THE ELITE QUARTERLY – Taxation

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Thank you for your ongoing support of *The Elite Quarterly*. We hope that you are experiencing continued success as we roll along towards the last quarter of 2018. Please refer to pages 22 and 23 for details of all of our subscription packages. Testing online at our website is more convenient than ever. Thank you for being a customer – we appreciate your business!

What's Inside This Issue

Instructions, Content Level, & Learning Objectives

Read the content on pages 1-17, the exam questions on pages 18-20, and the exam instructions on page 21. Select the best answer for each exam question and record the answers either on the answer sheet on page 21 or on-line at www.cpelite.com. This edition of the *Elite Quarterly* addresses many topics practitioners will undoubtedly encounter to some degree in the months ahead as we process waves of changes resulting from the TCJA. The content level for this course material is "Update" and field of study classification is "Taxation". A general understanding of federal income taxation is the prerequisite for this course. No advance preparation is required. The ***Learning Objectives*** for this course are:

1. Identify the rules in connection with bonus depreciation and corresponding phaseout provisions.
2. Recall the requirements for a "qualified appraiser" in connection with donations of property.
3. Calculate gains/losses with respect to revised rules for casualty losses.
4. Identify procedures to report Identity Theft with the IRS.
5. Recall details associated with the IRS's Annual Filing Season Program.
6. Identify which businesses are considered "Specified Service Business" under code Section 199A.
7. Recall "Income Based Caps" and limitations in calculating the Section 199A deduction.

Key Terms in This Issue of *THE ELITE QUARTERLY*

[Item 2] *Qualified Appraiser:* an individual with "verifiable education and experience in valuing the relevant type of property for which the appraisal is performed".

[Item 3] *Blue Book:* Publication from The Joint Committee on Taxation which follows significant enacted legislation and designed to clarify vague tax codification and offer related explanations.

[Item 6] *Letter 5071C*: Correspondence from the IRS requesting the taxpayer to verify his or her identity using an online tool and to tell the IRS if he or she filed the tax return in question.

[Item 7] *Password Manager:* assists in generating and retrieving complex passwords, potentially storing such passwords in an encrypted database or calculating them on demand.

[Item 8] *IRS Chief Counsel:* the chief legal advisor to the IRS Commissioner on all matters pertaining to the interpretation, administration and enforcement of the Internal Revenue Laws

[Item 9] *Administrative Procedure Act:* enacted on June 11, 1946, this is the United States federal statute that governs the way in which administrative agencies of the federal government of the United States may propose and establish regulations.

[Item 11*] "QBID":* Qualified Business Income Deduction, abbreviation for the Section 199A deduction.

[Item 12] "*Publicly Traded Partnership (PTP)":* business organization which is owned by two or more co-owners that is regularly traded on an established securities market.

[Item 13] "*Withholding Calculator*": An online tool to assist individuals with calculating the correct level of tax withheld from each paycheck (www.irs.gov/individuals/irs-withholding-calculator).

[ITEM 1] IRS proposed regulations on 100% bonus depreciation

The IRS issued proposed regulations on August 8, 2018 (Reg-104397-18) to increase the allowable first-year depreciation deduction for qualified property from 50% to 100%. Reg-104397-18 provides guidance on Sec. 168(k), which was amended by the Tax Cuts and Jobs Act (TCJA).

The TCJA extended and modified bonus depreciation, allowing businesses to immediately deduct 100% of the cost of eligible property in the year it is placed in service, through 2022. The amount of allowable bonus depreciation is then phased down over four years: 80% will be allowed for property placed in service in 2023, 60% in 2024, 40% in 2025, and 20% in 2026. Practitioners should note that for certain property with long production periods, these referenced dates will be extended out by one year.

These new rules generally apply retroactively to property acquired or placed in service after Sept. 27, 2017 (the TCJA was enacted Dec. 22, 2017). The TCJA also removed the rule that made bonus depreciation available only for new property and extended the period in which certain other property (including plants and films, television, and live theatrical productions) will qualify for 100% depreciation.

The proposed regulations describe and clarify the statutory requirements that must be met for depreciable property to qualify for the additional first-year depreciation deduction provided by Sec. 168(k). Additionally, the proposed regulations will guide practitioners on how to determine the additional first-year depreciation deduction and the amount of depreciation otherwise allowable for this property. Because the TCJA substantially amended Sec. 168(k), the proposed regulations update existing regulations in Regs. Sec. 1.168(k)-1 by providing a new section at Prop. Regs. Sec. 1.168(k)-2 for property acquired and placed in service after Sept. 27, 2017, and make conforming amendments to the existing regulations.

The proposed regulations provide that depreciable property must meet four requirements to be qualified property:

1) The depreciable property must be of a specified type;
2) The original use of the depreciable property must commence with the taxpayer, or used depreciable property must meet the acquisition requirements of Sec. 168(k)(2)(E)(ii);
3) The depreciable property must be placed in service by the taxpayer within a specified time period or must be planted or grafted by the taxpayer before a specified date; and
4) The depreciable property must be acquired by the taxpayer after Sept. 27, 2017.

Although the IRS said that the regulations would apply to qualified property placed in service during or after the taxpayer's tax year that includes the date the regulations are published as final in the Federal Register, it also is allowing taxpayers to rely on the proposed rules for property placed in service or after Sept. 27, 2017, by the taxpayer during tax years ending on or after Sept. 28, 2017. Written or electronic comments and requests for a public hearing concerning this proposed reg. must be received by IRS/Treasury by October 9, 2018.

[ITEM 2] Final rules - substantiation for charitable contributions

On July 30, 2018 the IRS published final regulations that implement changes made by the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006, to the substantiation and reporting rules for charitable contributions under Sec. 170 (T.D. 9836). These final regulations set forth:

- the substantiation requirements for contributions of more than $500;
- the new definitions of qualified appraisal and qualified appraiser applicable to noncash contributions;
- substantiation requirements for contributions of clothing and household items; and
- the recordkeeping requirements for all cash contributions.

Cash contributions

Regs. Sec. 1.170A-15 contains the substantiation rules for cash, check, or other monetary gifts, implementing the requirements of Sec. 170(f)(17). Under that section, no charitable contribution deduction is allowed for any monetary gift unless the donor maintains, as a record of the gift, a bank record or a written communication from the donee, showing:

a) the name of the donee,
b) the date of the contribution, and
c) the amount of the contribution.

The regulations clarify that these rules supplement the substantiation rules which require a contemporaneous written acknowledgment of contributions of $250 of more. The contemporaneous written acknowledgment must include:

1) the amount of cash and a description (but not value) of any property other than cash contributed;
2) a statement of whether the donee organization provided any goods or services in consideration, in whole or in part, for any such cash or property; and
3) a description and good faith estimate of the value of any such goods or services or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

Donations of property

For property under $250, the donor must obtain a receipt from the donee or keep reliable records. A donor who claims a noncash contribution of at least $250 but not more than $500 is required to obtain a contemporaneous written acknowledgment.

For a donation of more than $500 but not more than $5,000, the donor must obtain a contemporaneous written acknowledgment and file a completed Form 8283 (Section A), Noncash Charitable Contributions.

For claimed noncash contributions of $5,000 or more, in addition to a contemporaneous written acknowledgment, the donor must obtain a qualified appraisal and complete and file either Section A or Section B of Form 8283 (depending on the type of property contributed). For claimed noncash contributions of $500,000 or more, a donor must meet the requirements for a contribution of $5,000 or more and also attach a qualified appraisal to his or her tax return.

Reasonable-cause exception for a qualified appraisal

The IRS explained in the preamble to the final regulations that, in response to recent case law (Crimi v. Commissioner, T.C. Memo. 2013-51), the paragraph relating to the reasonable cause exception previously set forth in proposed regulation §1.170A-16(f)(6) has been deleted from the final regulations because it is inconsistent with the Tax Court's position. In Crimi, the IRS argued that there was no qualified appraisal. The Tax Court discussed the doctrine of substantial compliance with respect to the qualified appraisal regulation, but stated that it was unnecessary to decide whether it was applicable to the petitioners' case because they established that the failure was due to reasonable cause. Specifically, the court stated that a reasonable cause inquiry is *"inherently a fact-intensive one, and facts and circumstances must be judged on a case-by-case basis."* In this case, the court found that petitioners reasonably and in good faith relied on their long-time certified public accountant's advice that their appraisal met all the legal requirements to claim the deduction. Thus, the final regulations do not contain a standard for the reasonable cause exception.

