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TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

Interim IRS Guidance Clarifies How ACA Provisions Coordinate With $0 Exemption Amount—Notice 2018-84 provides guidance on two ACA provisions that are impacted by the TCJA. The premium tax credit and the shared responsibility payment both apply to taxpayers who claim personal exemption deductions for themselves and their families. Although taxpayers will not subtract exemption amounts in 2018, for purposes of these provisions they'll be treated as claiming personal deductions for each person listed on the tax return. Page 2

Disaster Relief: Wisconsin—Parts of Wisconsin have been declared major disaster area because of severe weather starting August 17, 2018. Federal deadlines for affected taxpayers are generally postponed until December 17, 2018, including the October 15 filing deadline for individuals and other taxpayers with valid extensions. IRS relief applies to both individual and public assistance counties. Disaster-related casualty losses may be claimed on 2017 or 2018 tax returns. Page 2

Updated List of Drought Counties for Special Extension Purposes—Notice 2018-79 provides an updated list of counties designated by the National Drought Mitigation Center as having suffered exceptional, extreme, or severe drought conditions during the period September 1, 2017 through August 31, 2018. Affected farmers and ranchers generally have until December 31, 2019, to replace livestock sold solely on account of drought conditions during 2014. Page 3

Qualified Business Income Deduction – Part 7: Residential Rental Activities—In this installment of our QBI deduction series we'll explore the QBID with respect to rental activities, concentrating on residential rental properties. To qualify for the QBID, an activity must rise to the level of a trade or business. Whether or not residential rental activities do so will often come down to analyzing the facts and circumstances of each taxpayer's particular situation. Page 4

QUESTION OF THE WEEK

A visually impaired client purchased special equipment which she needs in order to do work. Since employee business expenses are no longer deductible, is there any way for her to deduct this expense? She would not be able to do her job without this equipment. Page 5

INTERIM IRS GUIDANCE CLARFIES HOW ACA PROVISIONS COORDINATE WITH $0 EXEMPTION AMOUNT

Previous guidance on $0 exemption. In September, the Treasury Department and IRS issued proposed regulations indicating that for purposes of the §152(d)(1)(B) gross income test, the applicable exemption amount is $4,150 (for 2018) and not $0. Under the TCJA, even though the taxpayer does not subtract an exemption amount to arrive at taxable income, the $0 exemption amount does not apply to other tax provisions. Therefore, individuals with gross income that doesn't exceed $4,150 and who meet other requirements may be considered the taxpayer's qualifying relatives for head of household filing, the other dependent credit, and other tax benefits. See TAX in the News September 12, 2018.

ACA provisions. In a similar vein §36B, the section dealing with the premium tax credit, and §5000A, the section on the shared responsibility payment are both tied to the taxpayer's personal exemption deductions. The premium tax credit is potentially available to taxpayers and their family members who are enrolled in qualified health plans through the marketplace. On the other hand, taxpayers who do not have minimum essential health insurance for themselves and family members face a shared responsibility payment unless a penalty exemption applies.

The family members or applicable individuals referenced by these two code sections are the taxpayer, spouse, and any dependents for whom a personal exemption deduction is claimed on the tax return. IRS Notice 2018-84 provides the following interim guidance:

1. A taxpayer is considered to have claimed a personal exemption deduction for himself or herself for any given year that the taxpayer files an income tax return and does not qualify as a dependent of another taxpayer under §152 for the year.
2. A taxpayer is considered to have claimed a personal exemption deduction for another individual if the taxpayer is allowed a personal exemption deduction for that individual (i.e. the individual is the taxpayer's qualifying child or qualifying relative) and the taxpayer lists the individual's name and TIN on the tax return.

For tax year 2018, even though the personal exemption deduction amount is $0, the names and SSNs of the taxpayer, spouse, and dependents will continue to be listed on Form 1040. Eligibility for the PTC and/or liability for the ACA penalty will be determined accordingly. This interim guidance may be relied on immediately. The Treasury Department and IRS intend to amend §36B regulations. The §5000A regulations will not be amended since the shared responsibility payment is $0 after 2018.

DISASTER RELIEF—Wisconsin and Georgia (Hurricane Michael)

Parts of Wisconsin have been declared major disaster areas 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

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- 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.

Wisconsin disaster: severe storms, tornadoes, straight-line winds, flooding, and landslides starting August 17, 2018.

FEMA major disaster declaration announcement: DR-4402 October 18, 2018.

IRS release: WI-2018-07, dated October 19, 2018.

Covered disaster area: Crawford, Dane, Juneau, La Crosse, Monroe, Richland, Sauk, and Vernon counties.

Postponement periods: Tax returns and other time-sensitive acts due on or after August 17, 2018 and before December 17, 2018, are postponed until **December 17, 2018.** This includes the October 15 filing date for individuals and other taxpayers with valid extensions.

Employment and other excise tax deposits due on or after August 17, 2018, and before September 3, 2018, must be deposited by September 3, 2018.

UPDATED LIST OF DROUGHT COUNTIES FOR SPECIAL EXTENSION PURPOSES

Drought sales: Section 1033(e) allows a taxpayer to defer gain on the forced sale of livestock due to drought conditions if sale proceeds are used to purchase replacement livestock within four years after the year of the sale. Only sales of livestock that were made *solely* on account of drought, flood, or other weather-related conditions in an area designated as eligible for federal assistance qualify for this special treatment.

Extended replacement period. In some areas of the country, however, four years may not be an adequate amount of time for the taxpayer to replace livestock if drought or other conditions persist in an area for several years. The IRS has authority under §1033(e)(2)(B) to extend the replacement period on a regional basis if drought or other weather-related conditions result in an area being designated as eligible for federal assistance for more than three years.

