TAX NEWS

ACA Health Care Penalty and Exemption Roundup—Although the TCJA lowered the individual health care penalty to $0 effective in tax year 2019, it is still in place for tax year 2018 (TS2019). Additional hardship exemptions as well as changes in the hardship exemption process should allow more taxpayers to claim a penalty exemption for 2018. Most of the hardship exemptions, including a new exemption for limited availability of plans in one's county, may now be claimed directly on the tax return. Page 2

Interest Rate Increases to 6 Percent for First Quarter of 2019—The interest rate for January through March of 2019 increases to 6% for overpayments and underpayments. Page 3

Form 1095 Deadline Update—IRS Notice 2018-94 extends the deadline to March 4, 2019 for employers and other providers to furnish Form 1095-B and Form 1095-C to individuals. As in prior years, affected taxpayers may rely on other information to determine PTC eligibility and confirm minimum essential coverage. Page 3

Proposed Regulations Cover New Business Interest Expense Limitation; Small Businesses Are Exempt from the Limitation—New proposed regulations provide guidance on the TCJA's new business interest expense limitation under §163(j). Businesses with average annual gross receipts of $25 million or less are not subject to the limitation. Others must calculate the limitation on new Form 8990. Real property trades and businesses and farm businesses may optionally elect out of the limitation but are then subject to depreciation restrictions. Page 3

QUESTION OF THE WEEK

A client realized $20,000 in long-term capital gain from a stock sale. Since this amount is well under the 12% bracket for his filing status, is it still taxed at 0%? He also has wages of about $75,000.
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ACA HEALTH CARE PENALTY AND EXEMPTION ROUNDUP

The TCJA lowered the individual health care penalty to $0 effective in tax year 2019 (returns prepared in TS 2020). The penalty is still in force for tax year 2018 (returns prepared in TS 2019). However, some changes in the hardship exemption should allow more taxpayers to claim a penalty exemption for 2018. Qualifying events for hardship exemptions were expanded and there are slight changes making the process for claiming exemptions on the tax return easier.

New process for claiming hardship exemptions for 2018. Hardship exemptions can be claimed on Form 8965, *Health Coverage Exemptions*, by entering Code G in Part III. Identify the months to which the exemption applies. Taxpayers who have an existing Marketplace exemption certificate number (such as taxpayers with a religious exemption) can continue to use their ECN in Part I of Form 8965.

Taxpayers who claim a hardship exemption directly on Form 8965 should retain documentation to substantiate their exemption along with their tax records.

For more information, see the Form 8965 Instructions (Draft 10/24/18).

Hardship exemptions expanded for 2018. Taxpayers can now claim a coverage exemption for certain types of hardships directly on the tax return. These include:

- The taxpayer lived in a county where there is no qualified health plan offered, there is only one issuer offering coverage, or all affordable plans provide abortion coverage contrary to the taxpayer's beliefs;
- The taxpayer experienced personal circumstances that create a hardship, such as when no affordable plans provide access to needed specialty care; or
- The taxpayer experienced a hardship not included in this list that prevented the taxpayer from getting health insurance.

For more information, see https://www.healthcare.gov/health-coverage-exemptions/hardship-exemptions/.

Checkbox for full-year coverage. The checkbox that was previously on line 61 of Form 1040 has now been moved to page 1 of Form 1040 and retitled "Full-year health care coverage or exempt." The box may be checked if the taxpayer, spouse (if filing jointly) and anyone the taxpayer can or does claim as a dependent has qualifying health care coverage or a coverage exemption that covered all of 2018 or a combination of qualifying health care coverage and coverage exemptions for every month of 2018.

If the taxpayer doesn't qualify to check the "Full-year health coverage or exempt" box on page 1 of Form 1040, and if the taxpayer or another member of the tax household qualifies for an exemption that doesn't cover each month of the year, Form 8965 must be submitted with the tax return.

If the taxpayer qualifies for an exemption because of household income or gross income less than the filing threshold, the "Full-year health care coverage or exempt' box on page 1 of Form 1040 may be checked, and the taxpayer does not have to file Form 8965.

Taxpayers who need to make a shared responsibility payment with their return will report it on Schedule 4, line 61.

For more information, see the Form 1040 Instructions (Draft 9/26/18).

New Exemption for 2019. The SUPPORT for Patients and Communities Act (PL 115-271, Sec. 4003) provides an additional religious conscience exemption from the health care coverage requirement. The additional exemption applies beginning in 2019. If at any time in the future the health care penalty increases from $0 to any higher amount, we anticipate that further guidance will be issued about how to claim the exemption and who qualifies for the exemption.

INTEREST RATE INCREASES TO 6 PERCENT FOR FIRST QUARTER OF 2019

The IRS announced in IR-2018-244 and Rev. Rul. 2018-32 that interest rates for the first calendar quarter of 2019 (beginning January 1) will increase to 6 percent. The 6 percent rate last applied in the final quarter of 2008. The rates are:

- 6 percent for overpayments (5 percent in the case of a corporation);
- 6 percent for underpayments;
- 8 percent for large corporate underpayments; and
- 3 1/2 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 four years. Contact The Tax Institute through the Tax Research Center on DNA for factors for earlier years' returns.

