



TAX NEWS

Disaster Relief: North Carolina (Hurricane Florence)—Parts of North Carolina have been declared a major disaster area in the aftermath of Hurricane Florence starting September 7, 2018. Federal deadlines for affected taxpayers are generally postponed until January 31, 2019 including the October 15 filing deadline for individuals and other taxpayers with valid extensions. Disaster-related casualty losses may be claimed on 2017 or 2018 tax returns. [Page 2](#)

CMS Provides Streamlined Method for Obtaining Hardship Exemptions From ACA Penalty for Tax Year 2018—In previous years, consumers had to go through the process of applying for most hardship exemptions through the federal exchange. Under new CMS guidance, starting in 2018, consumers may claim any of the hardship exemptions on a federal tax return. They do not have to supply documentation to the marketplace or IRS but should keep it with their tax records. [Page 2](#)

Interest Rate Stays at 5 Percent for Fourth Quarter of 2018—The interest rate for October through December of 2018 stays at 5% for overpayments and underpayments. [Page 3](#)

Qualified Business Income Deduction – Part 3: QBI Vocabulary— The QBI deduction is fairly straightforward for taxpayers with taxable income at or under \$157,500 (\$315,000 for MFJ). Reductions apply once taxable income exceeds these thresholds and they are calculated differently for service and non-service businesses. In our third installment of the QBI deduction series we cover some of the terms and definitions needed to perform calculations that apply to higher income taxpayers. [Page 3](#)

QUESTION OF THE WEEK

For several years a client has been claiming dependent exemptions for his fiancé and her daughter. They live in his home and he is their sole support. In 2018 will he be able to claim the new \$500 credit for them? Can he now file as head of household or claim other tax benefits? [Page 4](#)

DISASTER RELIEF—North Carolina (Hurricane Florence)

Parts of North Carolina have been declared a major disaster area eligible for federal disaster aid to individuals and businesses. Be sure to check the IRS and FEMA links for updates to the covered disaster area.

Affected taxpayers have the option of waiting to claim 2018 disaster-related casualty losses on their 2018 tax return filed next year during the 2019 tax season or on an original or amended tax return for 2017 filed during 2018. In addition, the IRS has postponed deadlines for affected taxpayers to file returns, pay taxes, and perform other time-sensitive acts.

Affected taxpayers are those who:

- Live in the covered disaster area
- Have a main place of business located in the covered disaster area
- Have books and records needed to complete the return located in the disaster area
- Assist governments or qualified non-profit organizations in relief efforts
- Were injured or killed while visiting the area

Note: Generally, the IRS identifies affected taxpayers located in the disaster area and automatically applies filing and payment relief. Affected taxpayers outside the disaster area should call the IRS at 1-866-562-5227 to request tax relief.

North Carolina disaster: Hurricane Florence starting September 7, 2018

FEMA major disaster declaration announcement [DR-4393](#) September 14, 2018

IRS release: [IR-2018-187](#), dated September 15, 2018; also see "[Help for Victims of Hurricane Florence](#)"

Covered disaster area: Beaufort, Brunswick, Carteret, Craven, New Hanover, Onslow, Pamlico and Pender counties

Postponement periods: Tax returns and other time-sensitive acts due on or after September 7, 2018, and before January 31, 2019 are postponed until **January 31, 2019**.

This includes the following 2018 deadlines: the September 17 estimated tax deadline, quarterly excise and payroll tax returns due October 31, the September 17 filing deadline for businesses with valid extensions, and the October 15 filing date for individuals and other taxpayers with valid extensions.

Employment and other excise tax deposits due on or after September 7, 2018, and before September 24, 2018, must be deposited by September 24, 2018.

CMS PROVIDES STREAMLINED METHOD FOR OBTAINING HARDSHIP EXEMPTIONS FROM ACA PENALTY FOR TAX YEAR 2018

The Centers for Medicare and Medicaid Services (CMS) [announced](#) a new way for consumers to obtain a hardship exemption from the ACA individual shared responsibility payment for not maintaining health insurance. In general, an individual is eligible for a [hardship exemption](#) if he or she experienced a financial setback or other circumstances that prevented him or her from obtaining minimum essential coverage. Hardships are determined on a month-by-month basis.

