TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

IRS Will Delay Rollout of Redesigned W-4 Until Tax Year 2020—Soon after the TCJA passed, the IRS revised Form W-4 for 2018 to reflect tax law changes. The IRS then proposed a redesigned form which was to take effect for tax year 2019. Rather than using the traditional allowance system, the redesigned form is intended to provide more accurate withholding by giving employees an opportunity to enter information about all income, deductions, credits, etc. After considering feedback from the payroll and tax communities, the IRS has postponed the release of the redesigned form until tax year 2020. Instead, the upcoming 2019 Form W-4 will be similar to the 2018 W-4. Page 2

Moving Expense Clarification: 2017 Expenses Paid in 2018 Are Excludable—Although the TCJA suspended the qualified moving expense exclusion for tax years 2018 through 2025, the suspension applies only to moves that occurred *after* December 31, 2017. Notice 2018-75 explains that expenses paid or reimbursed by employers in 2018 are excludable from employees' wages if the payment or reimbursement was for an employee move that occurred *before* January 1, 2018. Employers may follow normal employment tax adjustment and refund procedures if they erroneously included the payment or reimbursement in taxable income. Page 2

Qualified Business Income Deduction – Part 4: Reductions for Non-SSTBs— The QBI deduction is fairly straightforward for taxpayers with taxable income not over $157,500 ($315,000 for MFJ). Reductions apply once taxable income exceeds these thresholds and they are calculated differently for specified service trades or businesses (SSTBs) and non-SSTBs. In our fourth installment of the QBI deduction series, we cover the reduction calculation for non-SSTBs. Page 2

QUESTION OF THE WEEK

Our clients had a difficult year, sustaining damage to both their main home because of a flood and their vacation home because of a fire. Their main home is in a county that was declared a major disaster area because of the flooding. They'll have a loss on that home. However, they will have insurance gain from the fire damage to their vacation home, but a loss on the car they kept at that site. How does the new law affect their casualty losses? Are they stuck paying tax on the gain because the fire was not in a disaster area? Page 5

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IRS WILL DELAY ROLLOUT OF REDESIGNED W-4 UNTIL TAX YEAR 2020

Last June, the IRS posted a draft of a proposed 2019 Form W-4, *Employee's Withholding Allowance Certificate*. Despite the term "allowance" in its title, the redesigned form and its accompanying instructions essentially did away with the allowance system. Instead, employees could enter nothing more than identifying information and filing status – and a default amount would be withheld from their paychecks. Or, they could optionally enter amounts for other jobs and other sources of income, adjustments, itemized deductions, credits (such as the child tax credit), and additional withholding requested.

The point of the makeover was to make paycheck withholding more accurate than the traditional allowance system has been able to accomplish. The final version of the form was to take effect for tax year 2019.

In a recent statement, the IRS announced that the proposed redesign is postponed to tax year 2020. After considering feedback from the payroll and tax communities, the Treasury Department and IRS are allowing more time to incorporate changes that will help employees improve withholding accuracy.

The IRS will release a new draft version of the 2019 W-4 in the coming weeks. The 2019 version will be similar to the 2018 version in that it reflects TCJA changes such as the $10,000 cap on state and local tax deductions. The IRS continues to encourage taxpayers to check their withholding and complete a new W-4 if necessary.

MOVING EXPENSE CLARIFICATION: 2017 EXPENSES PAID IN 2018 ARE EXCLUDABLE

Prior to the TCJA, qualified moving expenses paid or reimbursed by an employer were excludable from employees' gross income under §132(a)(6). The TCJA suspended the exclusion for tax years 2018 through 2025. IRS news release IR-2018-190 and Notice 2018-75 clarify that the suspension applies *only* with respect to moves that occurred *after* December 31, 2017. Accordingly, payments or reimbursements are excludable from an employee's 2018 income if an employer:

- Pays a third party moving service provider after December 31, 2017, for moving services provided to an employee before January 1, 2018, or
- Reimburses an employee after December 31, 2017, for a move that occurred before January 1, 2018.

Note that the pre-TCJA rules for excluding moving expenses still apply. That is, the expenses must be for work-related moving expenses that would have been deductible by the employee before the tax law change. The employee must not have deducted the expenses on his or her 2017 tax return.