IRS Notice 2006-82 provides guidance on the extended replacement period. If §1033(e)(2)(B) applies, the replacement period is extended to the first taxable year ending *after* the first drought-free year for the applicable region. For this purpose, the applicable region is the county that experienced the drought conditions on account of which the livestock was sold and all counties contiguous to that county, even if an adjoining county is in a neighboring state. The first drought-free year is the first 12-month period that:

1. Ends on August 31;
2. Ends in or after the last year of the taxpayer's 4-year replacement period; and
3. Does not include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the applicable region.

The extended replacement period applies to livestock held for draft, dairy, or breeding purposes. The special extension does not apply to poultry or to livestock raised for other purposes, such as for slaughter.

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Update for 2018: IRS Notice 2018-79 provides a list of counties designated by the National Drought Mitigation Center (NDMC) as having suffered exceptional, extreme or severe drought conditions during the period September 1, 2017 through August 31, 2018. For example, calendar year taxpayers in these areas whose four-year drought sale replacement period was scheduled to expire at the end of December 31, 2018 will have until December 31, 2019 to replace the livestock. An affected taxpayer in one of the applicable regions who was forced to sell livestock on account of drought in 2014 would thus have until December 31, 2019, to replace the livestock.

Generally, the one-year extension applies to forced sales that took place in 2014. Because of previous extensions that applied in many areas, sales before 2014 may also qualify for the extension. Also, additional extensions will be granted if severe drought conditions persist.

QUALIFIED BUSINESS INCOME DEDUCTION – PART 7: RESIDENTIAL RENTAL ACTIVITIES

As we've discussed previously, qualified business income refers to the taxpayer's profits or, in some instances, losses from each U.S. trade or business. QBI may be from a relevant passthrough entity (RPE) or from a disregarded entity, including businesses which report on Schedule C or Schedule F.

Would profits or losses from residential rental activities also be included in QBI? The answer is: perhaps.

We know from the proposed regulations that an activity must rise to the level of a trade or business under §162 but rather than defining the terms, this code section explains what types of expenses a trade or business may or may not deduct. Similarly, case law tells us that trade or business activity (or an individual's participation in the activity) must be regular, continuous and substantial but does not consistently apply these criteria to rental activities.

Nonetheless, there are some types of common rental situations that in nearly all cases are, or are not trades or businesses:

Rental activities that are *not* considered trades or businesses:

- Rental for less than FMV, aka a not-for-profit rental is not a trade or business due to the lack of profit motive.
- A single triple-net-lease (a lease agreement in which the tenant handles and pays for real estate taxes insurance, and maintenance) is not a trade or business due the extreme passive nature of the activity.
- A vacation home used as a personal residence is not a trade or business due to the lack of profit motive.

Rental activities that are considered trades or businesses:

- Self-rentals (i.e. rental to a commonly owned trade or business)
- A real estate professional who materially participates in the rental activity.

All other situations, including the common situation of a taxpayer with a few residential rental properties, depend on whether the taxpayer's participation in the rental activity is regular, continuous, and substantial based on facts and circumstances for the taxpayer's unique situation. Also, a rental activity (or any type of activity) may be a trade or business even if it is a passive activity.

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For residential rental activities, relevant factors to consider may include, but are not limited to the following:

1. The manner in which the taxpayer carries on the activity, such as the way the taxpayer keeps books and records.
2. The time and effort expended by the taxpayer or agent in carrying on the activity, such as the number of rental units and hours spent engaging in the activity.
3. The taxpayer's history of income or losses with respect to the activity.

Keep in mind that these factors have to be applied consistently. An important point to consider is that residential rental activities often result in a loss. Assuming the loss is not suspended under the passive activity rules, it will serve to lower or even eliminate the taxpayer's QBID for the year.

> **Example**: Wilbur has owned and actively managed four residential rental properties for several years. Although he has always turned a profit on his properties, and despite his expectations and best efforts, one of them had a number of problems and sustained a loss in 2018. By the end of the year though, he was back on track with a good tenant in place, repairs made, etc. and this property should once again be profitable in 2019.
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> If Wilbur treats his 2018 rental activities as a trade or business, the loss from the fourth property must be allocated to the positive QBI from the other three and will lower the total QBID. Wilber cannot selectively include only the three residential rental properties with profits in his trade or business for QBI purposes and omit the property with the loss.

We expect that the Treasury Department and IRS will provide additional guidelines for rental properties in the future.

QUESTION OF THE WEEK

Q. We have a new client who is visually impaired. She is considered legally blind and requires assistance in order to do her job. She purchased a special monitor and screen-reader software, which she explained is a program that converts text to speech. Since employee business expenses are no longer deductible, is there any way for her to deduct this expense?

A. Yes, assuming your client will itemize deductions in 2018, she can deduct the items you mentioned.

The TCJA eliminated all miscellaneous itemized deductions that are subject to the 2% of AGI floor, including employee business expenses. However, several miscellaneous deductions that are *not* subject to the 2% limitation were not eliminated by the TCJA. One of these is impairment-related work expenses. The individual must have a physical or mental disability which limits employment or other life activities. Impairment-related work expenses are ordinary and necessary business expenses connected with the individual's place of work and which enable the individual to work.

See "Impairment-Related Work Expenses" in IRS Pub. 529, *Miscellaneous Deductions*. For 2018, impairment-related work expenses are reported on Form 2106, *Employee Business Expenses*, and line 16 of Schedule A. Note that if your client does not have sufficient itemized deductions to exceed the standard deduction, the expense cannot be deducted anywhere else on the tax return. Expenses of Armed Forces reservists, performing artists, and certain government officials (the only other taxpayers who may deduct employee business expenses) report these expenses as an adjustment to income.