA §1401.
315. IRS News Rel. IR-2018-215 (Nov. 6, 2018).
316. *Free Tax Return Preparation for Qualifying Taxpayers*. Jul. 10, 2019. IRS. [www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers] Accessed on Jul. 29, 2019.

The TFA expands the availability of the tax assistance programs to include Native Americans, individuals living in rural areas, and members of the Armed Forces and their spouses. It also establishes a **matching** grant program to support the maintenance and expansion of VITA programs. Henceforth, the IRS may authorize multi-year grants (of up to three years) to qualified return preparation programs.[317] Generally, the IRS may allocate up to $30 million annually to fund these matching grants.[318]

Qualified return preparation programs must serve mostly lower income and underserved populations, as well as meet certain administrative and training requirements.[319] In addition, the programs must be sponsored by a nonprofit or governmental agency. Funds from these grants may only be used for direct costs described in IRC §7526A(b).

Additionally, the IRS is required to promote these programs using mass communications and other means.[320]

### IRS Information Regarding Low-Income Taxpayer Clinics[321]

Low-income taxpayer clinics (LITC) assist low-income taxpayers with representation in controversies before the IRS and provide education and outreach to non-native English speakers.[322]

The TFA authorizes IRS employees to provide taxpayers in need of such assistance with information about the availability of LITC and the eligibility requirements for receiving help from LITC. In addition, employees may provide LITC locations and contact information.

### Whistleblower Reforms[323]

Individuals may file a claim for an award if they submit information to the IRS that leads to detecting taxpayers who have underpaid their tax liabilities or detecting and prosecuting persons who have violated federal tax laws.[324]

In order to improve IRS communications with whistleblowers, the TFA allows the IRS to provide return information to the whistleblowers if necessary to determine a taxpayer's liability or the amount to be collected. The TFA requires the IRS to notify whistleblowers of the status of their claims at certain points in the review process and to provide status updates at other times upon written request of the whistleblower. In addition, the provision amends the Code to extend anti-retaliation provisions to whistleblowers who report information to the IRS.[325]

### Increased Preparer Penalties[326]

A tax return preparer who discloses any return information furnished to them or uses such information for any purpose other than to prepare or assist in preparing any such return is subject to penalties.[327] A $250 civil penalty is imposed for each unauthorized disclosure or use, up to $10,000 per calendar year.[328] When the unauthorized disclosure or use involves knowing or reckless conduct, the preparer is guilty of a misdemeanor and subject to a fine up to $1,000, one year of imprisonment, or both, together with the costs of prosecution.[329]

---

317. IRC §7526A(f) as added by TFA §1401.

318. Ibid.

319. IRC §7526A(e) as added by TFA §1401.

320. IRC §7526A(g) as added by TFA §1401.

321. IRC §7526(c)(6) as added by TFA §1402.

322. *Low Income Taxpayer Clinics*. May 13, 2019. IRS. [www.irs.gov/advocate/low-income-taxpayer-clinics] Accessed on Jul. 29, 2019.

323. TFA §1405.

324. IRC §7623.

325. IRC §7623(d) as added by TFA §1405(b).

326. TFA §2009.

327. IRC §6713.

328. IRC §6713(a).

329. IRC §7216.

The TFA increases the civil penalty from $250 to $1,000 for the disclosure of taxpayer identity information by a return preparer when such information is used in an **identity theft crime**, regardless of whether the crime involves the filing of a tax return.[330] The TFA also increases the calendar-year limitation from $10,000 to $50,000 in such cases. The $50,000 calendar-year limitation is applied separately from other provisions with respect to disclosures or uses made in connection with taxpayer identity theft.

Additionally, the maximum fine for knowing or reckless conduct is increased from $1,000 to **$100,000** when return information is disclosed or used in connection with an identity theft crime, regardless of whether the crime involves the filing of a tax return.[331]

## Practitioner Planning Tip

Tax professionals are urged to take additional preventative measures to ensure the security and confidentiality of customer records and information. Practitioners also must take steps to protect against unauthorized access to client records or information that could harm or create inconvenience for their customers. In some cases, it may be necessary to contract outside information technology support to establish the procedures (including a manual of these procedures and processes), software, hardware, and system monitoring needed to protect clients from any anticipated threats or hazards to the security or integrity of client records.

