THE TAX CUTS AND JOBS ACT:

LESSONS LEARNED

National Association of Enrolled Agents (NAEA)

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The year-end planning letters were provided courtesy of BDO.

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EXECUTIVE VICE PRESIDENT'S MESSAGE

In December 2017, Congress passed and the president signed into law the Tax Cuts and Jobs Act of 2017.

Even in that simple declarative sentence we have a lot to unpack. First, after many false starts and semi-successful changes to Title 26 (the Bush II tax cuts, anyone?), and from any perch in Washington, DC, what seemed like years and years of talk and handicapping (favorite DC parlor question: will tax reform happen this year/Congress?), Americans are delivered of a bouncing baby tax code. Second, the law isn't actually called the Tax Cuts and Jobs Act. Its full title is "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." No one calls it that, of course, but if even its name is so complicated and convoluted, do we have any hope of law that is, dare we even dream, simpler?

Or, as the French say, do we have a case of "Plus ça change, plus c'est même chose?"

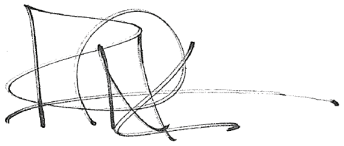
NAEA, as it continues to provide timely, actionable tax information, has hit the ball out of the park with this e-book. I'm happy to see enrolled agents (and NAEA members as well as respected instructors) Beth Logan, EA; Tom Gorczynski, EA, USTCP; and David Mellem, EA, as authors. Beth's article takes on a particular pain point: the new tax forms. Let it be known NAEA's advocates in DC told anyone who would stand still long enough the so-called "postcard" Form 1040 was a bomb of the same proportions of New Coke. We also believe, similar to New Coke, the abbreviated form (plus schedules) will not be with us for long. Tom takes a run at a practice area that has forever been vexing, rental property, and looks at it through the new §199A prism. And David closes out the e-book with a summation of what's changed, by the numbers, between 2019 and 2020.

Else, the SALT article is on time and on point. SALT and its unavoidable workarounds (which in this author's humble opinion are almost without fail too cute by half) has provided us with hours of enjoyment (or pain, depending on how one views such things) in the past two years and will continue to do so. And if readers are anything like we are in DC while in the midst of the fantasy football season, they are at least familiar with the general contour of fantasy sports, if not with the tax implications. This article alone may make you the most popular person at an upcoming social event.

Finally, we also provide (optionally) eight hours of continuing education (https://www.pathlms.com/naea/courses?category_ids[]=2940), as well as year-end planning letters for both individuals and businesses.

The NAEA publications team is proud to offer you this e-book and, spoiler alert, yes we do have a case of “the more things change, the more they remain the same.”

Onward!



Robert Kerr, EA
Executive Vice President

HOW TO USE THIS GUIDE

The second filing season under the Tax Cuts and Jobs Act (TCJA) will pose new challenges for tax professionals and their clients. Taxpayers will rely on you to advise and guide them in this era of tax reform since more regulations and legislation were enacted after the 2019 tax season at both the federal and state levels. Packed with overviews, analysis, and real-world examples, *The Tax Cuts and Jobs Act: Lessons Learned* is your resource to navigate the recent changes to the new tax law.

Published by the National Association of Enrolled Agents (NAEA), *The Tax Cuts and Jobs Act: Lessons Learned* is a tool designed to help tax practitioners understand the most recent changes to the tax code. This e-book provides guidance on a variety of areas affected including changes to Form 1040, qualified business income and rental activities, income from fantasy sports, expatriates, acquisition and disposition of intangibles, nonprofits, S corporations/C corporations, restaurants, and state and local taxes.

Each article has been reviewed by NAEA's Tax Education Team, which consists of Beth Logan, EA; Melissa Longmuir, EA; Jean Mammen, EA; Victoria A. McGinn, EA, CPA; Bill Nemeth, EA; John M. Perry III, EA, USTCP; and Mary Sunderland, EA, USTCP. A special thanks to them for all of their efforts.

Lastly, the resources section includes year-end planning letters and an IRS-approved online continuing education test that qualifies for eight credits.

Cheers to a successful tax season,

Janelle Julien

Managing Editor, NAEA Publications

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CHAPTERS

1 IT'S DEJA VU ALL OVER AGAIN: NEW TAX FORMS FOR 2019

BETH LOGAN, EA

Form 1040 changed significantly for the 2018 tax season. It is changing again for the 2019 tax year. It appears that the 2017 and 2018 forms had a baby — the 2019 form. In other words, the pendulum is swinging back a bit.

1040 AND 1040-SR

The changes are not a surprise. In the Bipartisan Budget Act passed on February 9, 2019, Congress ordered the IRS to concoct a new Form 1040, called the 1040-SR for seniors. The intent was to give taxpayers 65 years or older an easier form than the 1040 but without the income restrictions of forms 1040-A and 1040-EZ. Now, there are no income restrictions from any combination of:

- Social Security
- Qualified retirement plans, annuities, and deferred compensation plans
- Interest
- Dividends
- Capital gains and losses.

When Congress initially passed this legislation, it appeared that we would have four forms — 1040, 1040-A, 1040-EZ, and 1040-SR. (This does not include forms 1040-NR and 1040-PR.) Instead, the IRS changed the forms for 2018 and again for 2019. We now have forms 1040 and 1040-SR which are, for all intents and purposes, identical.

While 2018 brought us Schedules 1-6, 2019 has reduced those to Schedules 1-3. This change means that more information has been returned to Form 1040. It is still not a full front page nor a full back page, but it is now too long to call a postcard.

For 2019, Form 1040 (and Form 1040-SR) have returned the signature section to the second page and moved the income and adjusted gross income (AGI) to the front page. The address section can again handle a foreign address without an added schedule. The front page now goes all the way to the taxable income. The question about health insurance has been eliminated — remember that

there is no longer a federally-imposed penalty for not having health insurance. Another change in the beginning section is the combining of the standard deduction questions for both spouses into one subsection. This is much better than 2018 when most questions about the primary taxpayer's standard deduction were after the primary's name but one was actually listed after the spouse's name.

The numbered lines have changed again. (The IRS is testing our memory skills.) IRAs have again been separated from pensions and annuities resulting in 4a, 4b, 4c, and 4d to cover the totals and taxable amounts.

Capital gains have been returned to Form 1040 as line 6. We are back to the capital gains/losses going from Form 8949 to Schedule D to Form 1040 – it no longer has to pass through Schedule 1 to get to Form 1040.

The other income remains on Schedule 1. These are generally less common income sources such as rentals, sole proprietorships, unemployment, alimony, etc. The total is then transferred to line 7a and the total income is summed on line 7b. (We will get to Schedule 1 later.) The above the line adjustments are also on Schedule 1. The total transfers to line 8a and the AGI is calculated and placed on line 8b.

The standard or itemized deduction is shown on line 9. Qualified business income deduction (QBID) is calculated on Form 8995 or 8995-A and then included on line 10. (The family of forms 8995 are new and discussed later.) These deductions are summed on line 11a. AGI minus the deductions is taxable income which appears on line 11b.

Page two covers taxes due, credits, taxes paid or withheld, refunds, bank information, amount due, third party designee, and signatures. Initially it appears the same as last year, except the numbering. Watch out. Instead of Schedules 2-6, there are now only Schedules 2 and 3. The IRS also added lines to show the totals from some parts of these schedules, but not all. It is not consistent.

It is easiest to explain the changes to page two of Form 1040 by covering the numbered schedules. We will start with the easiest. Schedule 6 is gone because the foreign address lines are on page one of the 1040 and the third party designee is on page two with the signatures.

Before we get into the regular lines of Schedule 1, notice a new question at the top. "At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?"

Schedule 1, part one covers the other income and part two covers the above-the-line adjustments. The numbering starts at one and most of the "reserved" lines are gone. The IRS stated that they

could not change the line numbers last year because of the late date in changing the forms and the way the computer programs are set up.

There is a major change regarding alimony. Both the lines for alimony received and alimony paid require the taxpayer to include the "date of original divorce or separation agreement." Remember that the Tax Cuts and Jobs Act (TCJA) eliminated the alimony deduction for agreements after December 31, 2018. It is important to note that the official date of divorce is not the critical date. Instead, the alimony deduction is based on the date of the alimony agreement. In late 2018, courts throughout the country rushed to process alimony agreements to ensure that the alimony paid was deductible. When you talk to your clients, make sure to ask the date that the *alimony agreement* was finalized.

Schedule 2 has two parts. It is basically Schedules 2 and 4 from 2018. Part one is the tax that can be reduced by non-refundable credits. These are the alternative minimum tax (AMT) and the excess advanced premium tax credit repayment. Remember that while the requirement to have insurance was eliminated effective January 1, 2019, the repayment of excess insurance payments remains. The calculations of income versus poverty level and silver plan expenses are still completed on Form 8962.

Part two of Schedule 2 are the taxes due that cannot be reduced by non-refundable credits and include:

- Self-employment tax
- Unreported Social Security and Medicare contributions
- Penalties on early IRA withdrawals
- Schedule H household employee taxes
- First-time home buyer repayments
- Net investment income tax (NIIT) (Form 8960)
- Excess Medicare (Form 8959)
- §965 tax.

Yes, §965 now has a line on Schedule 2. Remember that for 2018 tax filing, Form 965-A was created to report the tax from the deferred foreign income. Income subject to §965 often appears on K-1s and 1099-DIV forms.

Schedule 3 covers refundable and non-refundable credits as well as other tax payments — essentially, Schedules 3 and 5 from 2018. Part one covers the non-refundable credits including education credits but not the child and dependent credits. Those remain on Form 1040. Part two

covers estimated tax payments, excess Social Security contributions, and some refundable credits. The earned income tax credit (EITC), the American opportunity tax credit (AOTC), and the additional child credit remain on Form 1040.

The differences between Form 1040 and Form 1040-SR are minimal. First, the text on Form 1040-SR is slightly larger. The IRS also added a detailed standard deduction chart showing all the options depending on blindness and age.

The instructions for forms 1040 and 1040-SR were released on October 10, 2019, and were still in the 30-day comment period when this article was written. Congress passed a law requiring this new form for taxpayers over 65 and using the standard deduction. According to the form and the instructions, the 1040-SR is acceptable whether the taxpayer is using the standard deduction or itemizing. It is generally thought that both taxpayers needed to meet the age limit but the instructions are not explicit.

FAMILY OF 8995 FORMS

Computing the QBID was handled on worksheets for 2018. For 2019, the computations will appear on Form 8995 or Form 8995-A. Form 8995 is for the simplified calculations while Form 8995-A handles the complicated situations. But there are still missing calculations.

The instructions for forms 8995 and 8995-A include a 17-question flow chart to help determine what income is included in qualified business income (QBI).

Form 8995 handles the simplified computation of the deduction but not the income. Therefore, the tax preparer or taxpayer needs to calculate the QBI. Any aggregation of business income is also excluded from this form. The total QBI from the aggregation is entered on line 1 and named as such.

Therefore, before using Form 8995, the total profit needs to be determined. The income is then reduced by the self-employment tax deduction, qualified retirement deduction, and the health insurance deduction. Other less common factors may also adjust the income to reach the QBI.

Once QBI is determined for all businesses and K-1s, including real estate investment trusts (REITs) and publicly traded partnerships (PTPs), then the information can be carried to Form 8995. Line 1 is the QBI from most businesses. Real estate investment trust dividends appear later. The income, losses, and carryforward losses are combined and multiplied by 20 percent. Next, the REIT dividends, PTP income, and PTP losses are combined and multiplied by 20 percent.

Lines 11-14 calculate taxable income less qualified capital gains. The qualified business income deduction is the lesser of 20 percent of QBI and 20 percent of ordinary taxable income. Long-term capital gains already have a lower rate, so they are excluded.

Losses must be carried forward to reduce future years QBID. These carryforward losses are calculated and shown on lines 16 and 17.

For more complicated QBID calculations including specified service trades or businesses (SSTB), there is Form 8995-A and its schedules, A-D. Schedule A determines the QBI for SSTBs. Schedule B is used to aggregate businesses. Schedule C nets losses, current and previous, with appropriate gains and calculates carryforward losses. Agriculture and horticulture co-ops use Schedule D.

The information from these four schedules is transferred to Form 8995-A for the more complex QBID computations. This is where the computations for QBID involving wages and assets are reported.

W-4

The IRS continues to change the W-4 in an attempt to make it more accurate. It now includes a head of household option. For married filing jointly taxpayers, there is an option to indicate that your spouse also has a job.

The child and dependent credits have increased several times and currently have a large impact on taxes due. They are also now included on the W-4.

It is recommended that most taxpayers complete the new W-4 form when it is available in 2020. And a big thank you to all NAEA members that helped to get the changes made.

DISCONTINUED FORMS

The IRS has discontinued Form 2555-EZ. Starting with the 2019 tax filings, all taxpayers claiming the foreign income exclusion will need to use Form 2555.

Schedule C-EZ has also been eliminated. All sole proprietors must use Schedule C.

Schedules 4-6, introduced last year, are now eliminated. Schedule 4 has been merged into Schedule 2, Schedule 5 into Schedule 3, and Schedule 6 into forms 1040 and 1040-SR.