Qualified appraisers

The regulations define a "qualified appraiser" as an individual with "verifiable education and experience in valuing the relevant type of property for which the appraisal is performed". Verifiable education and experience means the individual has successfully completed professional or college-level coursework in valuing the relevant type of property and has two or more years' experience in valuing that type of property or has earned a recognized appraiser designation.

Because appraisers may need more time to meet the new education and experience requirements of Regs. Sec. 170A-17, the new requirements apply only to contributions made on or after Jan. 1, 2019.

Effective date

Except for the qualified appraisal and appraiser requirements, the regulations are effective for contributions made after July 30, 2018, the date they were published as final in the Federal Register. But the IRS noted that the effective dates of the provisions of the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006 relating to substantiating and reporting charitable contributions precede the effective dates of the regulations, and the provisions of the two acts apply in accordance with their own applicability dates.

[ITEM 3] The new personal casualty loss tax rules

On Dec. 22, 2017, Trump signed the TCJA into law, adding Sec. 165(h)(5) to the Code. This provision sharply curtails personal casualty losses that taxpayers may deduct in tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026.

Prior Rules

Before the TCJA imposed new limits, Sec. 165(c)(3) granted authority to individual taxpayers to deduct uncompensated personal casualty losses. Personal casualty losses are defined as those not incurred in a trade or business or in any transaction entered into for profit, and arising from "fire, storm, shipwreck, or other casualty, or from theft." While neither the Code nor the Treasury regulations define a "casualty," the IRS has interpreted it to be "an identifiable event of a sudden, unexpected, or unusual nature" (Rev. Rul. 79-174). No doubt, weather-related phenomena such as tornadoes, hurricanes, mudslides, and wildfires meet this definition; likewise, events such as car accidents, vandalism, and incidents of civil unrest would fall within its scope. Losses arising from progressive deterioration through a steadily operating cause, however, are not deemed to be casualties (e.g., termite damage or normal seasonal variations in levels of a body of water).

There are three pivotal limitations to the allowance of personal casualty losses. First, the loss from each casualty is allowed only to the extent it exceeds $100. Second, aggregate losses for a tax year are allowed only to the extent they exceed the sum of (1) casualty gains and (2) 10% of the taxpayer's adjusted gross income. Third, no deduction is permitted in a tax year for the loss, or any portion of it, when a claim for compensation is outstanding for which there is a "reasonable prospect" of recovery.

Impact of TCJA

Subject to the traditional limitations specified above, taxpayers may continue to deduct personal casualty losses, but only to the extent they are attributable to federally declared disasters (Sec. 165(h)(5)(A)). However, taxpayers with personal casualty losses not related to federally declared disasters may deduct those losses to the extent of personal casualty gains (Sec. 165(h)(5)(B)). If an excess casualty gain exists after application of the losses from casualties from other than federally declared disasters, taxpayers next apply any federally declared disaster losses against the remaining casualty gain (Sec. 165(h)(5)(B)(i)).

"Whether" Forecast

In tax year 2015, approximately 72,000 individual taxpayers claimed more than $1.6 billion in casualty losses, an average claim of almost $23,000 apiece (IRS Statistics of Income, Individual Income Tax Returns Line Item Estimates, 2015, pages 32 and 33). With the new limitations introduced in the TCJA, the availability of this deduction is severely diminished going forward. Practitioners may wish to highlight this change in communications with clients, perhaps also noting its implications for reviewing property insurance coverage.

Tax advisers should also be alert to IRS guidance in this area, including the definition of "attributable to a federally declared disaster" in new Sec. 165(h)(5). Notably, while the provision defines a "federally declared disaster" by reference to the definition in Sec. 165(i)(5), it does not specify that property must be within an area so designated for its damage or loss to be deductible. Sec. 165(i)(5)(A) defines a "federally declared disaster" as one determined by the president to warrant federal assistance under the Stafford Act. However, Sec. 165(i)(5)(B) specifies that a disaster area must warrant federal assistance for the rules to apply, so unless and until the IRS provides guidance otherwise, the prudent course would be to consider Sec. 165(h)(5) similarly constrained.

Taxpayers may also in some cases have a valid claim that the damaged property is connected with a trade or business or a transaction entered into for profit, rather than personal-use property, and thus be able to deduct a casualty loss under Sec. 165(c)(1) or (2), which continue to apply for casualties other than those attributable to federally declared disasters. However, tax advisers should work with clients on whether they can substantiate business or profit-seeking use of such property, especially where any apparent characteristics of personal use could render its status questionable by the IRS with respect to a casualty loss deduction not attributable to a federally declared disaster.

[ITEM 4] Entertainment expense and transportation fringe benefits

Given the passage of the Tax Cuts and Jobs Act employers and their advisers are coping with the difficulties faced in implementing these new tax law changes and adjusting to a new normal. New tax laws are always a product of give-and-take, with many constituencies fighting to retain favorable rules and congressional staff putting the pieces together so there are enough votes to pass the legislation. One of the key changes brought about by this new legislation is in connection with entertainment expenses and transportation fringe benefits. We'll take this opportunity to review these changes in greater detail.

Entertainment expenses

Under the TCJA, entertainment expenses incurred on or after Jan. 1, 2018, are nondeductible. Prior to the most recent tax law changes, entertainment expenses were 50% deductible to the extent that they were directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion, associated with, the active conduct of a trade or business. Detailed regulations further defined when this could occur.

Over the years, businesses interpreted many activities as falling within these exceptions, interpreting the regulatory rules to claim more deductions for entertainment costs. IRS agents tended to ignore these costs, except where expenses were clearly entertainment. Over the years Congress enacted additional limitations on expenses, focusing on meal expenses, spousal travel, and conventions outside North America. Beginning in 2018, the new law makes all entertainment expenses nondeductible. Note that tax-exempt organizations are not affected by these rule changes except to the extent associated with unrelated business income.

Business meals

One area requiring immediate guidance is whether business meals with current and prospective clients are considered entertainment expenses and considered nondeductible. It may seem obvious that when a business owner shares a restaurant meal that is not lavish or extravagant with a current client or customer during which several topics are discussed, including the health of each other and their families, recent political developments, and business news affecting the client's industry, as well as the current and expected future projects for the client/customer, that the cost should be 50% deductible, just as business meals with other employees of the same firm are 50% deductible. However, what if the person joining the taxpayer is not a current client, but rather another professional or a prospective client? Should the business cost of doing so be any different?

Some commentators suggest that even the business meal with a current client or a meal with a prospect or other business relationship may be nondeductible as an entertainment expense. Their argument is based on the development of the tax law since entertainment expense deductions were prohibited in 1962, with an exception for business meals in circumstances conducive to business deductions (repealed in 1986), current regulations, and case law. IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses, which has not been modified since enactment of the legislation, makes the distinction between entertainment and non-entertainment meals meaningful and provides insight into how the IRS views meals:

"A meal as a form of entertainment. Entertainment includes the cost of a meal you provide to a customer or client, whether the meal is a part of other entertainment or by itself. A meal expense includes the cost of food, beverages, taxes, and tips for the meal. To deduct an entertainment-related meal, you or your employee must be present when the food or beverages are provided."

Taxpayers will prefer to look to the TCJA conference committee report, which describes both the House bill and Senate amendment by stating, "Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel)". A parenthetical phrase highlighting an example of food and beverage expense associated with operating a trade or business, suggests that this is not the only example. It appears then that Congress's intent is for business meals that are not incurred while traveling should be treated similarly.

In fact, former Ways and Means Committee Chairman Dave Camp's proposal, the Tax Reform Act of 2014, H.R. 1 (113th Cong.), which included this change, stated the rule more broadly. *"The 50-percent limitation under current law would apply only to expenses for food and beverages and to qualifying business meals under the provision, with no deduction allowed for other entertainment expenses".* Additionally, congressional committee staffers have informally indicated that it was not Congress's intent to limit deductions for business meals that are not lavish or extravagant beyond the 50% limit already in place.

If there was not uncertainty on this point, however, the AICPA and others would not be asking IRS for additional guidance. While we wait for guidance, how should we be advising our clients? We should caution clients that amounts may not be deductible, and we will not know if they are until IRS guidance is issued. In the interim, we may get some helpful language in the Joint Committee on Taxation's Bluebook, a description of the legislative changes. Until any guidance is received and definitively reviewed, a conservative approach may warrant making estimated tax payments assuming that amounts are not considered deductible.

Once we are in the process of preparing tax returns in the upcoming year, we would anticipate having guidance available to determine deductible amounts. It would seem fair and reasonable (and one would hope) to assume that business meals with a business purpose and intent are deductible. Tax administrators, realizing the importance of these rules for many taxpayers, will no doubt make every effort to issue guidance as soon as possible, with generous transition rules to the extent that the changes are unexpected.