FORM 1095 DEADLINE UPDATE

In Notice 2018-94, the IRS extended the deadline for issuing Form 1095-B and Form 1095-C to individuals. The new deadline is March 4, 2019. Thus, some taxpayers may not receive their Form 1095-B or 1095-C by the time they are ready to file their 2018 tax returns. These taxpayers may instead rely on other information received from their employers or other coverage providers to determine eligibility for the premium tax credit and to confirm they had minimum essential coverage for purposes of the health care penalty.

Employers and other providers must file 1095 forms and accompanying transmittals with the IRS by February 28, 2019, or April 1, 2019 if filing electronically.

The deadline for health care marketplaces to furnish Form 1095-A to individuals was not extended by this notice. Form 1095-A should be issued by January 31, 2019.

PROPOSED REGULATIONS COVER NEW BUSINESS INTEREST EXPENSE LIMITATION; SMALL BUSINESSES ARE EXEMPT FROM THE LIMITATION

IRS news release IR-2018-233 introduces proposed regulations relating to the TCJA's business interest expense limitation under §163(j). The limitation is effective for tax years beginning after December 31, 2017 (starting in 2018 for calendar year businesses). Taxpayers may rely on the proposed guidance (as long as all the rules are consistently applied) until final regulations are published in the federal register.

Important! Small business exception. The business interest expense limitation does not apply to businesses with average annual gross receipts of $25 million or less. For this purpose, the gross receipts test is applied to three tax years preceding the current year, or to the years the entity was in existence if fewer than three years.

Business interest expense limitation. Under the TCJA, a taxpayer's business interest expense deduction is limited to the sum of:

1. The taxpayer's business interest income.
2. 30% of the taxpayer's adjusted taxable income.
3. The taxpayer's floor plan financing interest expense.

Interest in excess of the limitation is carried forward to the next tax year.

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Interest income. Business interest income means interest includable in the taxpayer's gross income, such as interest on late receivables. It does *not* include investment interest.

Adjusted taxable income (ATI). Broadly, ATI means the taxpayer's taxable income without regard to business interest income and the §163(j) business interest expense deduction itself. ATI does not include net operating losses, the §199A QBI deduction and, for years before 2022, depreciation, amortization, and depletion deductions.

Floor plan financing. Floor plan financing is a type of financing used by retailers for "big ticket" items displayed in a showroom, such as automobiles and appliances.

Other exceptions. In addition to the small business exception, a real property trade or business, a farming business, and certain utility businesses may elect out of the §163(j) limitation. However, electing businesses are generally required to use the slower alternative depreciation system (ADS) and may not use bonus depreciation.

Partners and S corporation shareholders. The §163(j) limitation is figured at the partnership or S corporation level. Also, the small business exception is applied at the partnership or S corporation shareholder level.

The allowed interest expense deduction could be further limited for the partner or S corporation shareholder by passive loss rules and other limitations.

New Form. The limitation is calculated on a new form, Form 8990 (draft 10/29/18), *Limitation on Business Interest Expense Under Section 163(j)*. See the proposed regulations and Form 8990 instructions (draft 12/7/18) for details on the limitation.

QUESTION OF THE WEEK

Q. A client has a large long-term capital gain – about $20,000 – from the sale of stock. He also has wages of about $75,000. Since the capital gain is well under the 12% bracket, is it taxed at 0%? The client is single and doesn't itemize deductions. He has no other income for 2018.

A. Your client's long-term capital gain (LTCG) will be taxed at 15% rather than 10% (or 0%) because his taxable income is over the breakpoint for the 15% net capital gain rate.

Before 2018, an individual's net capital gain was taxed at 0% to the extent the individual's taxable income was in the lowest two tax brackets (10% and 15%). For those with taxable income in the highest tax bracket, 39.6%, the net capital gain rate was 20%.

Under the TCJA, the 0% / 15% / 20% net capital gain rates are preserved but the thresholds, or breakpoints, for those rates are no longer based on the ordinary tax brackets:

Ordinary income rates and brackets (Single taxpayers – 2018)

10% - taxable income $0-$9,525

12% - taxable income $9,526-$38,700

22% - taxable income $38,701-$82,500

24% - taxable income $82,501-$157,500

32% - taxable income $157,501-$200,000

35% - taxable income $200,001-$500,000

37% - taxable income over $500,000

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Net capital gain rates (Single taxpayers – 2018)

0% - taxable income $0-$38,600

15% - taxable income $38,601-$425,800

20% - taxable income over $425,800

Although the net capital gain breakpoints no longer mesh with ordinary tax brackets, the concept is the same: an individual's long-term capital gain is taxed at 0% only to the extent that the individual's taxable income is no more than $38,600. Applying this principal to your client's situation, his taxable income is $83,000 ($75,000 wages + $20,000 LTCG - $12,000 standard deduction). Since $83,000 is well over the 15% breakpoint ($38,601), his LTCG is taxed at 15%. Note that the calculation is a bit more complicated if taxable income straddles one of the breakpoints.

In this case, your client's total tax will be $12,805:

$9,805 tax on $63,000 ($83,000 - $20,000) ordinary taxable income taxed at ordinary rates
$3,000 tax on $20,000 LTCG taxed at 15%
$12,805 total tax

If your client's total taxable income had been $38,600 or less, the $20,000 would have been taxed at 0%. And if total taxable income had been over $425,800 it would have been taxed at 20%.

For the breakpoints for other filing statuses, see "Capital Gains Rates" in the Tax Research Center.