In previous years, consumers had to apply for most hardship exemptions through the federal exchange, obtain an exemption certificate number (ECN), and include the ECN on the tax return. If a hardship application had not yet been processed at the time the consumer was ready to file the tax return, it was acceptable to use "pending" in place of the ECN on the original tax return.

(Continued on page 3)

(Continued from page 2)

Under new CMS [guidance](#), for 2018, consumers may claim any hardship exemption on a federal tax return without presenting documentary evidence or a written explanation to the marketplace or the IRS. However, consumers should keep appropriate documentation with their tax records. For example, an individual who received a shut-off notice from a utility company should keep the notice with his or her tax records. Consumers still have the option of obtaining hardship exemptions through the marketplace under existing procedures.

There are no changes for hardship exemptions that were available on tax returns in prior years, such as income that is below the filing threshold. Also, there are no changes for other types of exemptions that must be applied for through the marketplace, such as certain religious exemptions. Starting in 2019, the penalty for not maintaining minimum essential coverage is lowered to \$0.

INTEREST RATE STAYS AT 5 PERCENT FOR THIRD QUARTER OF 2018

The IRS announced in [IR-2018-181](#) and [Rev. Rul. 2018-25](#) that interest rates for the fourth calendar quarter of 2018 (beginning October 1) will stay the same. The rates are:

- 5 percent for overpayments (4 percent in the case of a corporation);
- 5 percent for underpayments;
- 7 percent for large corporate underpayments; and
- 2.5 percent for the portion of a corporate overpayment exceeding \$10,000.

An updated interest rate factor chart is posted to "[What are the IRS interest rate factors for late filed individual returns?](#)" in the Tax Research Center's Tax Knowledge Base. This chart has factors for the latest three years. Contact The Tax Institute through the Tax Research Center on DNA for factors for earlier years' returns.

QUALIFIED BUSINESS INCOME DEDUCTION – PART 3: QBI VOCABULARY

In the last QBI Deduction article we delved into specified service trades or businesses (SSTBs). These are businesses that perform services in various fields, such as health, accounting, and law. The QBI deduction is reduced for all taxpayers with taxable income over \$157,500 (\$315,000 for MFJ) but reductions are steeper for Specified Service Trades or Businesses (SSTBs) than non-SSTBs. Before going into the complicated process of calculating the reductions, we'll first cover some of the terms and definitions needed to perform these calculations. The [proposed regulations](#) provide more details on each of these items.

Qualified business income (QBI) is the taxpayer's profit from each U.S. trade or business, such as net profit from a Schedule C or Schedule F. It also includes qualified income from a relevant passthrough entity (RPE), such as an S corporation shareholder's or partner's share of the business's ordinary income. It does not include net capital gains and losses. And it does not include the taxpayer's wages, including the reasonable wage paid to an S corporation shareholder/employee, or guaranteed payments made to a partner in a partnership.

Trade or business is not specifically defined in the Internal Revenue Code. For §199A purposes, the term generally has the same meaning that it has for §162, the section that deals with expenses that are, or are not, deductible by a trade or business. As with many other aspects of taxes, ultimately, the existence of a trade or business is determined by facts and circumstances. The term does *not* include the trade or business of being an employee and, as explained above, an employee's income is ineligible for the QBI deduction. Also, former employees, i.e. individuals who were properly treated as common law employees, then who were reclassified as contractors while continuing to perform the same duties, will be treated as employees. A trade or business may be an SSTB or non-SSTB.

(Continued on page 4)

(Continued from page 3)

Note: Rental activities will be discussed in a future article.