Form 8965 is not needed after the 2018 tax year, because the health insurance requirement

has been eliminated. Form 8962 is still valid because any excess credit must be repaid and any underpayment of credit is due to the taxpayer.

The associated instructions for the above forms have also been discontinued.

BUSINESS FORMS

The IRS has changed forms 1065 and 1120-S and the associated K-1 forms. The changes reflect both areas of interest to the IRS and changes caused by the TCJA. These forms are still open for comments as of the writing of this article (early October). Also, the instructions have not been released.

1065 K-1

There are four main changes to this form. First, the IRS has added part N to the left side which asks about the partner's share of net unrecognized s §704(c) Gain or (Loss). Second, the guaranteed payments, found on line 4, are broken down into guaranteed services, line 4a, and guaranteed capital, line 4b. Third, there are two new questions, numbers 21 and 22, asking if there is more than one activity for at-risk purposes and more than one for passive activity purposes.

Finally, and surprisingly, the QBID (aka, §199A) information has been reduced. Last year, it was provided in box 20 using codes Z-AD. Now is it only under code Z. The draft forms calls the line "§199A information" while the instructions call it "§199A income." From this, we can infer that the information will be even more hidden in the partner's instructions. As of October 1, 2019, the instructions for Form 1065 were not yet available. Unclear instructions may lead to businesses not providing all the necessary information for partners to receive the appropriate QBID.

1065

As with the K-1 form, the questions about the number of activities for at-risk purposes and passive activity purposes have been added.

1120-S K-1

The last two changes explained in Form 1065 K-1 section apply to Form 1120-S K-1 as well. The

two new questions about more than one at-risk and passive activity are questions 18 and 19. The §199A is only line 17, code V. Again, the instructions are not yet available.

1120-S

As with the K-1 form and Form 1065, the questions about the number of activities for at-risk purposes and passive activity purposes have been added.

THE WITHHOLDING CALCULATOR

This is not a form but it is an important tool that the IRS is providing. The calculator is pretty detailed and asks about many sources of income. The one thing it does not do is to try to separate qualified dividends and long-term capital gains from other income. Instead, all income is included at the ordinary income rate. Otherwise, it is pretty detailed. It can be found at:

https://apps.irs.gov/app/tax-withholding-estimator.

Let us hope these changes settle out for the 2020 tax year.

ABOUT THE AUTHOR

Beth Logan, EA, has two engineering degrees and an MBA but has become a tax nerd. She is the president of the Massachusetts Society of Enrolled Agents, has a tax practice in Chelmsford, and is a nationally published author. Her most recent book is *Divorce and Taxes After Tax Reform*.

FOR YOUR REVIEW

1. The following are now back on the Form 1040

A. Foreign address
B. Third party designee
C. Both
D. Neither

2. Schedule 2 now covers

A. Other income
B. Other taxes
C. Other credits
D. Tax payments

2 EFFECTS OF THE TCJA ON SALT REFUNDS

SARAH N. GAYMON, CPA

TJCA BACKGROUND

Prior to the Tax Cuts and Jobs Act (TCJA) there was no limit to the amount of state and local taxes (SALT) that could be deducted as an itemized deduction on an individual's income tax return. Taxpayers had the ability to deduct all property taxes and to deduct either sales taxes paid, or state income taxes paid. For taxable years beginning after December 31, 2017, TCJA placed a $10,000 limitation on the amount of SALT deductions that are allowed as an itemized deduction.

For the 2018 tax year, TCJA also increased the standard deduction to $12,000 for single filers, $18,000 for head of households, and $24,000 for married couples filing a joint return. The increase in the standard deduction along with the new limitation on SALT deductions have complicated the treatment of refunds for overpayments of state and local taxes. In previous years the treatment of state income tax refunds was straight forward; if a taxpayer took an itemized deduction which included state and local taxes paid, they were responsible for reporting any refund of those amounts as gross income.

The changes caused by TCJA now force taxpayers to ask the question; what portion of SALT refunds must be included into gross income for tax purposes? Determining the additional benefit received by the taxpayer after taking the itemized deduction is the key to calculating the refund amount that is includable into gross income. Earlier this year, the IRS released Revenue Ruling 2019-11 to offer guidance on this issue.

The tax code states that "gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter". In short, this means that taxpayers that are unable to itemize their deductions when filing their income tax return receive no additional tax benefit from reporting state and local taxes and therefore any refund of state and local taxes would be excluded from gross income.

In the event the taxpayer utilizes itemized deductions, the taxpayer must now consider the tax effect of the limit on SALT deductions and account for the benefit received by the deduction to figure how much of any SALT refunds are includable in gross income. In order to properly assess whether a benefit was received, taxpayers must now calculate what the itemized deduction would have been if the correct amount of taxes were paid in the prior year.

IMPACT ON STATE AND LOCAL TAX REFUNDS

Revenue Ruling 2019-11 provides four situations to help taxpayers assess whether any SALT refunds received will be included in gross income. These situations will be addressed in detail below. For each scenario, assume that the taxpayer's filing status is "single" and itemized deductions are used in lieu of the standard deduction.

SALT SCENARIOS

Situation 1: Taxpayer A paid local real property taxes of $4,000 and state income taxes of $5,000 in 2018. A's state and local tax deduction was not limited by the new TCJA limitation because it was below $10,000. Including other allowable itemized deductions, A claimed a total of $14,000 in itemized deductions on A's 2018 federal income tax return. In 2019, A received a $1,500 state income tax refund due to A's overpayment of state income taxes in 2018.

In *Situation 1* the taxpayer paid $9,000 in taxes but only owed $7,500 which generated a $1,500 refund. Taxpayer A did not exceed the $10,000 SALT limitation so the full $9,000 of state and local taxes is included in the itemized deductions. If the taxpayer had only paid the $7,500 state and local taxes due, it is apparent that both the itemized deduction and SALT deduction would have been reduced by $1,500. Because Taxpayer A received a $1,500 benefit as a reduction in his 2018 gross income, the full $1,500 refund in 2019 is includible as gross income.

Situation 2: Taxpayer B paid local real property taxes of $5,000 and state income taxes of $7,000 in 2018. The TCJA changes limited B's state and local tax deduction on B's 2018 federal income tax return to $10,000, so B could not deduct $2,000 of the $12,000 state and local taxes paid. Including other allowable itemized deductions, B claimed a total of $15,000 in itemized deductions on B's 2018 federal income tax return. In 2019, B received a $750 state income tax refund due to B's overpayment of state income taxes in 2018.

In *Situation 2*, Taxpayer B paid $12,000 in state and local taxes and received a $750 refund.

Had Taxpayer B just paid the $11,250 tax liability, he would have still exceeded the $10,000 SALT limitation leaving the itemized deduction unaffected by the $750 refund. Regardless of the refund, Taxpayer B's itemized deductions would remain unchanged, meaning the $750 overpayment provided no additional tax benefit to Taxpayer B. Therefore, Taxpayer B is not required to include the $750 refund in his 2019 gross income.

Situation 3: Taxpayer C paid local real property taxes of $5,000 and state income taxes of $6,000 in 2018. Changes to TCJA limited C's state and local tax deduction on C's 2018 federal income tax return to $10,000, so C could not deduct $1,000 of the $11,000 state and local taxes paid. Including other allowable itemized deductions, C claimed a total of $15,000 in itemized deductions on C's 2018 federal income tax return. In 2019, C received a $1,500 state income tax refund due to C's overpayment of state income taxes in 2018.

Taxpayer C has exceeded the SALT limitation by $1,000 and $10,000 of the $11,000 taxes paid is included in the itemized deductions. Because the actual tax liability was $9,500 and the taxpayer deducted $10,000, Taxpayer C will be responsible for reporting the additional $500 as gross income for 2019.

Situation 4: Taxpayer D paid local real property taxes of $4,250 and state income taxes of $6,000 in 2018. The changes under TCJA limited D's state and local tax deduction on D's 2018 federal income tax return to $10,000, so D could not deduct $250 of the $10,250 state and local taxes paid. Including other allowable itemized deductions, D claimed a total of $12,500 in itemized deductions on D's 2018 federal income tax return. In 2019, D received a $1,000 state income tax refund due to D's overpayment of state income taxes in 2018.

Calculating the portion of a SALT recovery that should be included in gross income is tricky when the refund would have taken a client below the itemized deduction limit as in Situation 4. If Taxpayer D never overpaid his prior year taxes, his actual SALT liability would have been $9,250 ($10,250 less his $1,000 refund). The $9,250 is $750 below the SALT limitation. If the taxpayer only reported the $9,250 tax liability, he would not have met the $12,000 itemized deduction minimum.

Under this scenario itemizing would not make sense because the standard deduction would have been higher than the benefit of taking the SALT deduction. The taxpayer received a $500 ($12,500 itemized deduction less the $12,000 standard deduction) benefit by including his SALT overpayment in his prior year 1040. Consequentially, $500 of the $1,000 refund must be included into gross income.

CONCLUSIONS

As with many other changes from TCJA, the $10,000 limit on SALT deductions has resulted in a greater need for tax professionals to analyze the net effect of SALT refunds. Determining the additional benefit received by the taxpayer after taking the itemized deduction is the key to calculating the refund amount that is includable into gross income. Taxes are not always straight forward, or easy. It is important to seek proper guidance when preparing tax returns. Please contact a member of the Tax Advisory Group at HBK if you have any questions regarding the inclusion of state and local tax refunds in gross income or any other changes to the tax law resulting from TCJA.

ABOUT THE AUTHOR

Sarah is a senior manager with HBK's Tax Advisory Group. She works out of the firm's West Palm Beach, Florida office. Her background includes tax compliance and tax consulting for high net worth individuals, family groups, trusts, estates, and gift tax issues. Sarah's experience also includes aiding in the year end planning process as well as the preparation and review of individual, trust, gift, estate, small family owned partnerships and small S-Corporation returns. She has completed extensive research in the gift and estate tax area and has contributed to the publication of an international estate and gift tax planning handbook as well as a tax publication in the Naples Daily News Estate Planning Insert. She earned a Bachelor of Science degree in Accounting and a Master of Science degree in Taxation Accounting from St. John's University in Queens, New York and is licensed to practice accounting in Florida, New York, and New Jersey.

Jerrod E. Longley is an intern in the West Palm Beach, Florida office of HBK CPAs & Consultants and contributed to this story.

FOR YOUR REVIEW

1. **Under the Tax Cuts and Jobs Act, a limitation of what amount was placed on SALT deductions that are allowed as an itemized deduction?**

   A. $15,000
   B. $40,000
   C. $50,000
   D. $10,000

2. **Revenue Ruling 2019-11 provides how many situations to help taxpayers assess whether any SALT refunds received will be included in gross income?**

   A. Four
   B. Five
   C. Three
   D. Zero

3 DEMYSTIFYING §199A AND RENTAL ACTIVITIES

THOMAS A. GORCZYNSKI, EA, USTCP

I read Gil Charney's analysis of the application of §199A to a rental activity in the September/October 2019 edition of *EA Journal* ("Your Questions Answered," pp. 12-13) and I do not agree with it. In that case, I believe the taxpayer clearly qualifies to take the §199A deduction on the rental income. Since there has been much practitioner confusion about when a rental activity qualifies for the §199A deduction, this topic deserves additional explanation and discussion.

BIG PICTURE

Under the final §199A regulations, a rental activity qualifies for the §199A deduction in one of three ways:

- It is a §162 trade or business.[1]
- A commonly controlled trade or business is the lessee.[2]
- It meets the safe harbor requirements.[3]

§162 TRADE OR BUSINESS

Under Supreme Court precedent, for an activity to be a trade or business activity, "the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify."[4]

There is no black-and-white test for whether an activity rises to the level of a §162 trade or business – it is dependent on the facts and circumstances of that taxpayer's particular situation.[5]

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[1]Treas. Reg. §1.199A-1(b)(14).

[2]Treas. Reg. §1.199A-1(b)(14).

[3]Rev. Proc. 2019-38.

[4]*Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987).

[5]*Higgins v. Commissioner*, 312 U.S. 212, 217 (1941).

In a 2001 Service Center Advice (SCA), the IRS opined that most rental activities qualify as §162 trade or business activities: "...Where it is clear from the facts that real estate is devoted to rental purposes, the courts have repeatedly held that such use constitutes use of property in a trade or business, regardless of whether or not it is the only property so used..."[6] The SCA cites numerous United States Tax Court cases over the last 70 years to support that statement.[7]

In *Hazard*, a case from the 1940s, the Tax Court determined that the rental of a single residential rental property rose to the level of a trade or business, even though the court record had no information regarding the activity level of the owner.

The IRS acquiesced to the *Hazard* decision and has not changed that position; a General Counsel Memorandum stated the IRS view on *Hazard* and the amount of activity required for a rental to rise to the level of a trade or business: "The problem that you raise is not with the legal standard applied by the courts, but with the relatively small amount of activity that the courts have found to be indicative of a trade or business. In view of the number of cases that have been decided on this issue, only some of which have been cited above, it is unlikely that the Service could now persuade the courts to take a more restrictive approach with respect to the amount of activity required to find that a taxpayer's rental activity constituted a trade or business."[8]

The preamble to the final §199A regulations provides factors to consider when determining if a rental activity rises to a §162 trade or business:[9]

- Type of rented property (commercial real property versus residential property).
- Number of properties rented.
- Owner's or the owner's agent's day-to-day involvement.
- Types and significance of any ancillary services provided under the lease.
- Terms of the lease (a net lease versus a traditional lease, and a short-term lease versus a long-term lease).