If an employer has already treated a payment or reimbursement as taxable income to the employee, the employer should follow normal employment tax adjustment and refund procedures. See Chapter 13 "Reporting Adjustments to Form 941 or 944" in IRS Pub. 15, *Employer's Tax Guide*.

Notice 2018-75 does not address the situation in which an individual incurred non-military-related 2017 moving expenses, paid the expenses in 2018, and will not be reimbursed by an employer. Presumably the same principle will apply, that is, the individual would be able to deduct the qualified expenses in 2018. However, we're awaiting further guidance on the matter.

QUALIFIED BUSINESS INCOME DEDUCTION – PART 4: REDUCTIONS FOR NON-SSTBs

In previous weeks we've explained that reductions apply to the QBI deduction once a taxpayer's income exceeds a taxable income threshold. For 2018, these thresholds are:

Lower threshold: $157,500 ($315,000 MFJ)

Upper threshold: $207,500 ($415,000 MFJ)

(Continued on page 3)

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(Continued from page 2)

As a reminder, threshold amounts refer to the *taxpayer's* taxable income and not the business's income. For instance, a partnership has QBI of $500,000. Partner A, who is a single taxpayer, has a 10% interest in the business and so receives a $50,000 share of the QBI. If Partner A's taxable income exceeds $157,500, his QBI deduction will be subject to reductions. Otherwise, it will not be subject to reductions.

Reduction calculations differ for SSTB's and non-SSTBs. In this week's installment, we'll work through the QBI deduction calculations for non-SSTBs. Note, in all of the reduction calculations in our illustrations, we're starting with 20% of QBI. At any income level though, the basic calculation is 20% of QBI or, if smaller, 20% of taxable income net of capital gain. To simplify the explanation as much as possible, we'll just refer to "20% of QBI" in these examples.

Taxable income exceeds upper threshold

If a non-SSTB taxpayer's taxable income exceeds $207,500 ($415,000 MFJ), the QBI deduction is subject to a wage and property limitation. The deduction is the *smaller* of:

- 20% of QBI, or
- The wage and property limitation.

There are two methods for calculating the wage and property limitation. The *larger* result is the limitation that applies.

- Method 1: Wages × 50%
- Method 2: Wages × 25% + UBIA × 2.5%

For this purpose, wages are defined as a taxpayer's share of common law wages paid by the trade or business. UBIA stands for "unadjusted basis immediately after acquisition," which is generally the cost of property. Please refer to Part 3 of the QBI Deduction series (TAX in the News September 19, 2018) for more complete definitions of these and other terms used in the calculations.

Illustration 1: Mabel is single. She has taxable income of $275,000 and QBI of $175,000. Applicable wages are $50,000 and UBIA is $10,000. Since Mabel's taxable income exceeds $207,500, she is subject to the wage and property limitation. Her QBI deduction is figured as follows:

20% of QBI = $35,000 ($175,000 QBI × 20%)

Wage/property limitation

Method 1 = $25,000 ($50,000 × 50%) ✓

Method 2 = $12,750 [($50,000 × 25%) + ($10,000 × 2.5%)]

The deduction is the *smaller* of 20% of QBI or the above wage/property limitation, and the *larger* of that limitation's Method 1 or Method 2. Since the wage/property limitation is less than 20% of QBI, one of the two methods in that limitation must be used. And since Method 1 yields the larger result, Mabel's QBI deduction is $25,000.

Before moving on to another illustration, there are a few things to note:

- If 20% of QBI is *smaller than* the Method 1 result, there is no need to calculate Method 2. Suppose Mabel's QBI is only $80,000. Since 20% of QBI is $16,000, which is less than the Method 1 result of $25,000, Mabel's QBI deduction *is* $16,000, the smaller of the two amounts, and the Method 2 result would be irrelevant.

(Continued on page 4)

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(Continued from page 3)

- The Method 2 calculation, which takes UBIA into account, will benefit taxpayers that may have little or no wages but many depreciable assets, as shown in the next example.

Illustration 2: Assume the same taxable income and QBI, but wages are $15,000 and UBIA is $200,000.