Transportation benefits

In the early 1990s, Congress wanted to provide incentives to use mass transit and limit the exclusion for employer-provided parking to a specified dollar amount, and enacted an exclusion for qualified transportation fringe benefits. While those benefits could be provided through a reimbursement arrangement (i.e., one in which the expense incurred by employees was reimbursed tax free by the employer, assuming substantiation requirements were met), amounts could not be provided in lieu of compensation. That rule changed for tax years beginning after 1997 when Congress provided that an employee could choose to reduce compensation to receive a nontaxable qualified transportation fringe benefit. The use of employer-provided parking exploded as a tax-free fringe benefit.

Some have thought that the salary reduction provisions of qualified transportation fringes provide an opportunity to avoid the disallowed deduction rule, because it appears that the employee is funding the benefit. However, that is not correct. If an employee reduces future compensation on a pre-tax basis in exchange for the employer providing parking, the parking benefit is a provision of a qualified transportation fringe benefit, the costs of which would be disallowed. However, if the salary reduction is on an after-tax basis, the employee is not receiving a qualified transportation fringe and the disallowed deduction or, in the case of a tax-exempt organization, unrelated business income is avoided.

Nondeductible Costs

Qualified parking is a qualified transportation fringe benefit. As such, there is a disallowed cost that the employer must determine for qualified parking. To determine that cost, taxpayers should look to lease costs or ownership costs and, if amounts are not separately stated, make a good-faith allocation of these costs, taking into account the relative fair market values of the various items included in the lease or ownership costs. For example, a parking lot owned by a business may have snow removal, depreciation, maintenance, security, and similar expenses. There may be costs to administering a program that provides transit passes to employees. The employer will need to aggregate all of these costs and, if the costs relate to employee and nonemployee use, allocate the costs between employees' use and others' use. A conservative approach to accumulating and identifying nondeductible costs should be applied in 2018 tax planning.

FMV of parking benefit

Because the employee exclusion amount is the fair market value (FMV) of the parking benefit provided, and the disallowed employer deduction is the cost of providing that parking benefit, questions arise regarding whether a value of $0 for qualified parking might eliminate the existence of the qualified transportation fringe benefit as the provision of the benefit by the employer is not a provision of anything of value.

Notice 94-3

This notice provides helpful guidance by stating that:

Generally, the value of parking provided by an employer to an employee is based on the cost (including taxes or other added fees) that an individual would incur in an arm's length transaction to obtain parking at the same site. If that cost is not ascertainable, then the value of parking is based on the cost that an individual would incur in an arm's-length transaction for a space in the same lot or a comparable lot in the same general location under the same or similar circumstances.

The notice continues by helpfully giving an example of an industrial plant in a rural area in which no commercial parking is available. In this example, while the employer provides parking free of charge, the FMV of the parking would be $0 because nonemployees would not normally pay for parking. The implication is that with a $0 market value, there is no qualified transportation fringe benefit. With no qualified transportation fringe benefit, the TCJA rule limiting employer deductions for qualified transportation fringes may not apply. (However, the inability to deduct commuting expenses may apply, if parking is considered to be part of commuting.)

Notice 94-3 applies to the income exclusion rule for qualified transportation fringe benefits and may not extend to this new disallowed deduction rule. The TCJA deduction limitation focuses on employer costs incurred and not employee value received. Thus, even if the $0 FMV rule applies, the employer may have a cost disallowed, since the employer likely has expenses for lease or maintenance of a parking lot and other related expenses.

While this is a reasonable position, IRS guidance is needed to be confident that a value of $0 could result in no disallowed deduction. Until that time, taxpayers should be conservative and assume that if the employer incurs costs for providing qualified transportation fringes, possibly including parking with a $0 FMV under the rules of Notice 94-3, there is a disallowed cost that must be determined. Again, a conservative approach can only bring good news when tax returns are prepared and guidance is available.

[ITEM 5] The "New" Form 1040

The IRS is currently working on a draft version of Form 1040 for 2018. This updated version is being designed to reduce the size of the form to two half-pages in length and eliminate approximately 50 lines from the 2017 version of the form. The tradeoff of this new form, however, is that many of the line items being moved off of the face of the 1040 will reappear on various new schedules.

The 2018 draft form, which has not yet been officially posted on the IRS website, uses the first page to gather information about the taxpayer and any dependents and for the taxpayer's signature. The second page gathers information on the taxpayer's income, deductions (including a new line for the Sec. 199A deduction), credits, and taxes paid. Many of the items reported on the 1040 will be calculated on various new schedules, which have also not yet been officially posted. These schedules include:

Schedule 1, *Additional Income and Adjustments to Income*, includes items from lines 10 through 37 of the 2017 Form 1040, such as business income, alimony received, capital gains or losses, and adjustments including educator expenses and student loan interest expense.

Schedule 2, *Tax*, includes items from lines 44 through 47 of the 2017 Form 1040, such as the tax on a child's unearned income (commonly called the kiddie tax), the alternative minimum tax, and any excess premium tax credit that must be repaid.

Schedule 3, *Nonrefundable Credits*, includes items from lines 48 through 55 of the 2017 Form 1040, such as the foreign tax credit, the credit for child and dependent child care, the education credit, and the residential energy credit.

Schedule 4, *Other Taxes*, includes items from 57 through 63 of the 2017 Form 1040, such as household employment taxes, the health care individual responsibility payment (the individual mandate), the net investment income tax, and the additional Medicare tax. It also includes a new line for reporting the Sec. 965 net tax liability installment from Form 965-A — a form that does not yet exist.

Schedule 5, *Other Payments and Refundable Credits*, includes items from lines 65 through 74 of the 2017 Form 1040, such as estimated tax payments, the net premium tax credit, and amounts paid with an extension request.

Schedule 6, *Foreign Address and Third Party Designee*, provides taxpayers who have a foreign address a place to list their country, province, and postal code (formerly these appeared on page 1 of the 1040) and provides all taxpayers with a place to list information for a third-party designee who can discuss the return with the IRS.

The draft Form 1040 and the new schedules also refer to various existing schedules, which presumably will continue to exist in updated form. These include:

- Schedule A, *Itemized Deductions*
- Schedule C, *Profit or Loss From Business*
- Schedule D, *Capital Gains and Losses*
- Schedule E, *Supplemental Income and Loss*
- Schedule F, *Profit or Loss From Farming*,
- Schedule H, *Household Employment Taxes*
- Schedule SE, *Self-Employment Tax*, and
- Schedule 8812, *Child Tax Credit*.

Worth noting is that Schedule B, *Interest and Ordinary Dividends*, Schedule J, *Income Averaging for Farmers and Fishermen*, and Schedule R, *Credit for the Elderly or the Disabled*, are not mentioned on the new form and schedules. A line exists for reporting the earned income tax credit, although Schedule EIC itself is not mentioned.

It will be interesting to see how these new schedules evolve as we proceed under the TCJA. Historically new forms only tend to grow in size and complexity with time. One can only chuckle when we hear elected officials celebrate how easy it is to calculate one's taxes now that we have fewer tax brackets in play (we believe we speak for a majority of practitioners when we say that having fewer tax brackets is not a time saving bonanza). Needless to say that the quest for tax simplification is still a distant goal…..

[ITEM 6] Identity theft procedures – Fact Sheet FS-2018-6

With the issuance of Fact Sheet FS-2018-6 in April, the IRS clarified procedures that apply to taxpayer identity theft. Taxpayers who attempt to e-file a tax return that the IRS rejects because a return bearing the taxpayer's Social Security number has already been filed should file Form 14039, *Identity Theft Affidavit*, by attaching it to a paper tax return and mailing it to the IRS. Upon its receipt, the IRS will investigate, clear the account, and then process the paper tax return.

Form 14039 is a fillable form available on irs.gov and on the Federal Trade Commission's website, ftc.gov.

The procedure in which the IRS identifies suspicious tax returns is based on filters at which point the IRS selects those tax returns for review. Subsequently, the IRS sends Letter 5071C, 4883C, or 5747C to the taxpayer asking him or her to contact the IRS and verify his or her identity. In these cases, Form 14039 is not required to be filed.

Letter 5071C asks the taxpayer to verify his or her identity using an online tool and to tell the IRS if he or she filed the tax return in question. At this stage of the process, no identity theft will be considered to have occurred. However, if the taxpayer does not respond, the tax return will not be processed. Letter 4883C asks the taxpayer to call the IRS to verify his or her identity and whether he or she filed the tax return. Letter 5747C is for those who have been a victim of a data breach. These individuals may be asked to visit an IRS Taxpayer Assistance Center to verify their identity.