In general, a single triple net lease has insufficient owner involvement for the activity to rise to

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[6]Service Center Advice 200120037, at 2-3.

[7]*Curphey v. Commissioner*, 73 T.C. 766 (1980); *Fegan v. Commissioner*, 71 T.C. 791, 814 (1979); *Elek v. Commissioner*, 30 T.C. 731 (1968); *O'Madigan v. Commissioner*, 19 T.C.M. 1178 (1960); *Lagreide v. Commissioner*, 23 T.C. 508 (1954); *Hazard v. Commissioner*, 7 T.C. 372 (1946).

[8]General Counsel Memorandum 38779.

[9]TD 9847, Federal Register, Vol. 84, No. 27, p.2955.

the level of a §162 trade or business.[10] However, it is possible that the rental of a triple net lease property in conjunction with other rental activities could cause all of the rental activities to collectively rise to the level of a §162 trade or business.[11]

Whether or not a rental activity is passive under §469 is not relevant to the §162 trade or business determination.[12] A rental activity can be both a passive activity and a §162 trade or business.

COMMONLY CONTROLLED TRADE OR BUSINESS

A rental activity can fail to be a §162 trade or business and yet qualify for the §199A deduction if the taxpayer rents the property to a commonly controlled trade or business. This is an exception to the general rule in the §199A final regulations.

Common control exists when the same person or group of persons, directly or by attribution under §267(b) or §707(b), owns 50 percent or more of both the rental activity and the trade or business.[13] An individual or pass-through entity must conduct the trade or business; a C corporation is ineligible for this provision.[14]

If a rental activity qualifies for the §199A deduction under this provision, and the commonly controlled business is a specified service trade or business (SSTB), then that portion of the rental property being rented to the 50 percent or more commonly-owned SSTB is treated as a separate SSTB with respect to the related parties.[15]

SAFE HARBOR

In September 2019, the IRS issued the final rental safe harbor, which applies to tax years ending after December 31, 2017. Taxpayers can still rely on the proposed rental safe harbor in Notice 2019-07 for the 2018 taxable year.[16]

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[10] *Neill v. Commissioner*, 46 B.T.A. 197, 198 (1942); *Herbert v. Commissioner*, 30 T.C. 26 (1958); Rev. Rul. 73-522.

[11] *Lewenhaupt v. Commissioner*, 20 T.C. 151 (1953); *CRSO v. Commissioner*, 128 T.C. 153 (2007).

[12] TD 9847, Federal Register, Vol. 84, No. 27, p.2955.

[13] Treas. Reg. §1.199A-4(b)(1)(i).

[14] Treas. Reg. §1.199A-1(b)(14).

[15] Treas. Reg. §1.199A-5(c)(2)(i).

[16] Rev. Proc. 2019-38, Section 4.

The purpose of the safe harbor to assist taxpayers in determining whether or not rental activities are a trade or business for purposes of the §199A deduction. Use of the safe harbor is completely optional and failure to meet the safe harbor requirements does not indicate that the rental activity does not meet the §162 trade or business standard.[17] Use of the safe harbor is an annual determination.[18]

To use the safe harbor, an individual or pass-through entity arranges its rental activities into one or more rental real estate enterprises. If the enterprise meets the safe harbor requirements, then taxpayer treats each enterprise as a single trade or business that qualifies for the §199A deduction. Since the enterprise is a single trade or business for §199A purposes, the taxpayer would add together the qualified business income (QBI), wages, and unadjusted basis in assets (UBIA) for each rental activity and do one §199A calculation for the enterprise.

The enterprise is only relevant for purposes of the safe harbor; it is separate from the §469 grouping election or aggregation under Treas. Reg. §1.199A-4. However, since the safe harbor treats the rental activities in an enterprise as a single trade or business for §199A purposes, aggregation is unnecessary for those rental activities since the single trade or business treatment has the same effect.

A taxpayer may either treat each rental activity as its own enterprise or put all commercial rental activities into one enterprise and all residential rental activities into another enterprise. A taxpayer can treat a mixed-use rental activity as either one enterprise or bifurcate it into separate residential and commercial interests. The taxpayer cannot place multiple mixed-use rental activities into one enterprise.[19]

Once a taxpayer arranges multiple rental activities into a single enterprise, the taxpayer must continue to treat all similar rental activities as a single enterprise as long as the taxpayer continues to rely on the safe harbor. If a taxpayer chooses to treat each rental activity as its own enterprise, then the taxpayer may choose in a later tax year to combine multiple rental activities into one enterprise, as allowed.[20]

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[17]Rev. Proc. 2019-38, Section 1.

[18]Rev. Proc. 2019-38, Section 1.

[19]Rev. Proc. 2019-38, Section 3.02.

[20]Rev. Proc. 2019-38, Section 3.02.

The following rental activities are ineligible for the safe harbor and a taxpayer cannot place them into an enterprise:[21]

- Real estate used by the taxpayer as a residence under §280A(d).
- Real estate leased under a triple net lease, with a triple net lease defined as a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities.
- Real estate where a commonly controlled trade or business conducted by an individual or pass-through entity is the lessee.
- The entire real estate interest if any portion of it is treated as a SSTB.

To qualify for the §199A deduction under the safe harbor, a rental real estate enterprise must meet three requirements:[22]

1. At least 250 hours of rental services performed with respect to the enterprise per year by owners, employees, contractors, or agents. Enterprises in existence for at least four years only need to meet the 250-hour requirement in any three of the five consecutive taxable years that end with the taxable year.
2. Contemporaneous records to document hours of all services performed, descriptions of all services performed, dates of services performed, and who performed the services. If employees or contractors perform the services, then the taxpayer should retain a description of the rental services performed by such employee or independent contractor, the amount of time each employee or independent contractor generally spends performing such services, and time, wage, or payment records for such employee or independent contractor.
3. Separate books and records to reflect income and expenses. If a rental real estate enterprise contains more than one property, then the taxpayer meets this requirement if he or she maintains income and expense information statements for each property and then consolidates them.

Rental services that qualify for the 250-hour requirement include advertising to rent or lease the real estate; negotiating and executing leases; verifying information contained in prospective

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[21]Rev. Proc. 2019-38, Section 3.05.

[22]Rev. Proc. 2019-38, Section 3.03.

tenant applications; collection of rent; daily operation, maintenance, and repair of the property; management of the real estate; purchase of materials; and supervision of employees and independent contractors.[23]

Activities that do not qualify as rental services for the 250-hour requirement include financial or investment management activities, such as arranging financing or procuring property; studying and reviewing financial statements or reports on operations; improving property per Treas. Reg. §1.263(a)-3(d); and hours spent traveling to and from the real estate.[24]

It is important to note that the contemporaneous records requirement does not apply for tax years beginning before January 1, 2020.[25] However, taxpayers will need to provide information to substantiate their qualifying for the §199A deduction, contemporaneous or not.

To use the safe harbor, the individual or pass-through entity must attach a statement to a timely filed tax return (amended tax returns for tax year 2018 only). The taxpayer can list multiple enterprises in one statement. The statement must include descriptions (including address and rental category) of all properties in each enterprise, descriptions (including address and rental category) of all properties acquired and disposed of during the tax year, and a representation that the taxpayer satisfied Rev. Proc. 2019-38.[26]

While the safe harbor provides additional certainty to individuals and entities whose rental activities clearly meet the §162 trade or business standard, it does not help taxpayers with limited rental activities who could have most benefitted from a safe harbor.

EXAMPLE

In the question in the original article, the taxpayer owned multiple rental properties, which she directly managed herself. She estimated 300 hours of activity per year with respect to the rental activities, and those hours included tasks such as managing maintenance, collecting rent, advertising, and showing units. She did not track her time in a log.

Assuming the properties are all residential rentals, and that the claimed 300 hours are "rental services" as defined in the safe harbor, she qualifies for the §199A deduction using the safe

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[23]Rev. Proc. 2019-38, Section 3.04.

[24]Rev. Proc. 2019-38, Section 3.04.

[25]Rev. Proc. 2019-38, Section 4.

[26]Rev. Proc. 2019-38, Section 3.03(D).

harbor. For tax year 2018, the safe harbor time documentation requirement does not apply. Therefore, as long as the taxpayer is willing to certify that she met the hours requirement in 2018, and met all other requirements, she can use the safe harbor. For tax year 2019 and forward, the taxpayer should start maintaining contemporaneous log of the hours spent by both her and her contractors if she wishes to use the safe harbor in future tax years.

The taxpayer's rentals also meet the §162 trade or business test. She spends approximately 25 hours per month managing multiple rental activities, and those activities generate one-third of her total income for the year. She has regular and continuous involvement with the rentals and clearly has an intent to make income or profit (and actually does!).

The original article claimed that "a taxpayer can treat rental activity as a trade or business for purposes of the QBI deduction based on the same facts-and-circumstances test IRS uses for the hobby-loss rules," then claims the lack of a time log and other documentation for the safe harbor suggests she does not have sufficient documentation to show the rental activities rise to the level of a trade or business.

While the §183 regulations are instructive when discerning an intent to make a profit in an activity, they are by no means controlling for the overall §162 trade or business determination –in fact, neither the final §199A regulations nor the preamble to those regulations reference §183. The lack of a log documenting one's time spent hardly indicates it was not carried on in a business-like manner, as there was no need to even consider keeping a time log until the safe harbor made it material to the §199A deduction determination.

Setting aside the fact that the taxpayer in this case clearly made a profit each year, as the rentals are a significant portion of her annual income, seven of the nine factors in the §183 regulations clearly favor her rental activities are engaged in for profit: time and effort expended; expectation of asset appreciation; success of the taxpayer in carrying on similar activities; history of income or loss; amount of profits, if any; financial status of the taxpayer; and no elements of personal pleasure or recreation.[27]

In fact, it is not a common situation for a rental activity to not be engaged in for profit. Taxpayers generally do not buy and manage rental properties for personal pleasure or recreation. Most owners have either positive cash flow or plan to hold the asset for appreciation while the renter pays the carrying costs – or both.

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[27]Treas. Reg. §1.183-2(b).

SUMMARY

Most rental activities will qualify for the §199A deduction as §162 trade or business activities as existing case law sets a relatively low bar as to the level of involvement required.

Practitioners have an ethical duty to consistently apply the law regardless of whether the rental activity generates positive qualified business income (possibly generating a §199A deduction) or negative qualified business income (possibly reducing current or future §199A deductions).

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FOR YOUR REVIEW

1. **To qualify for the §199A deduction under Rev. Proc. 2019-38, how many hours of rental services are required each year with respect to a rental real estate enterprise?**
   A. 250
   B. 500
   C. 750
   D. 1000

2. **Which of the following is NOT a factor to consider when determining if a rental activity rises to the level of a §162 trade or business?**
   A. Lease terms
   B. Location of property
   C. Number of properties rented
   D. Services provided under lease

4 DISPOSING OF IRC 197 INTANGIBLES: IT'S ALL OR NOTHING

JAMES P. SWANICK, CPA, AND MICHAEL J. TIGHE, CPA

In a column published in last summer's *Pennsylvania CPA Journal*, we discussed why we anticipated seeing more asset deals among mergers and acquisitions as a result of certain changes brought on by the Tax Cuts and Jobs Act of 2017. This includes deemed asset purchases via an Internal Revenue Code (IRC) §338(h)(10) election. Taxpayers would receive the benefit of getting a stepped-up basis in the assets acquired and resulting depreciation (including immediate expensing via bonus depreciation) and amortization deductions to follow. IRC §1060 provides guidance for allocating the purchase price among the various assets acquired in a business combination. The buyer follows what is commonly referred to as the residual method, and assigns values to the newly acquired hard assets (accounts receivable, inventory, fixed assets, etc.) and intangible assets (customer lists, noncompetes, etc.), with any excess purchase price ultimately assigned to goodwill. Typically, if these intangible assets were acquired from an unrelated third party, they are considered §197 intangibles. Pursuant to §197(a), taxpayers must amortize the intangibles on a straight-line basis, beginning in the month of acquisition over a period of 15 years, even if there is corroborating evidence substantiating a clear definite or legal life that is shorter than 15 years.

DISPOSING OF §197 INTANGIBLES

There is a unique rule within §197 that can catch taxpayers off guard and yield unfavorable results in a situation where their intangibles are either sold at a loss, abandoned, or deemed worthless. Under ordinary circumstances, when taxpayers dispose of a depreciable (or amortizable) asset, they are entitled to claim a loss to the extent the adjusted basis of the asset at the time of the disposition exceeds the amount realized. The adjusted basis of the asset is generally determined to be the initial purchase price of the asset less any accumulated amortization taken throughout its useful life up to the date of disposition. However, when taxpayers acquire §197 intangibles in a transaction (or series of related transactions), those intangibles become permanently tethered and cannot be bifurcated. Therefore, when the time comes to dispose of these intangibles, it is essentially an "all or nothing" approach in order to claim any potential loss

in the current year. The disallowed loss is not lost forever, but rather treated as an increase to the basis of the remaining §197 intangibles, on a pro rata basis, and will continue to be amortized over the remaining life of the §197 intangible assets being retained.