### Expansion of Electronic Filing[332]

Tax return preparers who file (or expect to file) more than 10 **individual** returns each year must file those returns electronically.[333] The TFA authorizes the IRS to waive this electronic filing requirement for preparers who demonstrate that they cannot meet this requirement because they are located in a geographic area that does not have access to Internet service (other than dial-up or satellite service).[334]

Return filers are also subject to an **overall** e-filing requirement if the total number of tax returns they prepare for **any** type of taxpayer entity is 250 or more during the year.[335] Under the TFA, this number decreases to 100 for calendar year 2021 and to 10 for calendar years thereafter.[336]

**Partnership Returns.**[337] A separate limitation applies to partnership returns. Tax preparers must e-file partnership returns if the total number they prepare in the 2019 calendar year is 150 or more. This number decreases to 100 in calendar year 2020 and 50 in calendar year 2021.

330. IRC §6713(b) as amended by TFA §2009.
331. IRC §7216(a) as amended by TFA §2009.
332. TFA §2301.
333. IRC §6011(e)(3)(B).
334. IRC §6011(e)(3)(D) as amended by TFA §2301.
335. IRC §6011(e)(2)(A).
336. IRC §6011(e)(5)(A) as amended by TFA §2301.
337. IRC §6011(e)(5)(B) as amended by TFA §2301.

### Use of Electronic Taxpayer Signatures[338]

The TFA requires the IRS to publish regulations and other guidelines that would permit the acceptance of taxpayers' electronic signatures for any request for disclosure of a taxpayer's return or return information or to execute a power of attorney to a practitioner.



### IRS Prohibition on Rehiring Certain Employees[339]

The TFA prohibits the IRS commissioner from rehiring any IRS employee whose employment was terminated for misconduct.

### Mandatory E-Filing by Exempt Organizations[340]

The TFA extends the e-filing requirement to all tax-exempt organizations required to file statements or returns in the Form 990 series or Form 8872, *Political Organization Report of Contributions and Expenditures*. Additionally, the IRS is required to make the filed returns available to the public as soon as practicable in a "machine-readable format."[341]

Transitional relief in the TFA allows the IRS to delay the application of this requirement by two years for small organizations, organizations filing Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)),* and any other organizations for which the IRS determines the requirement would cause undue burden.[342]

### Payment of Taxes by Debit and Credit Cards[343]

Taxpayers are generally permitted to pay taxes by commercially acceptable means such as credit and debit cards. The IRS may not pay any fee or provide any other consideration in connection with the use of credit, debit, or charge cards for the payment of income taxes.[344]

Following the TFA, the IRS may directly accept credit and debit card payments for taxes, provided the fee is paid by the taxpayer. However, the TFA also directs the IRS to minimize these fees when negotiating contracts to process credit and debit cards.

## TFA PROVISIONS EFFECTIVE DECEMBER 28, 2019

> **Note.** Several TFA provisions are effective "180 days after the date of the enactment of this Act."[345] The TFA was enacted on July 1, 2019; therefore, 180 days after this date is December 28, 2019.

### Limitation on Disclosures and Uses of Tax Return Information[346]

A taxpayer may authorize the IRS to disclose their return or return information to a third party as long as doing so will not prevent the IRS from effectively administering the federal tax laws.[347]

---

338. IRC §6061(b)(3) as amended by TFA §2302.
339. IRC §7804(d) as added by TFA §3001.
340. IRC §6033(n) as amended by TFA §3101.
341. IRC §6104(b) as amended by TFA §3101.
342. TFA §3101(d).
343. IRC §6311(d)(2) as amended by TFA §2303.
344. Ibid.
345. TFA §2304.
346. IRC §6103(c) as amended by TFA §2202.
347. IRC §6103(c) before amendment by the TFA.

The TFA adds the requirements that anyone designated by the taxpayer to receive their return information cannot use the information for anything other than the designated purpose and may not disclose the information to anyone else without the taxpayer's permission.[348] These conditions are effective for disclosures made after December 28, 2019.

### Taxpayer Notification of Unauthorized IRS Inspection or Disclosure[349]

Civil damages may be imposed when there is an unauthorized disclosure or inspection of returns or return information by an employee of the United States.[350]

The TFA requires the Treasury Department to notify the affected taxpayer if the IRS or a federal or state agency proposes any disciplinary or adverse action against a government employee for unauthorized inspection or disclosure of the taxpayer's information. This change is effective for disciplinary actions occurring after December 28, 2019.