[ITEM 7] Tax practitioners are warned to safeguard client data

The IRS began a new campaign to warn tax practitioners to beware of new threats from cybercriminals that target client data, allowing the criminals to prepare fraudulent tax returns that are difficult to detect. As part of that campaign, the IRS has introduced a new publication, Publication 5293, Data Security Resource Guide for Tax Professionals.

The IRS warns that data theft from tax practitioners continues to be a growing problem, with technically sophisticated cybercriminals employing evolving tactics to steal data. This campaign is a joint effort by the IRS and its Security Summit partners, which include state tax agencies and the private-sector tax preparation industry.

The IRS announced that, as part of its efforts, it has also updated Publication 4557, Safeguarding Taxpayer Data, to better reflect current threats tax professionals face. The IRS announcement also reiterated the steps it has urged tax practitioners to take to ensure client information is not breached:

Recognize phishing emails, especially those pretending to be from the IRS, a tax software provider, cloud storage provider, or state tax agencies. Never open a link or any attachment from a suspicious email. The IRS does not contact a tax professional via email initially.

Create a data security plan using Publication 4557, and Small Business Information Security — The Fundamentals, by the National Institute of Standards and Technology.

Review internal controls for the business by:

- installing anti-malware/anti-virus security software on all electronic devices and keeping software set to automatically update;
- creating strong passwords or passphrases and using different passwords for each account. (Use a password manager program to keep track of different passwords.);
- encrypting all sensitive files and emails;
- backing up sensitive data to a secure external source not connected full time to a network;
- wiping clean or destroying old computer hard drives and printers that contain sensitive data;
- limiting access to taxpayer data to those who need to know;
- checking IRS e-Services account weekly for the number of returns filed with the practitioner's electronic filing identification number (EFIN) to be sure only the practitioner has used it;
- reporting any data theft or data loss to the appropriate IRS Stakeholder Liaison; and
- staying connected to the IRS through subscriptions to e-News for Tax Professionals, QuickAlerts, and social media.

REVIEW QUESTIONS AND SOLUTIONS

1. Which of the following is not true in connection with IRS proposed regulations which state that depreciable property must meet certain requirements to be qualified property?
   a. The depreciable property must be of a specified type.
   b. The depreciable property must be placed in service by the taxpayer within a specified time period.
   c. The provision only applies to depreciable property acquired by the taxpayer after Dec 31, 2017.

2. For claimed noncash contributions of $500 or more but not more than $5,000, the donor _______.
   a. Is not required to obtain a written acknowledgement of the donation
   b. Must file the appropriate sections of Form 8283 when filing their tax return
   c. Must obtain a qualified appraisal for donations exceeding $2,500

3. Which of the following is not a limitation to the allowance of personal casualty losses, prior to the enactment of the TCJA?
   a. the loss from each casualty is allowed only to the extent it exceeds $100
   b. aggregate losses for a tax year are allowed only to the extent they exceed the sum of (1) casualty gains and (2) 10% of the taxpayer's adjusted gross income
   c. no deduction is permitted in a tax year for the loss, or any portion of it, when a claim for compensation is outstanding for which there is a "definitive prospect" of recovery.

4. According to IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses, which of the following is true concerning meal as a form of entertainment?
   a. A meal expense includes the cost of food, beverages, taxes, and tips for the meal.
   b. You (or your employee) do not have to be present when the food or beverages are provided to a client or customer.
   c. Makes no distinction between entertainment and nonentertainment meals.

5. Which of the following is not reported on a new schedule based on the IRS draft version of the shortened Form 1040 for 2018?
   a. Additional Income and Adjustments to Income
   b. Interest and Ordinary Dividends
   c. Other Payments and Refundable Credits

6. According to IRS Publication 4557, steps to ensure adequate internal controls for a business would include ________.
   a. retaining old computer hard drives and printers
   b. a change in settings to prevent software from updating automatically
   c. limiting access to taxpayer data to those who need to know

Solutions

1. **"A" is an incorrect response**. In addition, the original use of the depreciable property must commence with the taxpayer, or used depreciable property must meet the acquisition requirements of Sec. 168(k)(2)(E)(ii);
   "B" is an incorrect response. In the case of property planted or grafted, the property must be placed in service before a specified date.
   "C" is the correct response. The depreciable property must be acquired by the taxpayer after Sept 27, 2017

2. **"A" is an incorrect response**. A donor who claims a noncash contribution of at least $250 but not more than $500 is required to obtain a contemporaneous written acknowledgment.
   "B" is the correct response. Section A or Section B of Form 8283 would be completed depending on the type of property contributed
   "C" is an incorrect response. The requirement to obtain a qualified appraisal would occur for claimed noncash contributions of $5,000 or more

3. **"A" is an incorrect response**. Additionally, aggregate losses for a tax year are allowed only to the extent they exceed the sum of (1) casualty gains and (2) 10% of the taxpayer's adjusted gross income
   "B" is an incorrect response. Taxpayers would typically report these net personal casualty losses as itemized deductions and can use them to offset ordinary income.
   "C" is the correct response. The standard only requires a "reasonable prospect" of recovery.

4. **"A" is the correct response**. Currently IRS Publication 463 has not been modified since enactment of the TCJA.
   "B" is an incorrect response. You or your employee "would" need to be present.
   "C" is an incorrect response. Entertainment includes the cost of a meal you provide to a customer or client, whether the meal is a part of other entertainment or by itself.

5. **"A" is an incorrect response**. These amounts are tentatively to be included on "Schedule 1" and includes items from lines 10 through 37 of the 2017 Form 1040, such as business income, alimony received, capital gains or losses, and adjustments including educator expenses and student loan interest expense.
   "B" is the correct response. According to this draft Form 1040, Interest and Ordinary Dividends are not mentioned on the new form and schedules.
   "C" is an incorrect response. These amounts are tentatively to be included on "Schedule 5" and includes items from lines 65 through 74 of the 2017 Form 1040, such as estimated tax payments, the net premium tax credit, and amounts paid with an extension request.

6. **"B" is an incorrect response**. Wiping clean or destroying old computer hard drives and printers that contain sensitive data would be a correct statement.
   "A" is an incorrect response. Devices should be set so that software will update automatically.
   "C" is the correct response. The IRS has noted that in many cases, tax practitioners were not aware that their client's data had been stolen.

[ITEM 8] First-time abatement: Procedure and case law updates

Our next item will address recent developments in the IRS's application of its first-time abatement (FTA) penalty waiver policies as the Service continues to modernize its systems to apply abatement procedures consistently. The IRS recently released Office of Chief Counsel memorandum PMTA-2018-2, which sets forth how the IRS Office of Servicewide Penalties (OSP) has undertaken a project to automate the FTA process. While the Internal Revenue Manual (IRM) sets forth the IRS's policies regarding FTAs, recent memoranda released by the IRS, along with the Tax Court's recent rulings on FTAs, provide helpful perspective on how the IRS may apply this relief now and in the future.

FTA background

Since 2001, the IRS has applied FTAs to provide relief from delinquency penalties for otherwise compliant taxpayers. Under these policies, taxpayers may receive relief if they establish that the taxpayer (1) has filed, or filed a valid extension for, all currently due returns; (2) has paid or arranged to pay any tax currently due; and (3) has not received an applicable delinquency penalty for the return in the three prior years (or was not previously required to file such a return).

The IRS updated its FTA policies and the IRM following a 2012 report by the Treasury Inspector General for Tax Administration (TIGTA). TIGTA concluded, in part, that the IRS had failed to consistently apply its FTA policies and recommended that the Service better inform taxpayers of the ability to receive FTA relief. The TIGTA report also criticized the IRS, finding that the Service's Reasonable Cause Assistant tool it used to help employees process penalty abatement requests had made incorrect determinations in 89% of the cases sampled.

Automation of FTAs

While FTAs have been available to taxpayers for well over a decade, the IRS has historically provided relief only after a taxpayer affirmatively requested an FTA or abatement under reasonable cause. Under its proposed policy set forth in the IRS's memorandum, the Service will grant all taxpayers who meet the FTA requirements an FTA waiver. The IRS would achieve this result by mechanically "suppressing" the applicable penalties in the taxpayer's master file. The OSP estimates that this automation step will increase the number of waivers from 350,000 to 1.7 million annually, with a dollar increase in penalties abated from $578 million to $848 million per year. The memorandum concludes that the commissioner may choose not to impose the penalty on a class of taxpayers (i.e., those who qualify for an FTA) to enhance overall tax compliance.