It is important to note that this only applies if the adjusted basis is in excess of the sale price (i.e., sold at a loss), as any gain resulting from the disposition of a §197 intangible is recognized immediately under general tax law principles. Furthermore, the recapture rules for §1231 and §1245 property would apply, essentially treating any gain as ordinary – first to the extent of previous amortization deductions taken, with any excess gain receiving the more taxpayer-friendly capital gain treatment. To prevent taxpayers from manipulating the values assigned to intangibles either upon acquisition or disposition, Congress enacted §1245(b)(8), which says that if a taxpayer disposes of more than one §197 intangible in a transaction or series of transactions, all such §197 intangibles shall be treated as one §1245 property. This rule eliminates the possibility of assigning the sales price to the intangibles with the lowest adjusted basis in order to maximize capital gain treatment and avoid the fair share of taxes owed.

RELATED-PARTY TRANSACTIONS

Even if taxpayers plan to use related parties to acquire the assets of another business, there is no escaping the long reach of the general loss disallowance rules of §197(f). The code effectively adopted the related-party definition contained within §41(f)(1). This treats a group of related parties as a single taxpayer, and serves as a way of preventing taxpayers from circumventing the intended purpose of the loss disallowance rules. The timing of determining related-party status is governed by §197(f)(9)(C)(ii), which provides that a person shall be treated as related to another person if such relationship exists immediately before or immediately after the acquisition of the intangible involved.

For example, Company A and Company B are brother-sister corporations (who are in different consolidated groups, but under common control) and each acquires various assets of a target business in the same transaction(s). After allocating the purchase price among the assets acquired, various §197 intangibles are created that now become permanently linked. If Company A later sells its intangibles while Company B retains its own, then the loss becomes disallowed to Company A. However, instead of treating the disallowed loss as an increase to the basis of the retained intangibles of Company B, the intangibles simply continue to be amortized for tax purposes over the remaining 15-year period for the selling corporation. If in a future period Company B sells its existing §197 intangibles, then it is entitled to claim a full deduction for any

loss incurred, and Company A is entitled to write off the remaining adjusted basis in its §197 intangibles that had been previously disallowed.

ACQUISITION AND DISPOSITION

As with all material business transactions, it is imperative to have proper documentation and support for your tax position. Things can get complicated if you are selling both §197 intangibles with self-created intangibles (which are not considered §197 intangibles). Otherwise, it can be an uphill battle trying to prove that you entirely disposed of assets like customer lists and goodwill, while not retaining any of them whatsoever, even when a piece of that business line is still in existence.

Having thorough and contemporaneous documentation – not only during the time of acquisition of those intangibles but also upon their disposition in later years – is critical. There are endless court cases reflecting the competing objectives between the taxpayer and the IRS on this matter alone. The burden of proof is always on the taxpayer, but half the battle is knowing the rules highlighted above as well as knowing the specific areas that the IRS will target when dealing with the sale of §197 intangibles.

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FOR YOUR REVIEW

1. Which item qualifies as an intangible asset?

A. Inventory
B. Customer lists
C. Accounts receivable
D. Fixed assets

2. Which item qualifies as a hard asset?

A. Customer lists
B. Noncompetes
C. Inventory
D. None of the above

5 MINIMIZING TAX LIABILITY WITHOUT QIP GUIDANCE

LISA HAFFER, CPA, JD, AND DAVID DESROCHES, CPA

Restaurant owners who invested in interior improvements in 2018 may be surprised when they receive their 2018 tax returns and see higher than expected tax liabilities. This is a result of an inadvertent drafting error in the Tax Cuts and Jobs Act (TCJA) relating to the depreciation of restaurant improvements.

Before the TCJA, the tax law provided rules for multiple categories of restaurant property assets, many of which were eligible for favorable tax depreciation benefits. To simplify the rules, tax reform consolidated the categories applicable to interior improvements into the single category of qualified improvement property (QIP). If drafted correctly, QIP would be eligible for 100-percent bonus depreciation and a 15-year cost-recovery period. In what is believed to be an inadvertent drafting error that has received much press, interior improvements placed in service in 2018 must be depreciated over a 39-year life without bonus depreciation.

Because of this drafting error, while taxpayers may be enjoying the rewards of their recent renovations with an expanded and reinvigorated customer base, they may also be sweating their tax bill. In good news, there are workarounds that can help mitigate the impact of the QIP error in the absence of a retroactive technical correction to fix the error. Read on for two of the more popular strategies: the retail refresh safe harbor for remodels and cost segregation studies.

THE REMODEL-REFRESH SAFE HARBOR METHOD

Under IRS Revenue Procedure 2015-56, known as the Remodel-Refresh Safe Harbor, 75 percent of the costs of an improvement can be immediately expensed, with the remaining 25 percent depreciated over 39 years. Because this is a safe harbor, restaurants do not need to spend time analyzing invoices to determine whether a cost is a repair (eligible for immediate tax expense) or a capitalized asset (depreciated over 39 years for tax); 75 percent of costs are eligible for immediate deduction.

There are pros and cons to adopting the remodel safe harbor. A distinct advantage that the safe harbor offers over bonus depreciation is that the immediate 75-percent deduction reduces both

federal and state taxable income. QIP, by contrast, would have allowed for a 100-percent bonus deduction, but only on federal tax returns. Most states would require the bonus depreciation to be added back and the improvements to be depreciated without bonus over 39 years.

A disadvantage of using the safe harbor is that a restaurant cannot take partial disposition losses for items that are replaced, and instead must maintain assets in general asset accounts until a final disposition.

In addition, restaurants that incur debt to pay for their remodels may not reap the full benefits of the safe harbor. This is because of the new interest expense limitation rules implemented under tax reform, which limit the amount of interest that can be deducted in a given tax year to 30 percent of adjusted taxable income (ATI). For tax years prior to 2022, taxpayers can increase their ATI (and thus the amount of deductible interest) by adding back depreciation. In contrast, the 75 percent safe harbor remodel expense does not constitute depreciation for this purpose. Restaurants that used loans to pay for remodels will want to run projections to ensure that the benefits of the remodel expense are not diminished by disallowed interest expense deductions.

The ability to use the remodel safe harbor is contingent upon having audited financial statements. Restaurants with audited financials have until the extended due date of their 2018 return to adopt the safe harbor method for this tax year. Businesses that previously evaluated whether to adopt the safe harbor and determined that the cost of having an audit did not outweigh the potential benefits may want to take a second look considering the absence of favorable QIP benefits.

COST SEGREGATION STUDY

An alternate workaround for taxpayers with less stringent requirements than the remodel safe harbor is to have a cost segregation study performed on one or more of their improvement projects. A cost segregation study is an engineering-based study that analyzes construction costs to identify portions that can be written off quickly for tax purposes. Cost segregation studies can be performed on constructed buildings or improvements made to leased property; this article focuses on studies performed on leasehold improvements.

Decorative millwork and light fixtures, restaurant-specific electrical and plumbing work, and signage are a few examples of items that, if identified in cost segregation studies, may be eligible for 100-percent bonus depreciation and a five- or 15- year life. Without a study, these same assets would be depreciated over a 39-year life with no bonus.

Advantages of cost segregation studies include increased cash flow and significant net present value benefits. Perhaps the biggest advantage that cost segregation studies offer over the remodel safe harbor approach is that restaurants can pick and choose which current and/or prior projects they want to perform studies on. Cost segregation studies performed in the 2018 tax year on prior year projects can result in significant "catch-up" depreciation deductions that can be claimed on 2018 tax returns. Current deductions of "catch-up" depreciation is a tax planning tool that restaurants can use to defer having studies performed on certain projects until years that they have high taxable income.

Unlike the remodel safe harbor workaround, depreciation deductions generated via a cost segregation study are permitted to be added back when computing ATI for purposes of the new interest expense limits.

A disadvantage to cost segregation studies is that most states will require accelerated depreciation to be added back and replaced with a slower state depreciation regime. As a result, cost segregation studies performed for either 2018 projects (that generate 100-percent bonus) or prior year projects (that generate 50-percent bonus) will not generate the same immediate benefits for state tax as they do for federal tax.

BDO'S TAKE

Many businesses are extending their 2018 tax returns as they investigate solutions to the QIP error. If your clients have not yet decided whether to extend, these two potential solutions may be a good reason to consider doing so. Most pass-through entities must file by March 15, but a six-month extension would give them until September 16 to file; corporate taxes are due April 15, but an extension would give them until October 15 to file. Another reason to extend is the possibility that QIP will be fixed and made retroactively effective for the 2018 tax year.

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FOR YOUR REVIEW

1. **ATI is the acronym for**
   - A. Adjusted taxable income
   - B. Automatic transaction initiation
   - C. Average total inspection
   - D. All taxes included
2. **The acronym QIP stands for**
   - A. Questionnaires for investigations processing
   - B. Quality improvement plan
   - C. Quarterly installment payment
   - D. Qualified improvement property

6 THE NEW UNITED STATES EXPAT TAX REFORM DRAFT FOR 2019

NATHALIE GOLDSTEIN, EA

For a long time, Form 1040 (the typical United States tax return) had a pretty consistent, yet complicated look. Then the Trump administration announced a new tax bill: The Tax Cuts and Jobs Act, which was the largest tax reform in the United States in 30 years.

We already saw the reduced postcard version of Form 1040 introduced in tax season 2018. However, that was just the beginning of it. Here we will highlight the new United States expatriate (expat) tax reform draft coming in effect for the 2019 tax season.

This special announcement happened during the release of the new 2018 tax form. Taxpayers, consultants, and tax professionals equipped with the new tax law were appalled. On the new form, questions were simply removed from the old Form 1040 and added to new schedules and attachments. The United States tax return did not really get smaller but split up into different sections.

UNITED STATES EXPAT TAX REFORM DRAFT FOR 2019

Now, if you take a look at the new U.S. expat tax reform draft of 2019,[1] some changes from the 2018 form are still intact. However, you may notice it also goes back to looking like the previous U.S. tax return style that you and many tax professionals are most likely familiar with.

Americans living abroad, U.S. citizens in the United States, and permanent resident card (green card) holders are brought to (once again) another version of Form 1040.

The new expat tax reform draft of 2019 includes the following changes, plus some other points:

- Types of gross income and deductions used for taxable income is on page one.
- Capital gains or losses is on line six on the front page (instead of on Schedule 1).
- Better clarity that the name of the spouse under "choosing married filing separately," and the name of a child who is not a dependent in the "head of household" section is required.
- The additional child tax credit[2] and the earned income credit[3] are highlighted

sections. Remember to advise *expat families of their refundable $1,400 additional child tax credit*.

- The lines to enter the taxpayer's foreign address are now on page two instead of Schedule 6.
- Mandated health care coverage is no longer required. Thus, the checkbox for health care coverage has been removed.

INCREASED EXPAT EXCLUSION AND DEDUCTION AMOUNTS

The maximum foreign earned income exclusion amount increases to $105,900 for the tax year 2019.

From this, the standard deduction continues to increase as well:

- MFS = Married Filing Separately (the most common filing status for expats married to non-U.S. citizens)
- HoH = Head of Household (expats who would otherwise file as MFS can use HoH if they have qualifying children and keep up more than half of the household)
- MFJ = Married Filing Jointly
- QW = Qualifying Widow

Filing Status	2017 Standard Deduction	2018 Standard Deduction	2019 Standard Deduction
Single	$6,350	$12,000	$12,200
MFS	$6,350	$12,000	$12,200
MFJ	$12,700	$24,000	$24,400
QW	$12,700	$24,000	$24,400
HoH	$9,350	$18,000	$18,350

FORM 2555-EZ CAN NO LONGER BE USED IN 2019 AND BEYOND

The simplified version of the foreign earned income exclusion, Form 2555-EZ, is probably the most common U.S. expat tax form used. Unfortunately, the IRS released an announcement in 2018 that Form 2555-EZ will not be used after 2018.[4]

Therefore, all expats who wish to exclude foreign earned income and foreign housing costs from their U.S. tax return will need to use the more complex Form 2555 version.

RETIRING ABROAD, EXPAT SENIOR CITIZENS AND THE NEW TAX REFORM

The IRS, in addition to creating a newly designed tax return form, also drafted a new, simplified return for senior citizens. Senior citizens, even those abroad, still need to be aware of their filing requirements to make sure that they pay their U.S. taxes on time.

The original Form 1040-SR is known to replace Form 1040-EZ. This is because the IRS wants to make a better version of Form 1040 for the elderly. It is only two pages in length and allows senior citizens to report taxable amounts of the following: pension, Social Security benefits, annuities, and IRA distributions.

Additionally, U.S. expat senior citizens with foreign income can enter their information on income, interest, salaries, tips, wages, dividends, pensions, and more within the two pages.

While Form 1040-SR is reduced, the amount of pages has definitely become simpler. U.S. expat retirees will normally require additional attachments such as Form 8833: Treaty Disclosure, Form 2555: Foreign Earned Income Exclusion, and Form 1116: Foreign Tax Credit. The 2019 draft of Form 2555, Foreign Earned Income Exclusion, is confirmed to be attachable to the 1040-SR version.

THE IRS COMPLIANCE INITIATIVE ON EXPATRIATES

Moreover, the IRS has made it clear that they want U.S. expats to become tax compliant. Their official statement is:[5]

"The Internal Revenue Service will address noncompliance through a variety of treatment streams, including outreach, soft letters, and examination."