### Authentication of Users of IRS E-Services Accounts[351]

Beginning December 28, 2019, the TFA requires the IRS to verify the identity of any individual opening an e-Services account before they can use e-Services tools.

### IRS Notification of Suspected Identity Theft[352]

The TFA requires the IRS to notify an individual if there has been any suspected unauthorized use of their identity. The notification must state whether an investigation has been initiated, whether the investigation substantiated any unauthorized use of the taxpayer's identity, and whether any action has been taken (such as a referral for prosecution).[353]

This provision applies to determinations of identity theft or suspected identity theft that the IRS makes after December 31, 2019.

## TFA PROVISIONS EFFECTIVE JANUARY 1, 2020

### Misdirected Tax Refund Deposits[354]

The TFA directs the IRS to establish procedures for taxpayers to report instances in which a tax refund paid by electronic funds transfer was not received in the taxpayer's account. These procedures must include recovery of the erroneous refunds and delivery of them to the correct taxpayer account. The TFA requires the IRS to issue regulations in this regard by January 1, 2020.

### Notice Requirements Regarding Revocation of Tax-Exempt Status[355]

Charities and other nonprofit organizations are required to file annual information returns (Form 990 series). If these organizations do not file their returns for three consecutive years, their not-for-profit status is automatically revoked. Such organizations must reapply for not-for-profit status if they wish to continue to be treated as a tax-exempt organization.[356]

---

348. IRC §6103(c) as amended by TFA §2202.
349. IRC §7431(e) as amended by TFA §3002.
350. IRC §7431.
351. TFA §2304.
352. IRC §§7529(a) and (b) as added by TFA §2007(a)
353. Ibid.
354. IRC §6402(n) as amended by TFA §1407.
355. IRC §6033(j)(1) as amended by TFA §3102.
356. IRC §6033(j).

The TFA requires the IRS to notify an organization after the organization's second consecutive failure to file an information return. This notification gives the organization time to file an information return and prevent the revocation of their tax-exempt status.[357] This notification requirement applies to failures to file returns or notices for two consecutive years if the return or notice for the second year is due **after** December 31, 2019.[358]

### Increase in Late-Filing Penalty[359]

Taxpayers are subject to penalties for failure to file tax returns by the due date, subject to extensions and exceptions for reasonable cause. Generally, this late-filing penalty is 5% of the tax due per month or part of a month that the return is filed late, up to a maximum of 25%.[360] However, a **minimum** late-filing penalty applies that is equal to the **lesser** of $215 (for tax returns filed in 2020) or the tax liability.[361] Tax liability for these purposes is defined as the net amount due after the due date.[362]

The TFA increases the **minimum** late-filing penalty to the lesser of **$330** or the tax liability for returns required to be filed **after** December 31, 2019.[363] This amount is adjusted for inflation for returns required to be filed in calendar years beginning **after** 2020.

### Single Point of Contact for Tax-Related Identity Theft Victims[364]

The TFA requires the IRS to establish procedures to give taxpayers a single point of contact within the IRS for any taxpayer who is a victim of tax-related identity theft. The single point of contact is responsible for monitoring the taxpayer's case until it is completed. The contact also is responsible for coordinating with other units to resolve the taxpayer's issues as quickly as possible.

## TFA PROVISIONS EFFECTIVE JULY 1, 2020

### Taxpayer Access to Case Files

The IRS must provide taxpayers who have scheduled conferences with the appeals office access to the nonprivileged portions of the case file that concern the disputed issues. This information must be provided at least 10 days before the conference, unless the taxpayer elects to expedite the date of the conference.

This requirement is applicable to individual taxpayers whose AGI did not exceed $400,000 and for entities with gross receipts not exceeding $5 million for the tax year in question.[365]

This provision applies to conferences occurring after July 1, 2020.[366]

---

357. IRC §6033(j)(1) as amended by TFA §3102.
358. TFA §3102(b).
359. IRC §§6651(a) and (j) as amended by TFA §3201.
360. IRC §6651(a).
361. IRC §§6651(a) and (j); Rev. Proc. 2018-57, 2018-49 IRB 827.
362. IRC §6651(b).
363. IRC §6651(a) as amended by TFA 3201.
364. TFA §2006.
365. IRC §7803(e)(7).
366. TFA §1001(e)(2).