While the memorandum focuses on abatement of delinquency penalties for the identified class of otherwise compliant taxpayers, another recent IRS memorandum emphasized that the IRS may use the FTA process where the penalty was not assessed but rather was considered for a taxpayer in an examination. Specifically, Chief Counsel Advice (CCA) stated that an FTA is a policy decision of the IRS and it would be "a waste of resources for the penalty to have to be assessed, and then protested, and then abated, if the FTA was appropriate." Further procedures for or automation of FTA application in examinations would also better reconcile the IRS's FTA policies in post-assessment cases and the IRM's requirement that IRS employees not improperly assert delinquency penalties in the first instance as a bargaining chip in examinations.

Tax Court's consideration of FTAs

In Laidlaw, T.C. Memo. 2017-167, the Tax Court considered the taxpayers' arguments that the IRS erred by not waiving late-filing penalties under the FTA policies. The taxpayers failed to convince the court that their preparer timely filed their tax return extension, but they also argued that they were otherwise compliant in the prior three years and that the IRS should have granted FTA relief. The IRS countered that the taxpayers did not request abatement; that the FTA procedures were administrative, not judicial; and that there technically was no assessment of the late-filing penalties.

The Tax Court rejected the taxpayers' arguments, but in doing so it noted that the IRM then placed the FTA policy under the "Reasonable Cause Assistant" category in IRM Section 20.1.1.3.6. The Tax Court then concluded that because the taxpayers did not argue the existence of reasonable cause, and since there was no evidence that the taxpayers requested (or were denied) FTA relief, there was no basis in the record upon which to find for them.

Since the Laidlaw case, two developments may affect the court's future analysis of the case or the frequency with which it considers other such cases. First, on Nov. 21, 2017, the IRS revised the IRM, moving the FTA policy to a stand-alone section for administrative waivers, instead of under the "Reasonable Cause Assistant" content as the Tax Court emphasized. While an FTA is still clearly an administrative waiver, its separate placement in the IRM may yield a different result with the IRS and in Tax Court if the additional facts are properly included in the record. Second, the IRS's shift to automating the FTA process, along with its continued policy of not imposing penalties for negotiating strength, may result in fewer court cases litigating delinquency penalties.

The IRS's efforts to review automation of FTAs, together with other potential steps to modernize its procedures to apply penalties consistently and fairly, may permit the IRS to focus more resources on serially noncompliant taxpayers than on taxpayers who make an occasional mistake.

[ITEM 9] D.C. Circuit upholds IRS unenrolled tax preparer program

During August of 2018, The Court of Appeals for the D.C. Circuit held in American Institute of Certified Public Accountants v. Internal Revenue Service, No. 16-5256 (D.C. Cir. 8/14/18), that the AICPA had standing to challenge the IRS’s voluntary Annual Filing Season Program (the Program). However, the court held for the IRS on the merits, allowing the Service to continue the Program, which had already gone into effect while AICPA's challenge was pending.

Rejecting the AICPA's arguments to the contrary, the court unanimously held that the program was within the statutory authority delegated to the IRS, and held over a dissenting opinion that Revenue Procedure 2014-42, which established the Program was an interpretive rule, so the IRS did not violate the Administrative Procedure Act (APA) by failing to follow notice-and-comment rulemaking procedures in promulgating it.

Participants in the Program, which is open to all tax preparers but is designed for unenrolled preparers, are given a "Record of Completion" annually after they obtain a preparer tax identification number, complete certain education and testing requirements, and agree to be subject to the requirements for practicing before the IRS in Subpart B and Section 10.51 of Circular 230, Regulations Governing Practice Before the Internal Revenue Service. They are also permitted limited representation rights, meaning they can represent clients whose returns they prepared and signed before the IRS during an audit, a right that was previously available to any unenrolled tax preparer. Participation in the Program is voluntary.

The IRS established the Program in Rev. Proc. 2014-42, which it issued without a notice-and-comment period. The Program was a response to the invalidation of an earlier attempt to regulate unenrolled tax return preparers, introduced in 2011, called the Registered Tax Return Preparer program. That program was challenged and ultimately determined to be invalid because the IRS lacked statutory authority to regulate unenrolled tax return preparers under 31 U.S.C. 330(b).

The AICPA challenged the Program in the D.C. District Court, asserting the IRS's adoption of the Program in Rev. Proc. 2014-42 exceeded the IRS's statutory authority and violated the APA. The district court dismissed the case, saying that the AICPA lacked constitutional standing. The D.C. Circuit reversed and remanded the case to the district court. On remand, the IRS argued that the AICPA lacked statutory standing because it did not come within the zone of interests protected or regulated by the relevant statute. The district court entered judgment on the pleadings for the IRS and dismissed the case for lack of statutory standing, and the AICPA again appealed.

The D.C. Circuit reversed the lower court's holding that the AICPA lacked standing to challenge the IRS program, explaining that the AICPA's members have both constitutional and statutory standing because they employ unenrolled preparers and the Program increases the supervisory burdens on AICPA members with respect to those employees.

Having found that the AICPA had standing, the D.C. Circuit determined it was appropriate for it to decide the merits of the case. The AICPA argued that the Program is beyond the statutory authority delegated to the Treasury and hence to the IRS. The D.C. Circuit found that, on the contrary, the Program was within the IRS's statutory authority under 31 U.S.C. Section 330(a) and Sec. 7803(a)(2)(A).

The AICPA also argued that the Rev. Proc. 2014-42 is a legislative rule rather than an interpretive rule and therefore had to be adopted through notice-and-comment rulemaking pursuant to the APA. The D.C. Circuit disagreed, over a dissenting opinion, finding that an agency action constitutes a legislative rule only if the agency action binds private parties or the agency itself with the "force of law." According to the majority opinion on this issue, the revenue procedure and the Program "do not bind unenrolled preparers at all" so the rule was not a legislative rule subject to the APA requirements. The court rejected the AICPA's arguments that the rule was legislative because it limited unenrolled tax preparers' right to represent taxpayers before the IRS, a right that itself had been conferred through notice-and comment-rulemaking.

Thus, the D.C. Circuit held that the AICPA had standing to sue but the IRS prevailed on the merits of the case. Accordingly, it remanded the case to the district court for the purpose of entering judgment for the IRS.

[ITEM 10] **Argosy Technologies, LLC, T.C. Memo. 2018-35**

In a recent case, the Tax Court denied a married couple's claim that partnership penalties did not apply to their limited liability company (LLC) because they held it as a single member.

Argosy Technologies LLC had filed tax returns for 2010 and 2011 on Form 1065, including Schedule B-1, which listed the husband and wife each as 50% owners. The returns included a statement that the partnership elected to be covered under the TEFRA (Tax Equity and Fiscal Responsibility Act of 1982) unified audit procedures. The IRS subsequently determined unpaid tax liabilities and imposed late-filing penalties under for the tax years in question.

In 2014, the IRS issued a notice of intent to levy, which it sustained in a notice of determination. Argosy petitioned the Tax Court, contending it was a single-member LLC rather than a partnership and therefore could not be assessed a penalty under Sec. 6698, which pertains to failure to file a partnership tax return.

The issue in question concerned an election available to joint venture entities. Beginning with tax years after 2006, if spouses are the only members of a joint venture that conducts a trade or business in which they both materially participate then they may elect to be a qualified joint venture and not be treated for tax purposes as a partnership. In order to qualify, the spouses:

- must file a joint return for the tax year (with required schedules), and
- both must elect the application of this rule.

As a result, all items of income, gain, loss, deduction, and credit will be divided between the spouses in accordance with their individual shares of the joint venture as if they were from a trade or business that each spouse conducted as a sole proprietor.

Despite the fact that the couple claimed to have jointly been a single owner of the LLC, there was no evidence they filed an election to be a qualified joint venture under Sec. 761(f). The Tax Court concluded that because Argosy filed returns representing itself as a partnership, it could not disclaim its validity and argue that it was actually a different type of entity. As a result the court upheld late-filing penalties.

[ITEM 11] **New Tax Deduction 199A "QBID"**

The Tax Cuts and Jobs Act (TCJA), which was signed into law in December 2017 and began to take effect in 2018, created a new deduction for pass-through business owners. The deduction, called the 199A deduction, or as we will commonly refer to it in this discussion as "QBID" (Qualified Business Income Deduction) can in certain situations provide up to a 20 percent tax deduction on one's qualified business income. However, planning for and determining the best way to take advantage of the 199A deduction is a very complex process. Any pass-through entities planning to utilize this deduction should have already been in touch with their financial advisors and accountants, but many are still unaware of its existence or the specifics of how the deduction applies to them.

So, how does the QBID work? Let's address some of the basics.