20% of QBI = $35,000 ($175,000 QBI × 20%)

Wage/property limitation

Method 1 = $7,500 ($15,000 × 50%)

Method 2 = $8,750 [($15,000 × 25%) + ($200,000 × 2.5%)] ✓

Here, Method 2 yields the better result, so Mabel's QBI deduction is $8,750.

Taxable income is between the two thresholds

If a taxpayer's taxable income is between the lower and upper thresholds, the QBI deduction is also subject to the wage/property limitation, but the calculation has extra steps. First, calculate the basic 20% of QBI amount and the applicable wage/property limitation as explained above.

Step 1. Subtract the appropriate lower threshold amount ($157,500 or $315,000) from the taxpayer's taxable income.

Step 2. Divide the Step 1 result by $50,000 ($100,000 MFJ).

Step 3. Subtract the wage/property limitation from the 20% of QBI amount. This is the **reduction amount**.

Step 4. Multiply the reduction amount by the Step 2 percentage.

Step 5. Reduce the 20% of QBI amount by the Step 4 result.

Illustration 3: Assume the same facts as Illustration 1, but Mabel's taxable income is $190,000. As in Illustration 1, 20% of QBI ($175,000) is $35,000 and the wage/property limitation is $25,000. Since Mabel's taxable income is between $157,500 and $207,500 (the lower and upper thresholds), the additional steps are:

Step 1: $32,500 ($190,000 taxable income - $157,500 lower threshold)

Step 2: 65% ($32,500 / $50,000)

Step 3: $10,000 ($35,000 20% QBI amount - $25,000 wage/property limitation)

Step 4: $6,500 ($10,000 reduction amount × 65%)

Step 5: $28,500 ($35,000 unreduced 20% QBI - $6,500)

It may seem odd that taxpayers with taxable income between the two thresholds have a more complicated calculation than those with taxable income above the upper threshold. One way to understand this is that the reduction amount is phased in between the two thresholds. When Mabel's taxable income was more than the upper threshold, her full QBI deduction was reduced by 100% of the reduction amount, which was $10,000 in this case. With lower taxable income, the full QBI deduction was reduced by only 65% of the reduction amount. The closer taxable income is to the lower threshold, the smaller the reduction and, conversely, the closer taxable income is to the upper threshold, the larger the reduction until it is 100% of the reduction amount, as it is in Illustration 1.

We'll cover the calculation for SSTBs in another installment in the QBI deduction series.

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QUESTION OF THE WEEK

Q. Our clients sustained considerable damage to their main home last June because of storms and flooding in their town. Their home is in Cameron County, Texas, which was declared a major disaster area. Unfortunately for them, they've had a very difficult year. In addition to the flood, earlier in 2018, a fire at their vacation home damaged part of the house and completely ruined the car they keep there. We've done some preliminary calculations of their losses, taking insurance into account. It appears they'll have casualty losses for their main home and for the car. However, they will probably have a gain for the vacation home. How does the new law affect their casualty losses? Since they can't deduct the loss on the car, are they stuck with paying tax on the insurance gain on their vacation home?

A. Your clients may use the casualty loss on their car to offset the casualty gain stemming from the vacation home fire. If there is any remaining personal casualty gain it will be applied to the casualty loss on their main home stemming from the flood.

The TCJA modified §165(h) for tax years 2018 through 2025, limiting personal casualty loss deductions to losses sustained in a federally declared disaster area on account of the disaster. The loss to your clients' car, by itself, is a nondeductible loss because it is a personal casualty loss and not related to a federal disaster.

However, §165(h)(5)(B) carves out an exception for personal casualty gains. Under this exception, personal casualty losses, both deductible and non-deductible, may be used to offset personal casualty gains. Under an ordering rule in the law, the loss due to the fire (the nondeductible loss) would offset the gain first and then the loss due to the flood (the deductible loss) would offset any remaining gain.

To illustrate, say that the main home loss due to the flood is $25,000, the car loss is $8,000, and the vacation home gain is $10,000. Your clients would first offset the car loss by the vacation home gain, leaving $2,000 excess gain ($8,000 - $10,000) to offset the flood loss, bringing the deductible flood loss down to $23,000 ($25,000 - $2,000). Now suppose the car loss was $10,000 and the vacation home gain was only $8,000. In that case, your clients would have a $2,000 nondeductible loss on the car.

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