IRS (July 2019)

This announcement comes in time with the recent controversy regarding the Foreign Account Tax Compliance Act (FATCA), where hundreds of thousands of American expats face bank account closures.

If taxpayers receive a letter from the IRS or foreign bank, they have the following options:

- Provide their foreign bank with an accurately filled out W-9.
- Use the IRS amnesty option: A streamlined filing compliance procedure to avoid late filing penalties and fees.

Consequently, accidental Americans will need to become tax compliant,[6] starting with obtaining a U.S. taxpayer identification number (Social Security number).

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[1] www.irs.gov/pub/irs-dft/f1040--dft.pdf

[2] www.myexpattaxes.com/us-tax-refunds-for-an-american-family-abroad

[3] www.myexpattaxes.com/u-s-source-income-vs-foreign-income

[4] www.irs.gov/forms-pubs/form-2555-ez-will-not-be-used-after-2018-17-apr-2019

[5] www.irs.gov/businesses/corporations/the-irs-large-business-and-international-division-lbi-announces-the-approval-of-six-additional-compliance-campaigns

[6] www.myexpattaxes.com/accidental-americans-tax-compliant

ABOUT THE AUTHOR

Nathalie Goldstein, EA, is the co-founder and CEO of MyExpatTaxes - the only tax software designed specifically for U.S. Expats. With a background in technology and finance, Nathalie previously held a chief of staff position for one of the largest international IT companies, Cisco Systems in Vienna, Austria, after relocating from Silicon Valley. After launching MyExpatTaxes' software in March 2018, the company has seen rapid expansion and adoption across the globe.

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FOR YOUR REVIEW

1. **The IRS plans to address expat noncompliance by ____.**
   - A. Soft letters
   - B. Prosecution
   - C. Examination
   - D. Both A and C
2. **The original Form 1040-SR has replaced which form?**
   - A. Form 1040-EZ
   - B. Form 2555
   - C. Form 8833
   - D. Form 1040

7 THE FOREIGN INCOME EXCLUSION 2019 RULES FOR UNITED STATES EXPATS

NATHALIE GOLDSTEIN, EA

Tax season for United States expatriates (expats) happens all year round. From the April 15 deadline to automatic extensions into June, and filing deadlines into October, U.S. expats cannot escape the tax responsibility that comes with living abroad. But taxes as an expat can be empowering. They can save some serious money and reduce their tax bill by something called the foreign earned income exclusion.

Known as the FEIE, this foreign earned income tax credit is a money-saving deduction. It can also be a breath of fresh air for expats. It cannot only lower but completely eliminate their tax liability as a U.S. expat.

How can tax professionals assist U.S. expats with the FEIE? Read on to understand the rules for saving money through the 2019 foreign income exclusion for U.S. expats.

UNDERSTAND EXACTLY WHAT FEIE IS AS A U.S. EXPAT

It is important to understand exactly what is involved with if a U.S. expat decides to utilize the foreign earned income exclusion.

The FEIE (or Form 2555) is a tax benefit that allows U.S. expats to exclude a certain amount of foreign earned income from being taxed from the IRS. For 2019, the tax year is for 2018. From this, U.S. expats can exclude up to $103,900 of money earned outside the United States. For the 2019 tax season, the foreign earned income exclusion amount is increased to $105,900.

How do I calculate foreign earned income, for the exclusion?

- Your client earned $112,800 as foreign income in 2018. Subtract the maximum exclusion rate ($103,900) from his or her yearly salary leaving $8,900 that becomes taxable by the IRS.
- Something to remember is that the taxable amount is taxable at the rate applying to what was originally earned. It is called the stacking rule, and the exclusion will only apply to foreign earned income.

Any other income from pension funds, interest, capital gains, etc. cannot be excluded from the IRS foreign income exclusion. Also, U.S. expats can increase their foreign exclusion with qualified housing expenses[1] as well.

The maximum FEIE amount is only available for those who were qualified to use FEIE for the entire tax year. Otherwise, that FEIE amount is prorated based on the number of their qualifying days.

KNOW WHAT IS AND WHAT IS NOT COVERED FOR FEIE

Some of the income U.S. expats receive as a resident of a foreign country may not actually qualify for the IRS's foreign earned income exclusion. For example, the IRS has listed out the following types that cannot be covered:

- Pay for work in international waters.
- Pay received as an employee of the United States government or related agency.
- The values of meals and lodging are excluded from income since it was furnished for the convenience of the employer.
- Payments received after the end of the tax year in the subsequent year that services were performed.
- Pay in specific combat zones.
- Pension or annuity payments, and benefits like Social Security.

STAY UPDATED FOR MAXIMUM AMOUNT CHANGES

How can you help your clients take up the most of what the foreign earned income exclusion has to offer? It is important to stay up to date on the changes regarding the maximum amount. Every year, inflation within the country happens, so whatever the maximum amount for last year was, it will probably be different for the coming year.

Even though we are in the year 2019, U.S. expats must file federal income taxes from the last year (2018). So for the 2018 tax year, the maximum amount U.S. expats can exclude for paying taxes from their foreign income to the IRS is $103,900.

As we approach 2020, the maximum amount for the tax year 2019 is going to be different than the year before. So for U.S. expats, the maximum amount has risen to $105,900 for the 2019 tax year. This means they can exclude up to this amount from taxation (sounds pretty good to us...).

HOW TO QUALIFY FOR THE FOREIGN EARNED INCOME EXCLUSION

It is necessary for U.S. expats to know if they are even eligible to use the exclusion. Otherwise, they could be putting their time and effort into nothing.

The first thing to do is see if they qualify for the FEIE by using either the bona fide residence test or the physical presence test:

Bona fide residence test:

- Answer this: Were you a registered resident and subject to local income taxes in your host country for at least a full calendar year? Then you can claim the foreign earned income exclusion for up to the maximum amount ($105, 900).

Physical presence test:

- You will need to be outside of the U.S. for 330 full days in a consecutive 12-month period that begins or ends in the tax year. If yes, you qualify for the FEIE.
- *Even if you have been in the U.S. for more than 36 days in the tax year, there is a possibility you could still claim the foreign earned income exclusion. It depends on your unique, individual tax profile and situation.*

If your client ends up qualifying for the FEIE from passing one of the tests, he or she may also be able to get foreign housing deductions. This can help your client reduce his or her tax liability even more.

The foreign housing exclusion can allow excluding qualified housing expenses like rent, utilities, or repairs from taxation. Check out this blog[2] to learn more about this feature for families.

CLAIMING THE FOREIGN EARNED INCOME EXCLUSION

Once you are certain your client qualifies for the FEIE, you can now get started. You can do the work manually by completing the Form 2555 or Form 2555-EZ.

Form 2555 is the standard form for the foreign earned income exclusion. Form 2555-EZ is only for U.S. expats who are *not* planning to use foreign housing deductions in conjunction with the FEIE. Please note that the EZ version of the Form 2555 is discontinued after the 2018 tax season.

Once the form is completed, attach it to your client's federal tax return, put it in an envelope, stamp it, and send it on its way or e-file it.

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[1] www.myexpattaxes.com/the-foreign-housing-exclusion-for-us-expats

[2] www.myexpattaxes.com/the-foreign-housing-exclusion-for-us-expats

ABOUT THE AUTHOR

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FOR YOUR REVIEW

1. **Foreign earned income exclusion is reported on which form?**
   A. Form 1040-EZ
   B. Form 2555
   C. Form 8833
   D. Form 1040
2. **Which form was discontinued after the 2018 tax season?**
   A. Form 8833
   B. Form 2555
   C. Form 2555-EZ
   D. Form 1040-EZ

8 UPDATES FOR NONPROFITS UNDER THE NEW TAX ACT

CHRIS CONSOLETTI, JD, AND JOSHUA ENGLAND, JD

Tax exempt organizations should be aware of recent legislative and regulatory updates related to the Tax Cuts and Jobs Act (TCJA) and how these may affect charitable nonprofits.

Legislation Attempts to Repeal the New Unrelated Business Tax on Tax-Exempt Organizations Providing Qualified Fringe Benefits

On December 20, 2018, the House passed the Retirement, Savings, and Other Tax Relief Act (H.R. 88) that would eliminate the provision under §512(a)(7) of the TCJA where unrelated business income will now be increased by the *nondeductible* amount of fringe benefit expenses incurred by a tax-exempt organization.

As of this date, tax exempt organizations may rely upon the below guidance:

What is Considered a Nondeductible Parking Expense that will now Trigger Unrelated Business Income Tax?

On December 10, 2018, the IRS issued Notice 2018-99 which provides guidance on nondeductible parking fringe benefit expenses on which tax-exempt organizations would now be subject to unrelated business income tax (UBIT).

IRS Notice 2018-99 states that the parking expenses referenced in §512(a)(7) of the TCJA are "those expenses related to the property an employer owns or leases, at or near the employer's business or at a location from which the employee commutes to work." Parking expenses, for purposes of calculating UBIT below, do not include depreciation, but do include "repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments or a portion of a rent or lease payment."

The notice goes on to state that, until further guidance is provided, tax-exempt organizations may rely on the following methods to calculate nondeductible parking expenses subject to UBIT:

1. Calculate the disallowance for reserved employee spots:
   - This percentage of parking expenses is nondeductible under §274 and subject to UBIT.
2. Determine the primary use of remaining spots (“*primary use test*”):
   - If over 50 percent of the remaining spots are for the general public and not reserved for employees, then the remaining total parking expenses are not subject to UBIT.
3. Calculate the allowance for reserved nonemployee spots:
   - If the primary use of the remaining parking spots is not to provide parking to the general public, the exempt organization should determine the spots reserved for visitors and customers that cannot be used by employees. If the exempt organization has reserved non-employee spots, it may determine the percentage of reserved non-employee spots in relation to the remaining total parking spots and multiply that percentage by the taxpayer’s remaining total parking expenses. The result is the amount that is not included in UBIT.
4. Determine remaining use and allocable expenses:
   - If there are any allocable parking expenses not accounted for in the above three methods, a tax-exempt organization must reasonably determine the employee use of the remaining parking spots during normal business hours and allocate the parking expenses between nondeductible under §274 and subject to UBIT, or deductible and not subject to UBIT.

These rules may seem cumbersome and complicated. Tax professionals should advise clients to consider discontinuing specifically reserved parking spots for employees as a way to avoid being subject to UBIT.

IRS Issues Guidance Allowing for Retroactive Reduction of Reserved Parking Spots

On December 10, 2018, the IRS issued IR-2018-247, which provides guidance allowing tax-exempt organizations to retroactively reduce the amount of their nondeductible parking expenses by reducing or eliminating the number of employee reserved parking spots that will trigger UBIT, as mentioned above. By making this change, tax-exempt organizations may be able to avoid having to file a Form 990-T or reduce the resulting tax. The notice mentions that this change will “apply retroactively to January 1, 2018.” However, this change had to be completed by March 31, 2019, to be retroactively applied.

ESTIMATED TAX PENALTY RELIEF

Under §512(b) of the TCJA, the changes increasing UBIT by the *nondeductible* amount of fringe benefit expenses paid or incurred by a tax-exempt organization apply to amounts "paid or incurred after December 31, 2017."

On December 10, 2018, the IRS issued Notice 2018-100, which outlines relief from underpayment penalties for certain tax-exempt organizations that provided qualified transportation fringe benefits to employees.

In order to qualify for a waiver of underpayment penalties under this notice, the tax-exempt organization must:

1. Not have been required to file a Form 990-T in the preceding taxable year.
2. Timely pay the amount reported for the taxable year in which relief was granted.
3. Write "Notice 2018-100" on the top of its Form 990-T in order to claim the waiver.

2018 990T OBSERVATIONS

In §512(a)(6) of the TCJA, losses from one unrelated trade or business cannot be used to offset income from a separate unrelated trade or business. However, under IRS Notice 2018-67, an organization will be allowed to take, as a deduction from total unrelated business tax, any pre-2018 net operating loss deduction without being restricted by the "siloing" requirements of §512(a)(6). A tax-exempt organization will be allowed to have separate pre-2018 losses and post-2018 losses.

It was unclear, before the 2018 Form 990-T for 2018 was released, whether tax-exempt organizations would be allowed to use pre-2018 losses to offset UBIT paid for providing qualified fringe benefits. As line 34 lists "amounts paid for disallowed fringes" and line 36 states to subtract any "net operating loss arising in tax years beginning before January 1, 2018 from the amounts paid for disallowed fringes," tax-exempt organizations will be allowed to offset amounts paid for these disallowed fringes with any pre-2018 net operating losses.

IRS TE/GE FISCAL YEAR 2019 PROGRAM LETTER

In October of 2018, the IRS released a letter outlining their priorities regarding tax-exempt organizations for fiscal year 2019. The highlights of the program letter included plans to:

- Increase priority examinations of 501(c)(7)s, §4947(a)(1) nonexempt charitable trusts, and self-dealing by foundations.
- Increase use of data-driven selection models to identify informational returns with higher risk of employment tax non-compliance.
- Hire around 40 new revenue agents to work in the tax-exempt sector of the IRS, expediting determination applications and other areas of compliance.

Tax professionals should continue to remind their clients that the TCJA represents a dramatic overhaul of the U.S. tax code, and continue examination on how the mechanics and rules regarding these changes will be applied.