The QBID is in effect for the current duration of the TCJA, (8 years, 2018-2025). The QBID is calculated by multiplying Qualifying Business Income by 20%. Currently the guidance available at this writing concerning this new deduction is Statute, Committee Reports and Proposed Regulations (which we will address in our next Item Section). Income from S corporations, Partnerships, Schedule C's and E's would qualify for this deduction, however the QBID does not apply to C Corporations. The QBID does not reduce a taxpayers SE income and does not increase a taxpayers NOL's. Additionally the QBID does not need to be adjusted for AMT purposes. In terms of appearance on the 1040, QBID's are a below-the-line deduction (similar to the manner in which personal exemptions were presented).

Qualifying Business Income is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. This amount would also include REIT Dividends (if not a capital gain or qualifying dividend), PTP's and Qualified Cooperative Dividends. Not included in the definition of Qualifying Business income includes Wages, Short Term/Long Term Capital Gain or Loss, Dividends, and Interest income not allocable to a business.

Unless specifically excluded, ANY business qualifies, however this deduction does have limits. First, if the business is a specified service business that is defined as a business in the fields of health, law, [bill removed engineering and architecture as a specified service business for purposes of 199A] accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services, the deduction is phased out based on the taxpayer's taxable income. Specifically, the deduction is phased out for joint filers between the range of $315,000 and $415,000. For single filers, the phase-out range is $157,500 to $207,500. This means that the entire 20 percent deduction is lost for those couples or singles earning income from their pass-through business that exceeds the top end of the range.

For non-specified service businesses, the ranges of $315,000 to $415,000 for joint filers and $157,500 to $207,500 for single filers still play a role; however, instead of phasing out the deduction, they phase in a potential 199A limitation. For non-specified service businesses above the stated thresholds, the deduction becomes limited to the lesser amount derived from one of the two following ways of calculating the deduction:

- 20 percent qualified business income deduction or
- The greater of either 50 percent of the W-2 wages of the business or The sum of 25 percent of the W-2 wages of the business and 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

The planning points people need to consider are vast. Most of it relates to the individual's income, business structure, W-2 employees, and property ownership. Because the lack of W-2 wages can limit some business owners from taking the QBID, some business owners might need to take a higher W-2 wage for themselves. Others might need to decrease their W-2 wages, as W-2 wage income won't qualify for the deduction, just qualified business income. However, this should be done very carefully and only as it relates to the actual reasonableness of wages. Historically we have seen countless instances of working with clients to determine reasonable wages in the context of an S-Corp. Similarly we will see added planning opportunities and discussions related to the QBID.

Choice of entity is such an important decision for business owners, particularly in light of passage of Section 199A. Careful planning and discussions with clients concerning entity choice for current and future entities should be added to any client questionnaire. Additionally, pretax retirement plans will impact this calculation. One must also consider that the QBID deduction is limited based on the taxable income of the taxpayer.

Those with other businesses may need to pay close attention to their unadjusted basis in property in order to maximize their 199A deduction. Essentially, this limit puts many business owners into the real estate business. Some owners might want to consider buying property that they rent or, if they own multiple buildings, it could make sense to shift debt to different properties or re-leverage debt to maximize the unadjusted basis in order to open up a higher deduction amount under 199A.

The QBID now provides taxpayers with the best tax rates since 1990. Top marginal effective tax rates on Qualified Business Income are 29.6% (37% regular rate x 80% rate adjustment after QBID deduction). Practitioners should actively be working with their clients to educate and plan for the impact of this deduction during the remainder of 2018. This new code provision provides us with a great opportunity to strengthen relationships with our clients and add value to the planning and compliance process.

<u>Example 1:</u> You earn $100,000 as a sole proprietor. In this case, you potentially get a deduction equal to 20% of the $100,000—or $20,000.

<u>Example 2:</u> If an S corporation shareholder's share of the profits in some venture equals $100,000, but $60,000 of this profit is paid out as shareholder-employee wages and then the other $40,000 gets reported on the S corporation K-1, only that $40,000 of profit counts as qualified business income and plugs into the qualified business income deduction formula.

<u>Example 3:</u> If a partner's share of the profits in some venture equals $100,000, but $80,000 of this profit is paid out as a guaranteed payment and then the other $20,000 gets paid out as a distribution and reported on the partnership K-1, only that $20,000 of profit counts as qualified business income and plugs into the Section 199A formula.

<u>Example 4:</u> You earn $100,000 in a sole proprietorship but you use the $24,000 married-filing-jointly standard deduction and shelter $26,000 using a solo 401(k). In this case, your taxable income equals $50,000. You don't get a Section 199A deduction equal to 20% of the $100,000 of sole proprietorship profits ($20,000) but instead get a Section 199A deduction equal to 20% of $50,000 ($10,000).

<u>Example 5:</u> You are married and earn $100,000 in a sole proprietorship. Your spouse earns $60,000 in a regular, W-2 job. You use the $24,000 standard deduction and shelter $26,000 using a solo 401(k). In this case, your qualified business income equals $100,000 so the deduction equals 20% of the $100,000 ($20,000). Your family's taxable income, $110,000, doesn't come into the Section 199A deduction calculation since it's higher than the qualified business income.

[ITEM 12] 199A Proposed Regulations issued

During the first part of August, the IRS issued proposed regulations on Sec. 199A, (REG-107892-18). At the same time, it issued Notice 2018-64, which provides guidance on how to compute W-2 wages for purposes of the deduction. The proposed rules include a way that taxpayers can group or aggregate separate trades or businesses and an anti-abuse rule designed to prevent taxpayers from separating out parts of an otherwise disqualified business in an attempt to qualify those separated parts for the Sec. 199A deduction.

The IRS is requesting comments on all of the proposed rules, which must be received within 45 days of the date they are published in the Federal Register. The Service noted that, although the rules will not be effective until published as final in the Federal Register, taxpayers may rely on them until then.

The regulations address a variety of subjects.

<u>Prop. Regs. Sec. 1.199A-1</u> contains the operational rules, including how to determine the deduction for taxpayers with incomes at or below the threshold amounts and for those with incomes above the thresholds. It also contains definitions of the following terms: aggregated trade or business, applicable percentage, phase-in range, qualified business income, QBI component, qualified PTP income, qualified REIT dividends,

reduction amount, relevant passthrough entity (RPE), specified service trade or business (SSTB), threshold amount, total QBI amount, unadjusted basis immediately after acquisition (UBIA) of qualified property, and W-2 wages.

The definition of a trade or business is also in this section; the IRS decided to apply the definition of "trade or business" contained in Sec. 162(a) because the definition of trade or business under Sec. 162 is derived from a large amount of case law and administrative guidance interpreting the meaning of trade or business in the context of a broad range of industries. This will provide for administrable rules that are appropriate for the purposes of Sec. 199A and that taxpayers have experience applying, and the IRS believes it will reduce compliance costs, burden, and administrative complexity.

Prop. Regs. Sec. 1.199A-2 contains rules for determining W-2 wages and the UBIA of qualified property, both of which are components in calculating limitations on the deduction. The W-2 wage rules of proposed §1.199A-2 generally follow the rules under former section 199. Section 199, which was repealed by the TCJA, provided for a deduction with respect to certain domestic production activities and contained a W-2 wage limitation similar to the one in section 199A. The legislative text of the W-2 wage limitation in section 199A is modeled on the text of former section 199, and both taxpayers and the IRS have developed experience in applying those W-2 wage rules for over a decade.

Prop Regs. Sec. 1.199A-3 restates the definitions in Sec. 199A(c) and provides additional guidance on the determination of QBI, qualified REIT dividends, and qualified PTP income.

Prop. Regs. Sec. 1.199A-4 contains aggregation rules allowing separate trades or businesses to be grouped when applying the Sec. 199A rules. The IRS rejected comments suggesting the application of the grouping rules under Sec. 469, the passive loss provision, and instead proposed a flexible method that looks into common ownership, shared services, and other commonality, but specifically excludes specified service trade or business (SSTBs) from being aggregated under the rules. The regulations impose a duty of consistency that requires that once multiple trades or businesses are aggregated into a single aggregated trade or business under Sec. 199A, taxpayers must consistently report the aggregated group in subsequent tax years.

Prop. Regs. Sec. 1.199A-5 defines specified service trades or businesses and the trade or business of performing services as an employee. The regulations include an anti-abuse rule designed to prevent taxpayers from separating out parts of what otherwise would be an integrated SSTB, such as the administrative functions, in an attempt to qualify those separated parts for the deduction.

Prop. Regs. Sec. 1.199A-6 provides guidance that certain specified entities (for example, relevant passthrough entities (RPE), qualified publically traded partnerships (PTPs), trusts, and estates) may need to follow for purposes of computing the entities' or their owners' section 199A deductions.