### Comprehensive Customer Service Strategy

By July 1, 2020, the TFA requires the IRS to develop and submit to Congress a written comprehensive customer service strategy to be implemented over the subsequent 10 years. The strategy must address how the IRS intends to provide assistance to taxpayers that:

- Is secure;
- Meets reasonable taxpayer expectations, and
- Adopts appropriate best practices of private-sector customer service, including online services, telephone call-back services, and training of employees providing customer services.

### IRS Management of Identity Refund Fraud Cases[367]

By July 1, 2020, the TFA requires the IRS to develop and implement publicly available caseworker guidelines that reduce the burdens for identity theft victims as they work with the IRS to sort out their tax issues. The guidelines may include procedures to reduce the amount of time victims have to wait to receive their tax refunds, the number of IRS employees with whom victims would need to interact, and the timeframe within which the issues related to the identity theft should be resolved.

## TFA PROVISION EFFECTIVE BETWEEN JANUARY 1, 2022, AND DECEMBER 31, 2022

### Disclosure of Taxpayer Information for Third-Party Income Verification[368]

The IVES is a program run by the IRS, which is used by lenders to verify a taxpayer's income. IVES users request taxpayer transcripts via fax, and the IRS delivers these transcripts to the requestor's secure mailbox generally within two to three business days.[369]

The TFA requires the IRS to substitute the existing IVES program with one that is accessed via the Internet, is fully automated, and is accomplished in as close to real-time as is practicable. Additionally, the TFA authorizes the IRS to charge a separate user fee over a 2-year period beginning January 1, 2020, on all IVES requests.

## TFA PROVISION EFFECTIVE JANUARY 1, 2023

### Internet Platform for Form 1099 Filings[370]

By January 1, 2023, the TFA requires the IRS to develop an Internet platform that allows persons to do the following.

1. Prepare and file Forms 1099.
2. Prepare Forms 1099 for distribution to recipients other than the IRS.
3. Maintain a record of completed, filed, and distributed Forms 1099.

The TFA requires the platform to have a user interface and functionality similar to the business services online suite of services provided by the Social Security Administration.

367. TFA §2008.

368. TFA §2201.

369. *Income Verification Express Service*. Jun. 4, 2019. IRS. [www.irs.gov/individuals/international-taxpayers/income-verification-express-service] Accessed on Jul. 30, 2019.

370. TFA §2102.

## TFA PROVISION EFFECTIVE JULY 1, 2024

### Identity Protection Personal Identification Numbers[371]

An identity protection personal identification number (IP PIN) is a 6-digit number assigned to eligible taxpayers by the IRS to provide protection for taxpayers whose SSN was used by unauthorized persons to file fraudulent federal income tax returns. Prior to the enactment of the TFA, taxpayers either had to demonstrate they were already a victim of identity theft or reside in specific areas of the country before the IRS would issue an IP PIN.[372] Residents of the following areas (based on the address used for the last tax return) are currently allowed to request IP PINs: Florida, Georgia, District of Columbia, Michigan, California, Maryland, Nevada, Delaware, Illinois, and Rhode Island.[373]

The TFA requires the IRS to establish a program under which **any concerned taxpayer** regardless of their state of residence can request an IP PIN to use in filing their return. This program must be fully implemented by July 1, 2024.

## REVISED 2018 SCHEDULE D TAX WORKSHEET[374]

The 2018 Schedule D tax worksheet in the original Schedule D (Form 1040) instructions contained an error. Potentially affected taxpayers were those with gains taxed at a maximum 28% rate reported on line 18 of Schedule D or unrecaptured §1250 gains (taxed at a maximum 25% rate) reported on line 19 of Schedule D.

See **uofi.tax/19b2x4** [www.irs.gov/pub/irs-pdf/i1040sd.pdf] for the corrected IRS worksheet, which was made available on May 16, 2019.

Affected taxpayers need not file an amended return with the IRS or call the IRS. The IRS is reviewing returns submitted prior to May 16, 2019, and will provide more information at a later time.

---

371. TFA §2005.

372. *Get An Identity Protection PIN (IP PIN).* Jul. 10, 2019. IRS. [www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin] Accessed on Jul. 30, 2019.

373. Ibid.

374. *Error in Tax Calculation in Schedule D Tax Worksheet (Form 1040).* May 16, 2019. IRS. [www.irs.gov/forms-pubs/error-in-tax-calculation-in-schedule-d-tax-worksheet-form-1040] Accessed on Sep. 6, 2019.