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Chris, in conjunction with a multi-disciplinary team of CPAs, investment, and business advisors, provides effective tax planning and research, tax compliance, charitable planning, and asset protection solutions for individuals and their families, trusts & estates, nonprofits & foundations, corporations and partnerships. He has expertise in tax law pertaining to wealth preservation vehicles and will use all of the rules under the law to ensure that AAFCPAs' clients have every opportunity to protect and save their assets. He engages clients in in-depth discussions to identify what assets need to be shielded, and what current measures are in place for risk management. Contact him at 774-512-4180 or cconsoletti@aafcpa.com.

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FOR YOUR REVIEW

1. **The acronym UBIT stands for**

   A. Universal basic income tax
   B. Unrelated business income tax
   C. Unconditional basic income tax
   D. Usage-based insurance tax

2. **Which legislation attempts to eliminate the provision under §512(a)(7) of the TCJA?**

   A. Retirement, Savings, and Other Tax Relief Act
   B. Taxpayer First Act of 2019
   C. Unlawful Internet Gambling Enforcement Act of 2006
   D. Tax Reform Act of 1986

9 CHECKED THE BOX? FEELING GILTI NOW?

LOU VLAHOS, JD, USTCP

ONCE UPON A TIME

I recently recalled a client that was referred to us a few years back, shortly before it was acquired by a larger company. The client was closely held by U.S. individuals and by an S corporation, and was organized as a Delaware LLC that was treated as a partnership for U.S. tax purposes.

Beginning in the ea rly 2000s, the LLC had formed or acquired several foreign corporate subsidiaries (the "Foreign Subs"). I remembered reviewing a few years' worth of the LLC's partnership tax returns (on IRS Form 1065)[i] and, based upon what I knew of the LLC's business and that of the Foreign Subs, I did not expect to find any subpart F income on the returns – in other words, any foreign business income realized by the Foreign Subs would not have been subject to U.S. income tax in the hands of the LLC until such income was distributed as a dividend to the LLC.[ii] However, I noticed losses from foreign operations on Schedule K of the returns. When I asked about the source of the losses, I was told they were attributable to the Foreign Subs.

As I looked further into the subsidiaries, I learned that each of them was organized as a business entity with "limited liability" under the law of the jurisdiction in which it operated – meaning that no owner or member of the entity had personal liability for the entity's obligations by reason of being a member.[iii] Thus, each Foreign Sub's default classification for U.S. tax purposes was as an "association" (i.e., as an entity that was treated as a corporation).[iv] More relevant to the issue before me, each Foreign Sub was a "foreign eligible entity" that may have elected to change its classification for U.S. tax purposes.[v]

I asked to see the IRS Form 8832, Entity Classification Election,[vi] that I assumed must have been filed by each Foreign Sub to elect to be disregarded as an entity separate from the LLC – the so-called "check the box".[vii] Such an election would have caused each subsidiary to be treated as a branch of the LLC, with the branch losses treated as having been realized directly by the LLC.[viii]

As it turned out, no such elections had been made. When I asked what the client intended when it acquired or organized the Foreign Subs, I was informed that they were to be treated as branches, which was consistent with the LLC's tax returns as filed (as reflected on the Schedule K).

In order to redress the situation, we requested, and obtained, a ruling from the IRS that allowed the Foreign Subs to file late entity classification elections.

All's well that ends well. Right?

THE END OF TAX DEFERRAL

Fast forward. The LLC is no longer a client. The Tax Cuts and Jobs Act is enacted.[ix] Every U.S. person that owns a controlled foreign subsidiary that is treated as a corporation (or association) for U.S. tax purposes (a "CFC") is scrambling to understand the new anti-deferral rules,[x] and to develop a plan for managing their impact.

In particular, tax advisers are discovering the benefits under the Act of being a direct C corporation parent of a CFC, or – in the case of an individual U.S. shareholder who owns stock of a CFC either directly, or indirectly through a partnership or an S corporation – the benefit of electing under §962 of the Code to be treated as a C corporation shareholder of the CFC.[xi]

GILTI

In order to limit a U.S. person's ability to defer the U.S. taxation of a CFC's non-subpart F, foreign-source income, the Act introduced a new class of income–global intangible low-taxed income (GILTI)–that must be included in income by a U.S. shareholder of a CFC.

This provision generally requires the current inclusion in income by a U.S. shareholder of (i) their share of a CFC's non-subpart F income, (ii) less an amount equal to their share of 10 percent of the adjusted basis of the CFC's tangible property used in its trade or business of a type with respect to which a depreciation deduction is generally allowable – the difference being the U.S. shareholder's GILTI.

This income inclusion rule applies to both individual and corporate U.S. shareholders.

In the case of an individual shareholder, the maximum federal income tax rate applicable to GILTI is 37 percent. This is the rate that will apply, for example, to a U.S. individual who directly owns at least 10 percent of the stock of a CFC, or to one who indirectly owns such CFC stock through an S corporation or partnership.

More forgiving rules apply in the case of a U.S. shareholder that is a domestic C corporation. Such a corporation is generally allowed a deduction of an amount equal to 50 percent of its GILTI (the "50-percent deduction") for purposes of determining its taxable income;[xii] thus, the effective

federal corporate tax rate for GILTI is actually 10.5 percent.[xiii]

In addition, for any amount of GILTI included in the gross income of a domestic corporation, the corporation is allowed a deemed-paid credit equal to 80 percent of the foreign taxes paid or accrued by the CFC with respect to such GILTI (the "80-percent FTC").[xiv]

Based on the interaction of the 50-percent deduction and the 80-percent FTC, the U.S. tax rate on GILTI that is included in the income of a domestic C corporation will be zero (0) where the foreign tax rate on such income is at least 13.125 percent.[xv]

FOREIGN BRANCHES

Of course, not all foreign subsidiaries of a U.S. person are treated as corporations for U.S. tax purposes. As in the case of the Foreign Subs, described above, a foreign subsidiary may be treated as a branch of its U.S. owner for tax purposes.

Because these foreign subsidiaries are not treated as corporations for U.S. tax purposes, they are not CFCs. Therefore, neither the GILTI nor the subpart F anti-deferral rules apply to them.

Rather, the income generated by a branch of a U.S. person (including income that would have been treated as GILTI in the case of a CFC) is treated as having been earned directly by the U.S. person, and is included in such U.S. person's gross income on a current basis, without any deferral whatsoever.[xvi]

In the case of a U.S. individual owner of the branch – whether directly or through a partnership or S corporation – the foreign branch income will be subject to federal income tax at a maximum rate of 37 percent. In the case of an owner that is a C corporation, the foreign branch income will be subject to federal tax at the flat 21 percent rate applicable to corporations.

Because the branch is not a CFC for U.S. tax purposes, neither the 50-percent deduction nor the 80-percent FTC, that are available for GILTI, may be used to reduce or even eliminate the U.S. income tax on the branch income.[xvii] That being said, the U.S. owner of the branch generally may still claim a tax credit for the foreign taxes paid by the branch, thereby reducing their U.S. income tax liability attributable to the branch income.[xviii]

INCORPORATE THE BRANCH?

Under these circumstances, would it make sense for the U.S. owner of the branch to incorporate

the branch, and thereby convert it into a CFC, the income of which may be eligible for the reduced tax rates on GILTI described above?

Such an incorporation may be effectuated by contributing the assets comprising the branch (and subject to its liabilities) to a foreign corporation in exchange for all of its stock.

Alternatively, where the branch is held through a foreign eligible entity – a corporation, for all intents and purposes, under local law – that has elected ("checked the box") to be treated as a disregarded entity for U.S. tax purposes (as in the case of the LLC's Foreign Subs, described above), the U.S. owner may consider having the foreign entity elect to be treated, instead, as an association that is taxable as a corporation for U.S. tax purposes.[xix]

Either of these options may seem like a good idea – but not necessarily.

Section 367

In general, a U.S. person will not recognize gain if they transfer property to a corporation solely in exchange for stock in such corporation and, immediately after the exchange, the transferor is in control of the corporation.[xx]

However, in order to prevent a U.S. person from placing certain assets beyond the reach of the U.S. income tax by transferring them to a foreign corporation on a tax-favored basis (as described immediately above), the Code provides that if a U.S. person transfers property to a foreign corporation in exchange for stock in the foreign corporation, the transfer by the U.S. person becomes taxable.[xxi]

Prior to the Act, the Code provided an exception to this recognition rule; specifically, the transfer of property[xxii] by a U.S. person to a foreign corporation in exchange for its stock would not be treated as a taxable exchange where the property was to be used by the foreign corporation in the active conduct of a trade or business outside of the U.S.[xxiii]

The Act repealed this nonrecognition rule for exchanges after December 31, 2017. Thus, a transfer of property used in the active conduct of a trade or business outside the U.S. –a foreign branch– by a U.S. person to a foreign corporation no longer qualifies for nonrecognition of gain.

Branch Losses

The Act also added a new rule which provides that, if a U.S. corporation transfers substantially all of the assets of a foreign branch to a foreign corporation with respect to which it owns at least 10 percent of the total voting power or total value after the transfer, the U.S. corporation will include in its gross income an amount equal to the "transferred loss amount" of the branch.[xxiv]

In general, the transferred loss amount is equal to the losses incurred by the foreign branch after December 31, 2017, and before the transfer, for which a deduction was allowed to the U.S. corporation. The amount is reduced by certain taxable income earned, and gain recognized, by the foreign branch, including the amount of gain recognized by the U.S. corporation on account of the transfer of the branch assets.

WHAT IS A TAXPAYER TO DO?

It appears that there are not many options available to a U.S. person with a foreign branch.

The U.S. person may continue to operate through the branch; it will not be subject to the GILTI rules; it will be subject to current U.S. income tax on all of its branch-derived income at its ordinary federal income tax rate; it will be entitled to a credit against its U.S. tax for any foreign income tax paid by the branch; the remittance by the branch of its earnings to the U.S. person will not be subject to U.S. tax, though the foreign jurisdiction of the branch may impose a withholding tax on such a distribution, for which a credit should be available to the U.S. person.

The U.S. person may incorporate the branch, as described above, and pay the resulting U.S. income tax liability – of course, the liability should be quantified before any change in form is effectuated; the GILTI and the CFC subpart F rules would then become applicable; with that, the recognition of a limited amount of foreign-sourced income may be deferred; in addition, the U.S. person – whether a C corporation or an individual who elects under §962 of the Code (including one who holds the foreign corporation stock through a partnership or an S corporation) – will be able to achieve the reduced U.S. income tax rate resulting from the application of the reduced 21 percent corporate rate, the 50-percent deduction, and the 80-percent FTC.

The U.S. taxpayer may eliminate the branch entirely –which may be impractical from a business perspective– in which case its foreign-sourced income will continue to be subject to U.S. income tax, though the taxpayer may be able to avoid paying any foreign taxes,[xxv] not to mention the U.S. reporting requirements that are attendant on the ownership and operation of a foreign business entity.

The decision will ultimately depend upon each taxpayer's unique facts and circumstances, including the business reasons that caused the U.S. person to operate overseas to begin with.

ABOUT THE AUTHOR

Lou Vlahos is a partner and leads the firm's tax practice. He has extensive experience in all aspects of corporate, individual and partnership income taxation, and in estate and gift taxation, including tax planning, transactions, ruling requests, and tax controversy. Lou has lectured extensively and has written for various legal and business publications.

Lou received his LL.M. in taxation from New York University, his JD from Harvard Law School, and graduated with an A.B. magna cum laude, Phi Beta Kappa from Columbia College. He is admitted to practice in New York State and in the U.S. Tax Court. Lou has an AV Preeminent Martindale-Hubbell Peer Review Rating.

FOR YOUR REVIEW

1. **GILTI is the acronym for**

   A. Globalization internationalization localization translation income
   B. Graphics interaction learning technologies interface
   C. Global intangible low-taxed income
   D. Government issued long-term income

2. **Which section of the IRC indicates that a U.S. person will not recognize gain if he/she transfers property to a corporation solely in exchange for stock in such corporation?**

   A. §162
   B. §367
   C. §165(d)
   D. §183-2(b)

[i] https://www.irs.gov/pub/irs-pdf/f1065.pdf

[ii] In other words, recognition of the subsidiaries' income would have been deferred.

[iii]In general, this determination is based solely on the law pursuant to which the entity is organized. A member has personal liability, for this purpose, if the creditors of the entity may seek satisfaction of all or any portion of the debts or claims against the entity from the member as such. Reg. Sec. 301.7701-3.

[iv]I had already determined that none of the foreign subsidiaries was described in Reg. sec. 301.7701-2 as a "per se corporation."

[v]Reg. Sec. 7701-3(a) and 301.7701-3(b)(2).

[vi]https://www.irs.gov/pub/irs-pdf/f8832.pdf

[vii]A deemed liquidation of the association. Reg. Sec. 301.7701-3(g).

[viii]A controlled foreign corporation's losses for a taxable year do not flow through to its U.S. shareholders; rather, they reduce the CFC's earnings and profits for the year. According to Sec. 952 of the Code, a CFC's subpart F income for a taxable year cannot exceed its earnings and profits for that year. In addition, the amount of subpart F income included in a U.S. shareholder's gross income for a taxable year may generally be reduced by the shareholder's share of a deficit in the CFC's earnings and profits from an earlier taxable year that is attributable to an active trade or business of the CFC.