Beginning threshold, lower threshold, or threshold amount refers to a specific taxable income level. For 2018, the threshold is \$157,500 (\$315,000 for MFJ). These amounts will be adjusted for inflation after 2018. Here, taxable income refers to the taxpayer's (not the business's) taxable income, i.e. gross income less adjustments and deductions (standard of itemized), immediately before the QBI deduction. For taxpayers with taxable income at or below the beginning threshold, the QBI deduction formula is fairly straightforward. It is 20% of QBI or, if smaller, 20% of the taxpayer's taxable income, less any net capital gains. This is the only limitation that applies, whether the QBI is from an SSTB or non-SSTB.

Upper threshold or ceiling refers to the threshold amount plus \$50,000 (\$100,000 MFJ). Thus, for 2018 the ceiling is \$207,500 (\$415,000 MFJ). What happens *between* the two thresholds, and once taxable income reaches and exceeds the upper threshold *does* depend on whether the QBI is from an SSTB or non-SSTB.

Wage and property tests or limitations apply when the taxpayer's taxable income reaches the lower threshold amount. While the reduction calculations differ for non-SSTBs and SSTBs, there are two important items that must be considered for either type of calculation.

Wages. This term refers to the W-2 wages that are paid to the qualifying business's common law employees on a calendar year basis, including S corporation shareholder/employees, and reported to the Social Security Administration. Note that although the taxpayer's wages are not QBI, wages do figure into deduction limitations that apply to higher income taxpayers. [Notice 2018-64](#) provides three methods for calculating W-2 wages. The "unmodified box method," for example, uses the smaller of box 1 (wages, tips, and other compensation) or box 5 (Medicare wages and tips) for all employees. The taxpayer must use one of the three methods consistently for the tax year. See the notice for the other two methods, SSA reporting issues, fiscal year taxpayers, and other details.

Unadjusted Basis Immediately after Acquisition (UBIA). This is the second item needed to calculate wage and property limitations. It refers to the basis of qualified property without regard to depreciation claimed, including §179, bonus depreciation, and regular MACRS depreciation. Qualified property is tangible depreciable property used in the taxpayer's U.S. trade or business operations. UBIA in most instances will simply be the cost of the qualified property. Property remains qualified for the longer of 1) 10 years, or 2) the last day of the last full year of the applicable recovery period. For example, five-year MACRS property placed in service in 2012 is still qualified property in 2018, no matter how the taxpayer depreciated it, and remains qualified through 2021.

Taken together, wages and UBIA will be used to calculate reductions that apply to the taxpayer's QBI deduction. In the next article in this series we'll go over the calculations for non-SSTBs, followed by the calculations for SSTBs. In future articles we'll discuss more advanced calculation problems, including the calculation for taxpayers with multiple businesses and/or businesses with losses, and calculations that include PTP or REIT income.

QUESTION OF THE WEEK

Q. My client has been living with his fiancé and her daughter for a few years. He is not the child's father. His fiancé has no income and no reason to file a tax return; he is their sole support. In prior years, he claimed dependent exemptions for the two of them. His 2018 income will be around \$45,000. Will he be eligible for the new \$500 credit? Can he now file as head of household and claim other tax benefits?

(Continued on page 5)

(Continued from page 4)

A. Your client is eligible for the \$500 credit for other dependents, but not for any other dependent-connected tax benefits.

Under the TCJA, the new §24(h)(4) credit for other dependents is available to a taxpayer who has a qualifying child (who is ineligible for the child tax credit) or a qualifying relative. In this situation, it appears your client's fiancé and her daughter are qualifying relatives under §152(d)(2)(H). That is, they are not related to him but are members of his household the entire year and presumably meet the other qualifying relative tests. While the daughter is potentially a qualifying child of her mother, since the mother has no return filing requirement and doesn't file a return, she is not a "taxpayer" and the daughter is not treated as her qualifying child.

Given these facts, your client may claim the \$500 credit for each of his dependents. Note that the credit for other dependents is subject to paid preparer due diligence requirements.

Otherwise, there are no changes to dependent-connected tax benefits that impact your client. As under prior law, head of household filing status is not available if the taxpayer's only dependent is an unrelated individual who is a member of the taxpayer's household. This restriction has not changed under the TCJA. Your client cannot claim the EITC or CTC because these tax benefits require a qualifying child.