Notice 2018-64 contains a proposed revenue procedure that provides guidance on methods for calculating W-2 wages.

These proposed regulations provide a wealth of extended examples to aid tax practitioners with various scenarios and interplay of variables in determining the deduction under Section 199A. Select examples are provided below which address the impact of capital gains, wages, and REIT dividends when calculating the allowable deduction.

Example 1. A, an unmarried individual, owns and operates a computer repair shop as a sole proprietorship. The business generated $100,000 in net taxable income from operations in 2018. A has no capital gains or losses. After allowable deductions not relating to the business, A's total taxable income for 2018 is $81,000. The business's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. A's section 199A deduction for 2018 is equal to $16,200, the lesser of 20% of A's QBI from the business ($100,000 x 20% = $20,000) and 20% of A's total taxable income for the taxable year ($81,000 x 20% = $16,200).

Example 2. Assume the same facts as in Example 1 of this paragraph (c)(3), except that A also has $7,000 in net capital gain for 2018 and that, after allowable deductions not relating to the business, A's taxable income for 2018 is $74,000. A's taxable income minus net capital gain is $67,000 ($74,000 - $7,000). A's section 199A deduction is equal to $13,400, the lesser of 20% of A's QBI from the business ($100,000 x 20% = $20,000) and 20% of A's total taxable income minus net capital gain for the taxable year ($67,000 x 20% = $13,400).

Example 3. B and C are married and file a joint individual income tax return. B earned $500,000 in wages as an employee of an unrelated company in 2018. C owns 100% of the shares of X, an S corporation that provides landscaping services. X generated $100,000 in net income from operations in 2018. X paid C $150,000 in wages in 2018. B and C have no capital gains or losses. After allowable deductions not related to X, B and C's total taxable income for 2018 is $270,000. B's and C's wages are not considered to be income from a trade or business for purposes of the section 199A deduction. Because X is an S corporation, its QBI is determined at the S corporation level. X's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. The wages paid by X to C are considered to be a qualified item of deduction for purposes of determining

X's QBI. The section 199A deduction with respect to X's QBI is then determined by C, X's sole shareholder, and is claimed on the joint return filed by B and C. B and C's section 199A deduction is equal to $20,000, the lesser of 20% of C's QBI from the business ($100,000 x 20% = $20,000) and 20% of B and C's total taxable income for the taxable year ($270,000 x 20% = $54,000).

Example 4. *Assume the same facts as in Example 3 of this paragraph (c)(3) except that B also earns $1,000 in qualified REIT dividends and $500 in qualified PTP income in 2018, increasing taxable income to $271,500. B and C's section 199A deduction is equal to $20,300, the lesser of (i) 20% of C's QBI from the business ($100,000 x 20% = $20,000) plus 20% of B's combined qualified REIT dividends and qualified PTP income ($1500 x 20% = $300) and (ii) 20% of B and C's total taxable for the taxable year ($271,500 x 20% = $54,300).*

[ITEM 13] Final Thoughts…. April 15, 2019

The previous edition of the *Elite Quarterly* addressed the "Withholding Calculator" and recommendations to review these amounts given the passage of the TCJA. We wish to expand on this topic and discuss a recent Government Accountability Office report (GAO), which shows that more Americans may end up owing the US Treasury in April because their employers are not withholding enough from their paychecks following passage of the TCJA.

Under the Tax Cuts and Jobs Act, The Treasury department had new discretion in 2018 to adopt rules under which the total withholding allowance is determined based on certain factors, rather than to tie the withholding allowance to the personal exemption. As a result of time constraints, the Treasury department considered the value of the withholding allowance to be the only parameter they could change to affect withholding for 2018. The Treasury department decided that the withholding tables for 2018 should be compatible with the existing Forms W-4 employees had already filed because there would not have been enough time for employers and payroll providers to accommodate larger changes in 2018 that may have required employees to file new Forms W-4.

Representatives of an association representing payroll providers corroborated that payroll providers would need six to eight months to incorporate major structural changes into their software, input new information, and ensure that employees updated their Forms W-4.

In light of these challenges, Treasury had several objectives in deciding the withholding allowance value for 2018, according to Treasury officials and a Treasury memo regarding the decision. These included:

- Provide for accurate withholding
- Avoid increasing both overwithholding or underwithholding, and
- Avoid increasing overwithholding for taxpayers whose tax liability decreased

The Treasury department assessed how alternative withholding allowance values may affect taxpayers by running simulations of changes concerning withholdings for individual taxpayers with wage income in 2018. The simulations revealed that:

- The percentage of taxpayers with wages with overwithheld tax decreased from 76% to 73%.
- Conversely, the percentage of taxpayers with wages with underwithheld tax increased from 18% to 21%.
- The percentage of taxpayers with wages with accurately withheld tax stayed unchanged at 6%.

In assessing how withholding for hypothetical taxpayer examples would change based on the Tax Cuts and Jobs Act, the report indicated that the $4,150 withholding allowance value would have varying effects on taxpayers depending on their unique circumstances:

- Taxpayers at the greatest risk of underwithheld taxes consisted of married filing joint taxpayers with two children under the age of 17, one job with employee earning $180,000 of wage income, with $20,000 of additional income and itemized deductions.
- Taxpayers with two children under 17, one job in which the employee earns $75,000 and takes the standard deduction have a higher probability of overwithholding taxes relative to their tax liability.
- The study also found that single taxpayer with no children, one job in which the employee earns approximately $30,000 in wages and utilize the standard deduction would be, on balance, have an accurate level of withholdings relative to their tax liability.

The entire report can be found and downloaded via www.gao.gov/assets/700/693582.pdf. This 31 page report is a worthwhile read and can provide another valuable opportunity to proactively work with clients in anticipation of tax return filings for this coming year. Tax planning is an annual given for those clients with high income and sophisticated personal circumstances. We advise that those clients on "auto-pilot" be given a second look. You may find that safe Safe harbor estimated tax payments or "no change" to withholding levels are simply insufficient in the coming year. I have found that clients who owe a substantial balance in any given year are typically aware of the situation since tax planning has been performed and advanced notice of any pending liability is understood. However, we all have experienced the wrath of clients who have routinely received, and expect, refunds on an annual basis (no matter how large or small) and suddenly are asked to write a check. Be forewarned, now is the time to begin reviewing client lists, and consider which individuals require a revisit to current withholdings and estimated tax payments. Far better to work on reducing any deficit between now and next April, and avoid making that dreaded phone call.

REVIEW QUESTIONS AND SOLUTIONS

7. ______________ addresses the topic of FTA's (first time abatements).
   a. American Institute of Certified Public Accountants v. Internal Revenue Service
   b. Laidlaw, T.C. Memo. 2017-167
   c. Argosy Technologies, LLC, T.C. Memo

8. Which of the following programs was challenged and ultimately determined to be invalid because the IRS lacked statutory authority?
   a. Volunteer Income Tax Assistance Program.
   b. Annual Filing Season Program
   c. Registered Tax Return Preparer program.

9. Which of the following is considered a "specified service business" under code section 199A?
   a. Performing Arts
   b. Engineering
   c. Architecture

10. For specified service businesses, the 199A deduction for joint filers is phased out when taxable income is between __________.
    a. $200,000 - $400,000
    b. $157,500 - $207,500
    c. $315,000 - $415,000

11. Rules for determining W-2 wages and the UBIA of qualified property can be found in Prop. Reg ______.
    a. 1.199A-2
    b. 1.199A-3
    c. 1.199A-4

12. Based on simulations run by the Treasury Department, the GAO says taxes for 30 million Americans — 21 percent of taxpayers ___________ .
    a. are being overwittheld in taxes by their employers.
    b. are being underwithheld in taxes by their employers.
    c. have the correct amount of taxes withheld.

Solutions

7. **"A" is an incorrect response**. This case involves a challenge to the IRS's voluntary Annual Filing Season Program.
   "B" is the correct response. The Tax Court rejected the taxpayers' arguments, but in doing so it triggered changes to the FTA policy under the "Reasonable Cause Assistant" category in IRM Section 20.1.1.3.6.
   "C" is an incorrect response. This case addresses the denial of a married couple's claim that partnership penalties did not apply to their limited liability company (LLC) because they held it as a single member.

8. **"A" is an incorrect response**. This IRS initiative is designed to support free tax preparation service for the underserved through various partner organizations.
   "B" is an incorrect response. The AFSP is a voluntary IRS program designed to incentivize non-credentialed tax return preparers to participate in continuing education (CE) courses.
   "C" is the correct response. This program was initially introduced in 2011 and designed to regulate unenrolled tax return preparers.