[ix]December 22, 2017. P.L. 115-97; the "Act."

[x]IRC Sec. 951A, effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

[xi]https://www.taxlawforchb.com/2019/03/u-s-individuals-electing-to-be-treated-as-corporations-american-werewolves/

[xii]IRC Sec. 250.

[xiii]The 21 percent flat rate multiplied by 50 percent.

[xiv]IRC Sec. 960(d). This is to be compared with the foreign tax credit available to a domestic corporation that includes subpart F income in its gross income; in that case, under IRC Sec. 960(a), the domestic corporation is deemed to have paid so much of the CFC's foreign income taxes as are properly attributable to such subpart F income.

[xv]13.125 percent multiplied by 80 percent equals 10.5 percent.

[xvi]Including the limited deferral that is still available under the GILTI rules.

[xvii]The Section 962 election is only available with respect to a CFC.

[xviii]The Act added a new rule that limits the ability of a U.S. taxpayer to use the "excess" foreign tax credits attributable to a branch – the amount of foreign tax paid by the branch in excess of the U.S. income tax that would otherwise be imposed on the income of the branch – to reduce the taxpayer's U.S. income tax on its other foreign-source income.

[xix]The owner of the eligible entity would be treated as having contributed all of the assets and liabilities of the entity to the association in exchange for stock of the association. Reg. Sec. 301.7701-3(g).It should be noted that, in general, an entity that has already elected to change its tax classification cannot make a second election during the 60-month period following the effective date of the first election.

[xx]IRC Sec. 351.

[xxi]IRC Sec. 367(a). This is accomplished by providing that the foreign corporation shall not be considered a corporation for purposes of Section 351 of the Code.

[xxii]Certain assets were excluded from this rule; for example, inventory and certain intangibles.

[xxiii]The "active trade or business" exception to gain recognition under Section 367(a) of the Code. Reg. Sec. 1.367(a)-2.

[xxiv]IRC Sec. 91.

[xxv]It may not be treated as "doing business" in the foreign jurisdiction. In the case of a treaty country, the U.S. taxpayer may be treated as not having a permanent establishment in the foreign country.

10 EARNING REAL INCOME FROM FANTASY SPORTS

Tax Opportunities and Pitfalls under the TCJA

Andrew D. Gross, CPA; Jamie Hoelscher, Marc Ortegren, and William E. Maas, CPA, JD

According to the Fantasy Sports Trade Association (FSTA), fantasy sports is a $7 billion industry, with 59.3 million people in the United States and Canada playing fantasy sports.[1] Such notoriety, however, comes with tax implications for winning players. The Tax Cuts and Jobs Act of 2017 (TCJA) offers some tax opportunities and pitfalls that fantasy players should understand. This article explores those opportunities and pitfalls, showing that the benefits and potential drawbacks depend on whether fantasy sports is classified as gambling or a hobby for the casual player who does not meet the criteria of a professional fantasy player.

FANTASY SPORTS: GAMBLING OR HOBBY?

There is currently an ongoing debate as to whether fantasy sports can be classified as gambling under tax rules.[1] The FSTA strongly argues that fantasy sports are games of skill rather than luck; this is consistent with the special carve-out that fantasy sports have under the Unlawful Internet Gambling Enforcement Act of 2006. The fact that fantasy sports were not targeted by this act, however, does not necessarily mean these activities are not considered gambling for tax purposes. In fact, other, more traditional gambling activities such as horse racing were also specifically excluded from the Unlawful Internet Gambling Enforcement Act and are still considered gambling activities for tax purposes. The TCJA does not clarify the definition of gambling, and without additional guidance, there is uncertainty as to how fantasy income and expenses should be reported.

If fantasy sports are not treated as gambling, the hobby loss rules apply for fantasy sports players [assuming the player does meet the requirements to be a professional player under Internal Revenue Code (IRC) §183]. In that case, the TCJA eliminates taxpayers' ability to deduct fantasy expenses even if fantasy income is reported. Prior to 2018, hobby losses were deductible as miscellaneous deductions subject to the 2 percent adjusted gross income (AGI) floor. Under the TCJA, which eliminated these deductions for tax years 2018–2025, income from hobbies is still included in income, but hobby losses are no longer deductible.

Many people have argued that fantasy sports are wagering transactions and therefore, consistent with IRC §165(d), fantasy sports losses should be deductible to the extent of fantasy players' winnings. While the TCJA was detrimental to taxpayers with income from hobbies, its treatment of gambling income and losses is more favorable. Gambling losses were previously assumed to be the actual cost of wagers placed; in the TCJA, however, Congress clarified the meaning of what constitutes gambling expenses and expanded gambling costs to include other costs associated with generating gambling income. According to IRC §165(d), "losses from wagering transactions shall be allowed only to the extent of the gains from such transactions. For purposes of the preceding sentence, in the case of taxable years beginning after December 31, 2017, and before January 1, 2026, the term 'losses from wagering transactions' includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction."

This suggests that, consistent with other sections in the IRC, other expenses that are ordinary and necessary to execute wagering transactions are deductible as gambling losses. IRC §162 indicates that any expenses that are "ordinary and necessary" in carrying on any trade or business are

deductible. For professional gamblers, these expenses are deducted on Schedule C as wagering losses; for those not meeting the criteria to be considered professional gamblers, the new language in IRC §165 indicates that these would be wagering losses and reported on Schedule A as "other itemized deductions" (on the 2018 IRS Schedule A). For more traditional nonprofessional gamblers, this includes the ability to deduct expenses related to travel, lodging, and meals for gambling tournaments as other itemized deductions, to the extent of gambling winnings.

For fantasy sports players, potential ordinary and necessary expenses may be different. According to the FTSA, there are over 150 companies in the fantasy sports industry selling services to fantasy players. The mean expenditure per player for fantasy sports is $556, including $54 for online subscriptions, magazines, and other fantasy-related informational materials that would not have traditionally been thought of as gambling deductions prior to the TCJA.[2] The amount spent per person varies greatly depending upon the fantasy sport service provider utilized, frequency of use, and utilization of supplemental informational materials; premium online analysis subscriptions can cost several hundred dollars.

Beyond online subscriptions, magazines, and other fantasy sports-related materials, taxpayers who have fantasy sports winnings may be able to deduct 50 percent of the cost associated with the food and drink at their draft parties . Fantasy sports players may even be able to set up a home office used exclusively for their fantasy activities and deduct those related expenses. Furthermore, losses from other gambling activities, such as casinos, horse racing, or regular sports betting, could also offset fantasy sports winnings.

To date, the IRS has not weighed in as to whether fantasy sports winnings are gambling or hobby income. Without guidance, an argument could be made for either position. In reality, it is likely that most fantasy players will want to be more aggressive and claim the activities are gambling for tax purposes. **Exhibit 1** presents a comparison of potentially deductible costs and expenses under the old and new rules.[3] **Exhibit 2** compares treatments of fantasy sports under the new and old rules, as well as the treatment for professional fantasy players.[4]

EXHIBIT 1

Potentially Deductible Fantasy Sports Expenses under Old and New Rules

Exhibit 1
Potentially Deductible Fantasy Sports Expenses under Old and New Rules

Expense	Old Rules	New Rules
Entry fee not already deducted from winnings	•	•
Losses from other gambling and betting activities	•	•
Fantasy sports–related magazine subscriptions		•
Fantasy sports website subscriptions		•
50% of food costs at fantasy sports draft parties		•
Cost of any office equipment or office space exclusively dedicated to fantasy sports		•
Cost of any punishments (e.g., tattoos) for losing in a fantasy sports league		•

EXHIBIT 2

Example of the Tax Impact of Different Classifications of Fantasy Sports

Exhibit 2
Example of the Tax Impact of Different Classifications of Fantasy Sports

	Hobby Treatment		Gambling Treatment		Professional Player
	Old Rules	New Rules	Old Rules	New Rules	
Increase in AGI	$10,000	$10,000	$10,000	$10,000	$2,500
Itemized deductions	$7,500[1]	$0	$6,000	$7,500	$0
Increase in taxable income[2]	$2,500	$10,000	$4,000	$2,500	$2,500[3]

Note: Taxpayer is an avid fantasy sports player. During a single tax year, Taxpayer won $10,000 on Fantasy Site A, but incurred a loss of $6,000 on Fantasy Site B. Taxpayer spent $1,500 on subscriptions and other costs associated with fantasy play. The impact of these fantasy activities varies depending on how fantasy sports are treated as illustrated above.

1. Subject to 2% of AGI floor
2. Assuming that the taxpayer does not take the standard deduction
3. Subject to self-employment tax and 20% qualified business income deduction

THE INCREASED STANDARD DEDUCTION

For casual fantasy sports players, the only fantasy-related deductions allowed are classified as "other itemized deductions" of wagering losses and related deductions. The increase in the standard deduction under the TCJA will cause many taxpayers to stop itemizing, thereby eliminating any potential benefit of fantasy sports-related expenses. Taxpayers with fantasy sports winnings in a particular year may want to bunch other itemized deductions such as real estate taxes or charitable contributions in that year in order to utilize fantasy sports-related losses.

THE PROFESSIONAL PLAYER

This article has thus far focused on the treatment of winnings and losses for the casual fantasy player who does not qualify as a business under IRC §183. For the serious fantasy sports player, however, treating gambling as a trade or business may be appropriate. As in the case of professional gamblers, income and expenses are recorded on Schedule C; this bypasses the need to itemize in order to take advantage of the tax-related deductions and may qualify players for a new 20 percent qualified business income deduction on Form 1040. Taxpayers who recognize profits on Schedule C will be subject to both income and self-employment taxes; therefore, it is not always beneficial to be considered a professional.

The TCJA does have a downside for professional sports players. Prior to 2018, other gambling expenses such as travel and lodging were not considered wagering losses and therefore not limited to gambling winnings as specified in IRC §165(d) [*Mayo v. Commissioner*, 136 T.C. 81 (2011)]. This allowed gamblers to have a net loss on gambling activities up to the amount of these other expenses. The TCJA defined wagering losses to include other related expenses, thereby limiting all gambling expenses to the extent of gambling winnings. Therefore, professional gamblers will no longer be able to claim net losses related to gambling activities on Schedule C.

Being considered a professional player takes more than just a profit motive. Professional gamblers have the burden to prove that their activity is "pursued full time, and with regularity, to the production of income for a livelihood and not merely a hobby" ([*Commissioner v. Groetzinger*, 59 AFTR 2d 87-532 (107 S. Ct. 980) (1987)]. Whether a fantasy sports player meets this test is based on nine relevant factors:

- The manner in which the taxpayer carries on the activities.
- The expertise of the taxpayer and his advisors.
- The time and effort expended by the taxpayer in carrying on the activity.

- The expectation that assets used in activity may appreciate in value.
- The success of the taxpayer in carrying on other similar or dissimilar activities.
- The taxpayer's history of income or losses with respect to the activity.
- The amount of occasional profits, if any, that are earned.
- The financial status of the taxpayer.
- Elements of personal pleasure or recreation.

Despite the provision of these nine factors, "no one factor is determinative in making this determination" [IRC §183-2(b)]. Determining whether activities truly constitute a business is not always clear cut, and each individual taxpayer's circumstances are unique. Taxpayers can expect a fair amount of scrutiny from the IRS when claiming to be a professional fantasy sports player, particularly when the taxpayer benefits from taking that position. Some taxpayers with gambling losses as a result of gaming have been able to sustain gambling activities as a business based upon documentation maintained by the casinos they visited, the time and effort they expended, their previous profits, lack of personal pleasure, and success attained in other profitable businesses (*Myers v. Commissioner*, TC Summary Opinion 2007-194)—while others have not (*Ferguson v. Commissioner*, TC Summary Opinion 2007-30).

THE IMPORTANCE OF DOCUMENTATION

Regardless of whether a taxpayer is a professional player or just trying to take an itemized deduction for wagering losses, documentation is very important. IRC §6001 places the burden of keeping records on the taxpayer, and the courts have routinely thrown out gambling and other losses that cannot be substantiated. For the professional, not only is it important to have receipts and documentation for deductions, but it is also important to document the efforts made to demonstrate the intent to make a profit. The burden of proof rests on the taxpayer to prove that the activity was conducted in a businesslike manner, and failure to keep contemporaneous records can be an indication that gambling is not being conducted in such a manner (*Boneparte Jr. v. Commissioner*, TC Memo 2017-193).

Understanding the documentation is also important. While most gambling is reported on Form W-2G, fantasy sports operators typically issue Form 1099-Misc to fantasy players winning more than $600. Under IRS Notice 2015-21, a taxpayer determines wagering gain or loss from electronically tracked slot machines at the end of a single "session" of play, rather than on a bet-by-bet basis. In fact, a 2015 Chief Counsel memorandum (CCM 20153601F) concluded that a taxpayer's multiple buy-ins for the same poker tournament could not be aggregated for purposes

of Form W2-G, as each buy-in was a separate session because the tournament circumstances were different each time. A private letter ruling (PLR 200532035) by the IRS identified three potential methods for calculating winnings:

- The gross method, which reports total winnings
- The net method, which reports winnings from contests less the entry fees for any contest won
- The cumulative net method, which reports winnings less total entry fees paid.

In PLR 200532035, the IRS advised that the net method was appropriate. Not every fantasy sports site follows that guidance, however, and it is important to know how winnings are reported for Form 1099 purposes. For example, Fan Duel calculates the Form 1099 amount as prize winnings (total entry fees + any bonuses + any entries into paid contests using earned fan duel points).[1] Therefore, the Form 1099 issued would already include the cost of losing contests, and thus would not be allowable as another itemized deduction from gambling for tax reporting purposes. This is because these sites do not view fantasy sports as gambling and therefore justify not breaking down sessions of play in accordance with IRS Notice 2015-21. This deviation from other reporting could be problematic in the event of an IRS audit.

Individuals using PayPal, credit cards, or similar third-party vendors to withdraw winnings from fantasy sports sites may also receive a Form 1099-K from those organizations.[2] To the extent that this occurs, it may appear as though taxpayers have more winnings than actually exist.

THE GAME HAS NEW RULES

Under the TCJA, gambling losses are still deductible, but the deductibility of hobby-related expenses has been eliminated. Furthermore, the definition of gambling losses has been expanded to include other expenses incurred as part of wagering. As such, fantasy players may benefit by treating their fantasy sports as gambling and claiming additional fantasy sports-related expenses that were not previously deductible.

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FOR YOUR REVIEW

1. **The definition of fantasy sports has a special carve-out under which legislation?**
   A. Tax Cuts and Jobs Act of 2017
   B. Taxpayer First Act of 2019
   C. Unlawful Internet Gambling Enforcement Act of 2006
   D. Tax Reform Act of 1986
2. **Most gambling is reported on**
   A. Schedule C
   B. Form W-2G
   C. Schedule A
   D. Form 1040

[1]https://thefsga.org/press-release-fantasy-sports-now-a-7-billion-industry/

[2]www.journalofaccountancy.com/newsletters/2016/feb/how-to-report-fantasy-football-winnings.html

[3]https://fsta.org/research/industry-demographics/

[4]www.nysscpa.org/news/publications/the-cpa-journal/article-detail?ArticleID=12999#T1

[5]www.nysscpa.org/news/publications/the-cpa-journal/article-detail?ArticleID=12999#T2

[6]www.legalsportsreport.com/8105/daily-fantasy-sports-taxes-1099s/

[7]www.legalsportsreport.com/8105/daily-fantasy-sports-taxes-1099s/

11 2019 & 2020 KEY NUMBERS

DAVID L. MELLEM, EA

Many numbers we use in our profession are indexed for inflation. The effective date for many of these inflation calculations is August 31. This chart contains the amounts for 2019 and 2020 for many items we deal with on a regular basis. These amounts are the official IRS amounts. Any amounts that have not yet been officially released by IRS are indicated with an "*".

Tax Rates	2019	2020
SINGLE		
10% bracket tops at	9,700	9,875
12% bracket tops at	39,475	40,125
22% bracket tops at	84,200	85,525
24% bracket tops at	160,725	163,300
32% bracket tops at	204,100	207,350
35% bracket tops at	510,300	518,400
37% after	510,300	518,400

Tax Rates	2019	2020
HEAD OF HOUSEHOLD (HOH)		
10% bracket tops at	13,850	14,100
12% bracket tops at	52,850	53,700
22% bracket tops at	84,200	85,500
24% bracket tops at	160,700	163,300
32% bracket tops at	204,100	207,350
35% bracket tops at	510,300	518,400
37% after	510,300	518,400

MARRIED FILING JOINT/QUALIFIED WIDOW(ER) (MFJ)		
10% bracket tops at	19,400	19,750
12% bracket tops at	78,950	80,250
22% bracket tops at 1	168,400	171,050
24% bracket tops at	321,450	326,600
32% bracket tops at	408,200	414,700
35% bracket tops at	612,350	622,050
37% after	612,350	622,050

MARRIED FILING SEPARATELY (MFS)		
10% bracket tops at	9,700	9,875
12% bracket tops at	39,475	40,125
22% bracket tops at	84,200	85,525
24% bracket tops at	160,725	163,300
32% bracket tops at	204,100	207,350
35% bracket tops at	306,175	311,025
37% after	306,175	311,025

Tax Rates	2019	2020
ESTATES & TRUSTS		
10% bracket tops at	2,600	2,600
24% bracket tops at	9,300	9,450
35% bracket tops at	12,750	12,950
34% bracket tops at	12,750	12,950
CAPITAL GAIN RATES AT 15% BETWEEN:		
Single	39,375-434,550	40,000-441,450
Married Filing Jointly	78,750-488,850	80,000-496,600
Head of Household	52,750-461,700	53,600-469,050
Married Filing Separately	39,375-244,425	40,000-248,300
Estates & Trusts	39,375-244,425	2.,650-13,150
(The 20% capital gain rate applies after the above maximum amount)		
STANDARD DEDUCTION		
Single	12,200	12,400
Married Filing Joint/ Qualified Widow(er)	24,400	24,800
Head of Household	18,350	18,650
Married Filing Separate	12,200	12,400*
Dependents	1,100	1,100
	(or 350 plus earned income)	(or 350 plus earned income)
Extra for Age or Blindness		
Single	1,650	1,650
Married	1,300	1,300
KIDDIE TAX		
Exempt from kiddie tax	2,200	2,200
Parents can elect to report on their return if child's income is more than, but less than:	1,100 / 11,000	1,100 / 11,000

Tax Rates	2019	2020
EXEMPTION AMOUNT (no longer used for exemptions but still used for gross income test, disability trusts and other purposes)		
	4200	4300
ALTERNATIVE MINIMUM TAX EXEMPTION		
Single and HH	71,700	72,900
Married Filing Joint/ Qualified Widow(er)	111,700	113,400
Married Filing Separately	55,850	56,700
Estates and Trusts	25,000	25,400
Child subject to Kiddie Tax	7,750	7900
	plus earned income	plus earned income
ALTERNATIVE MINIMUM TAX EXEMPTION PHASE-OUT		
Single and HH	510,300	518,400
Married Filing Joint/ Qualified Widow(er)	1,020,600	1,036,800
Married Filing Separately	510,300	518,400
Estates & Trusts	83,500	84,800
SECTION 199A (QBI)		
Married Filing Joint	321,400	326,600
Married Filing Separately	160,700	163,300
All other filers	160,700	163,300
(The phase in is not indexed and remains at $100,000 for MFJ and $50,000 for all others.)		
EDUCATOR EXPENSE		
	250	250
NANNY TAX THRESHOLD		
	2,100	2200
ADOPTION CREDIT & EXCLUSION		
*Phase-out range	14,080 211,160-251,160	14,300* 214,520-254,520

Tax Rates	2019	2020
SAVER'S CREDIT PHASE-OUT CEILINGS		
50% credit ceiling	MFJ 38,500, HOH 28,875, S & MFS 19,250	MFJ 39,000, HH 29,250, S & MFS 19,500
20% credit ceiling	MFJ 41,500, HOH 31,125, S & MFS 20,750	MFJ 42,500, HH 31,875, S & MFS 21,250
10% credit ceiling	MFJ 64,000, HOH 48,000, S & MFS 32,000	MFJ 65,000, HH 48,750, S & MFS 32,500
CHILD TAX CREDIT		
- Income base for refundable portion	2,500	2500
- Refundable portion cannot exceed	1,400	1400
EARNED INCOME CREDIT		
Maximum credit income level		
no children	6,920 of income	7,030 of income
one child	10,370 of income	10,540 of income
two children	14,570 of income	14,800 of income
three children or more	14,570 of income	14,800 of income
Maximum AGI		
no children	15,570 (21,370 for MFJ)	15,820 (21,710 for MFJ)
one child	41,094 (46,884 for MFJ)	41,756 (47,656 for MFJ)
two children	46,703 (52,493 for MFJ)	47,440 (53,330 for MFJ)
three children or more	50,162 (55,952 for MFJ)	50,954 (56,844 for MFJ)
Investment income (max)	3,600	3,650
EDUCATION CREDITS		
American Opportunity Credit	100% of first 2,000 + 25% of second 2,000	100% of first 2,000* + 25% of second 2,000

Tax Rates	2019	2020
PHASE-OUT LEVEL FOR:		
American Opportunity Credit	Begins at 80,000 (160,000 MFJ)	Begins at 80,000 (160,000 MFJ)
Lifetime Learning Credit	Begins at 58,000 (116,000 MFJ)	Begins at 59,000 (118,000 MFJ)
Savings Bonds used for Education	Begins at 81,100 (121,600 MFJ)	Begins at 82,350 (123,550 MFJ)
Student Loan Interest	70,000-85,000 (140,000-170,000 for MFJ)	70,000-85,000 (140,000-170,000 for MFJ)
TRANSPORTATION FRINGES		
Parking, Transit passes, commuter highway	265	270
§179 expensing	1,020,000 maximum * w/phase-out beginning at 2,550,000 of qualified purchases	1,040,000 maximum w/phase-out beginning at 2,590,000 of qualified purchases
FOREIGN EARNED INCOME EXCLUSION		
	105,900	107,600
Maximum housing deduction	31,170	32,280
LONG-TERM CARE		
Premiums – max deductible		
Not over age 40	420	430
>40, but not >50	790	810
>50, but not >60	1,580	1,630
>60, but not >70	4,220	4,350
>70	5,270	5,430
Benefits – max excludible	370/day	380/day

Tax Rates	2019	2020
GIFT TAX EXCLUSION (ANNUAL)		
	15,000	15,000
Estate & Gift Tax Exclusion (lifetime)	11,400,000	11,580,000
Gifts to noncitizen spouse	155,000	157,000
EDICAL SAVINGS ACCOUNTS (MSA)		
Self only coverage	2,350-3,500 deductible 4,650 out of pocket max	2,350-3,550 deductible 4,750 out of pocket max
Family coverage	4,650-7,000 deductible * 8,400 out of pocket max *	4,750-7,100 deductible 8,650 out of pocket max
HEALTH SAVINGS ACCOUNTS (HSA)		
Self only plan	At least 1,350 minimum deductible and out of pocket max of 6,750 Contribution maximum of 3,500	At least 1,400 minimum deductible and out of pocket max of 6,900 Contribution maximum of 3,550
Family plan	At least 2,700 minimum deductible and out of pocket max of 13,500 Contribution maximum of 7,000	At least 2,800 minimum deductible and out of pocket max of 13,800 Contribution maximum of 7,100
QUALIFIED SMALL EMPLOYER HEALTH REIMBURSEMENT ARRANGEMENTS (HRA)		
Self only coverage	5,150	5,250
Family coverage	10,450	10,600
FLEXIBLE SPENDING ARRANGEMENTS (FSA)		
	2,700	2,750
SOCIAL SECURITY ITEMS		
Increase in benefits	2.8%	1.6%
Maximum earnings subject to Social Security tax	132,900	137,700
Amount needed for a quarter of coverage	1,360	1410
Annual limit on earnings: Taxpayers under full retirement age before having to repay benefits	17,640	18,240
Taxpayers who reach full age during the year (applies to months before the month of full retirement)	3,910/month	4,050/month
Medicare premiums	base = 135.50	*

Tax Rates	2019	2020
PENSION AMOUNTS		
Defined contribution maximum	56,000	57,000
Defined benefit maximum	225,000	230,000
Annual compensation for calculations	280,000	285,000
SEP earnings for a year	600	600
Deferrals		
SIMPLE	13,000 (+3,000 catch up)	13,500 (+3,000 catch up)
Other elective deferrals (401(k), 403(b), SARSEP, 457)	19,000 (+6,000 catch up)	19,500 (+6,500 catch up)
IRA	6,000 (+1,000 catch up)	6,000 (+1,000 catch up)
PHASE-OUT LEVEL FOR:		
IRA contributions when "covered"	64,000-74,000 103,000-123,000 for MFJ 0-10,000 for MFS	65,000-75,000 104,000-124,000 for MFJ 0-10,000 for MFS
Roth IRA contributions	122,000-137,000 193,000-203,000 for MFJ 0-10,000 for MFS	124,000-139,000 196000-206,000 for MFJ 0-10,000 for MFS
PER DIEMS		
Meals	55-76/day effective 10/1/18	unchanged
Mileage	.58 mile (.26 = depreciation) .14 for charity .20 for medical & moving	* * .14 for charity *
PENALTIES		
6651(a) Failure to file tax return	215	330
- 6695(g) due diligence failure (EIC, CTC, AOTC, HOH)520 *	530	540
- 6698(b)(1) to Failure to file partnership or S corporation return (per month per Schedule K1)	205	210
- 6721(d) Failure to file 1099s/W2s	270	280
- 6721(e) Willful failure to file 1099s/W2s	550	560
- 5000A Failure to have insurance	0	0

SUV MAXIMUM SECTION 179 LIMITATION		
- (this is now indexed after 2018)	25,000	25,900

LIMITATION ON USE OF CASH METHOD OF ACCOUNTING (GROSS INCOME TEST)		
	26,000,000	26,000,000

EXCESS BUSINESS LOSS (SECTION 461(L)(E)(A))		
Married Filing Joint	510,000	518,000
Others	255,000	259,000

Resources for 2020 amounts

Revenue Procedure 2019-25 (HSA)

Revenue Procedure 2019-44

Notice 2019-59

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