9. **"A" is the correct response.** As a result this deduction would be phased out based on the owner's taxable income.
"B is an incorrect response. Lobbying efforts resulted in the removal of engineering and architecture for the purposes of this definition.
"C" is an incorrect response. Specified service businesses would include, in part, accounting, actuarial science, performing arts and athletics.

10. **"A" is an incorrect response**. This means that the entire 20 percent deduction is lost for those couples or singles earning income from their pass-through business that exceeds the top end of the range.
"B" is an incorrect response. These phaseout amounts are for single filers.
"C" is the correct response. A specified service business is defined as a business in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services.

11. **"A" is the correct response**. W-2 wages and the UBIA of qualified property are both components in calculating limitations on the deduction.
"B" is an incorrect response. This section restates the definitions in Sec. 199A(c) and provides additional guidance on the determination of QBI.
"C" is an incorrect response. This section contains aggregation rules allowing separate trades or businesses to be grouped when applying the Sec. 199A rules.

12. **"A" is an incorrect response**. According to these simulations, 73% of taxpayers will be overwittheld regarding personal income taxes and receive a refund this filing year.
"B is the correct response. Running the same simulation without including changes from the TCJA would result in only 18% of taxpayers being underwithheld.
"C" is an incorrect response. A typical taxpayer with the greatest concern for underwithholdings of taxes would include married joint filers with $180,000 in income, $20,000 of which comes from non-wage income who have two kids and itemizes deductions.

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******* EXAM QUESTIONS *******

*Place your answers to the following 20 Multiple Choice Questions on the enclosed answer sheet (**page 21**).*

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1. The TCJA extended and modified bonus depreciation allowing for a 100% deduction for the cost of eligible property in the year it is placed in service through 2022. Subsequent years will see a reduction in the percentage of allowable bonus depreciation. Excluding property with long production periods, ______ will be the final year in which the bonus depreciation will be allowed.
   a) 2023
   b) 2024
   c) 2025
   d) 2026

2. In connection with donations of property, Reg. Sec. 1.170A-17(b)(1) defines a "qualified appraiser" as an individual with "verifiable education and experience…" Which of the following criteria would satisfy this requirement for an appraiser?
   a) College level coursework and 1 year of experience
   b) College level coursework and 5 years of experience
   c) 5 years of experience only
   d) None of the above

3. The new requirements with respect to education and experience for appraisers will begin with contributions made on or after ___________.
   a) Jan 1, 2019
   b) July 1, 2019
   c) Jan 1, 2020
   d) Jan 1, 2021

4. The IRS requires that additional substantiation requirements apply when donations involve property. Contemporaneous written acknowledgement is required for property donations in excess of _____ .
   a) $ 0
   b) $ 250
   c) $ 500
   d) $ 5,000

5. During 2018 Jack and Janet experienced a personal jewelry theft resulting in a $20,000 loss. Subsequently the couple was able to recover $5,000 of this loss from their insurance company. The total amount of net gain or loss (resulting from the loss and partial recovery) that the couple would recognize on their 2018 joint tax return is _________.
   a) $0
   b) $20,000 loss
   c) $5,000 gain
   d) $15,000 loss

6. Passage of the TCJA has ____________ the availability of the casualty loss deduction.
   a) enhanced
   b) severely diminished
   c) not affected
   d) doubled

7. Your client, a married couple, has contacted you regarding a personal financial loss during 2018. Their home was recently damaged by a storm. Losses from the damages total $10,000. They inform you that the storm was categorized as a "federally declared disaster". You correctly advise them that __________.

a) Subject to limits in place prior to passage of the TCJA, the loss is deductible
b) The loss is not deductible under any circumstance
c) Losses from federally declared disasters are fully deductible without considering AGI limitations.
d) Losses of this nature may only be used to offset personal casualty gains.

8. Which of the following is not true in connection with meals expenses after passage of the Tax Cuts and Jobs Act.
   a) Meals expense includes the cost of food and beverages.
   b) Meals expense includes the cost of taxes and tips.
   c) Meals expense is disallowed for taxpayers even it is an expense associated with operating their trade/business.
   d) Different tax treatment exists between "entertainment" and "non-entertainment" meals expense.

9. Generally, the value of parking provided by an employer to an employee is based on ___________ that an individual would incur in an arm's length transaction to obtain parking at the same site.
   a) the cost (including taxes or other added fees)
   b) IRS issued tables and not the cost
   c) Employer stipends
   d) None of the above

10. With the issuance of Fact Sheet FS-2018-6 in April, the IRS clarified procedures that apply to taxpayer identity theft. Form ____, Identity Theft Affidavit is utilized in this procedure.
    a) 2848
    b) 14039
    c) 867
    d) 5309

11. Since 2001 and in connection with IRM §§20.1.1.3.3.2.1.(2) and (4), which of the following actions must a taxpayer undertake in order to avail themselves to First Time Abatement (FTA) relief from delinquency penalties?
    a) Taxpayer has filed, or file a valid extension for, all currently due returns.
    b) Taxpayer has paid or arranged to pay any tax currently due.
    c) Taxpayer has not received an applicable delinquency penalty for the tax return in the three prior years.
    d) All of the above.

12. IRS efforts to review automations of FTAs (First Time Abatements) and modernize related procedures will result in ______________ .
    a) An anticipated reduction in court cases devoted to litigating tax penalties.
    b) Equal application of penalties to serially noncompliant taxpayers as well as individuals making an occasional error.
    c) Both a & b
    d) None of the above

13. Individuals who successfully complete the IRS's voluntary Annual Filing Season Program receive a(n):
    a) Certificate of Acceptance
    b) Award of Distinguishment
    c) Record of Completion
    d) Area 51 Clearance

14. Which of the following is not true regarding the IRS's Annual Filing Season Program?
    a) Participants in the program are permitted limited representation rights
    b) Participants are subject to the requirements for practicing before the IRS in Subpart B of Section 10.51 of Circular 230
    c) Participants may opt out of obtaining a preparer tax identification number (PTIN)
    d) Participation in the program is voluntary

15. Prior to the advent of the Annual Filing Season Program, the IRS, in 2011, had introduced a program designed to regulate unenrolled tax return preparers. The _______ was subsequently challenged and determined to be invalid.
    a) Registered Tax Preparer Program
    b) Tax Registration initiative
    c) PHICO Program
    d) P.O.P. initiative

16. Which of the following is not true concerning an election by two spouses to be treated as a qualified joint venture under Sec. 761(f)
    a) The spouses will not be treated for tax purposes as a partnership.
    b) The spouses may elect to file either married filing joint, or married filing separate
    c) The qualified joint venture election may be made by filing a joint tax return with required schedules.
    d) None of the above

17. Section 199A defines the following businesses as "Specified Service Business" except for?
    a) Accounting
    b) Engineering
    c) Health
    d) Law

18. Which of the following taxpayer entities may not be entitled to take a Section 199A deduction?
    a) C Corporations
    b) S Corporations
    c) Sole proprietors
    d) Trusts

19. Your client is a physician and is interested in learning more about the new Qualified Business Income Deduction. You inform her that the Income-Based caps for determining this deduction are based on:
    a) Taxable Income
    b) Net Business Income
    c) Capped limits
    d) Adjusted Gross Income

20. S. Clemens is your client and files as a married taxpayer. He has income from a business that is not considered "Specified Service Business" Income. Combined, Mr. Clemens and his wife have $175,000 in taxable income and he has a tentative Qualified Business Income Deduction (QBID) of $10,000. You tell him that _____________ .
    a) His QBID would be subject to a wage cap.
    b) His QBID would be subject to a property cap.
    c) His QBID would be subject to both a wage and property cap.
    d) He would receive the full $10,000 QBID.

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EXAM INSTRUCTIONS AND ANSWER SHEET – Fall 2018, VOLUME XXVII, NUMBER 3, TAXATION

There are 20 EXAM questions which are on pages 18-20 of the newsletter. Choose the best answer based on the limited facts of each question and record your answer below. Indicate your responses in the newsletter for your personal records and **complete the "Newsletter Evaluation" below.**

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Upon completion of this course, practitioners will be able to apply the earned income credit rules to determine if a taxpayer is eligible for the tax credit; identify the common errors committed in connection with the earned income credit; describe the consequences of the IRS' disallowance of the earned income credit; and recognize the tax return preparer's EIC due diligence requirements.

BUNDLE [2]

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This course examines key individual, business, retirement, and estate tax provisions recently enacted or indexed for inflation. The emphasis is on quick access to major tax changes having special meaning to the tax practitioner and return preparer.

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This course examines and explains the basics of corporate taxation. The focus is on regular or C corporations, their formation, and operation under tax law.

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