THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

January 16, 2019

ACA update—Last December, a federal judge in the Northern District of Texas ruled that the ACA individual mandate and thus all ACA provisions are unconstitutional. See TAX in the News December 19, 2018. Subsequent to the ruling, Judge Reed O'Connor issued a stay order indicating that the ACA will remain in effect during the expected appeals process.

TAX NEWS

Change to Nonresident Alien Filing Requirements Under the TCJA—The IRS has released drafts of the 2018 Form 1040-NR and instructions. Before the TCJA, nonresident aliens generally needed to file only if their gross income was more than the applicable exemption amount for the year. With the TCJA's suspension of the personal exemption, most nonresident aliens must file with any amount of gross income. However, there are exceptions that apply to some nonresident alien taxpayers. Page 2

New Law Amends MSRRA to Provide More Residence Options for Spouses of Servicemembers—The Military Spouses Residence Relief Act (MSRRA) protects the residence of a servicemember's spouse who relocates solely to accompany the servicemember to a duty station. The MSRRA allows the spouse to maintain his or her residence, but only if the servicemember and spouse had the same residence or domicile prior to the spouse's move to the duty station. The recently passed Veterans Benefits and Transition Act allows the spouse to elect to use the servicemember's residence for state tax filing purposes, even though the two did not share the same residence or domicile prior to the move. This election is first available in tax year 2018. Page 3

QUESTION OF THE WEEK

Children who are members of Native American Tribes in this area receive per capita payments. Under what circumstances may a child claim the full standard deduction to offset his or her share of per capita income? Page 3

ORIGINAL INSIGHTS

Tales from the Tax Court: An Ohio sales tax curveball — A recent decision by the Ohio Supreme Court demonstrates how bobblehead dolls led to a pickle of a court case. Full insight. View all insights at www.thetaxinstitute.com/insights/.

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CHANGE TO NONRESIDENT ALIEN FILING REQUIREMENTS UNDER THE TCJA

Prior to the TCJA, nonresident aliens generally did not need to file a U.S. tax return if their gross income from U.S. source wages was below the amount of one personal exemption ($4,050 for 2017). Because the TCJA eliminated the deduction for personal exemptions in tax years 2018-2025, this "personal services exception" is not available for tax years 2018-2025.

Under the general rules for filing Form 1040-NR, nonresident aliens must file Form 1040-NR (draft 08/22/18), *U.S. Nonresident Alien Income Tax Return*, if any of the following apply:

- The taxpayer was a nonresident alien engaged in a trade or business in the U.S. during 2018. The taxpayer must file even if he or she had no income from a trade or business conducted in the U.S., had no U.S. source income, or is exempt from U.S. tax under a tax treaty or any section of the IRC.
- The taxpayer was a nonresident alien not engaged in a trade or business in the U.S. during 2018 and:
    - The taxpayer received income from U.S. sources that is reported on Schedule NEC, lines 1 through 12, *and*
    - Not all of the U.S. tax the taxpayer owes was withheld from that income.

There are three exceptions to the Form 1040-NR filing requirements. These exceptions were available under prior law and are generally not impacted by the TCJA.

Exception 1. Nonresident aliens who are students, teachers, or trainees and are temporarily present in the U.S. under an "F," "J," "M," or "Q" visa and do not have income that is subject to tax under §871 (income on Form 1040NR, lines 8 through 21, and on page 4, Schedule NEC, lines 1 through 12) are not required to file a Form 1040-NR for the tax year. This code section refers to income effectively connected with a U.S. trade or business (reported on page 1, lines 8 through 21) and income not effectively connected with a U.S. trade or business (reported on page 4, Schedule NEC, lines 1 through 12).

Exception 2. Students and business apprentices from India do not need to file a U.S. income tax return if they are eligible to claim the benefits of Article 21(2) of the U.S.-India tax treaty. The taxpayer must qualify to file as single or as a qualifying widow(er), and their gross income for the tax year must be $12,000 or less if single ($24,000 for a QW). The changes in the filing threshold for students and business apprentices from India reflect these taxpayers' ability to claim the standard deduction under the terms of the treaty.

Exception 3. Finally, nonresident alien partners in a U.S. partnership who are not engaged in a trade or business in the U.S. during the tax year and who do not have income that is effectively connected with a U.S. trade or business are not required to file Form 1040-NR for the tax year. The nonresident alien partners would have a Schedule K-1 from the partnership that only has income from U.S. sources reportable on Schedule NEC, lines 1 through 12. Note however that if the partnership withholds taxes on this income during the subsequent tax year and the withholding reported in box 10 of Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding* is more *or* less than the tax due on the income, the taxpayer will need to file a Form 1040-NR for the subsequent tax year.

Nonresident aliens should be aware that even if they do not otherwise have to file a return, they should file one if it is advantageous to do so. For example, a nonresident alien should file a U.S. tax return if he or she is eligible to get a refund of over-withheld federal taxes. Also, although it is not common, a nonresident alien engaged in a U.S. trade or business may be eligible for the additional child tax credit, the credit for federal tax on fuels, the premium tax credit, or the health coverage tax credit.

See Form 1040NR Instructions (draft 12/26/18) for more information on nonresident alien filing requirements.

NEW LAW AMENDS MSRRA TO PROVIDE MORE RESIDENCE OPTIONS FOR SPOUSES OF SERVICEMEMBERS

Background

The Military Spouses Residency Relief Act of 2009 (MSRRA) serves to protect the residence of a servicemember's spouse who relocates solely to accompany the servicemember to a duty station in compliance with military orders. Under the MSRRA:

> "A spouse of a servicemember shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the person, property, or income of the spouse by reason of being absent or present in any tax jurisdiction of the United States solely to be with the servicemember in compliance with the servicemember's military orders if the residence or domicile, as the case may be, is the same for the servicemember and the spouse."

See "State Returns for Military Spouses. How is the income of a servicemember's spouse (civilian spouse) taxed by the state where the servicemember (military spouse) is stationed?" in the Tax Research Center for details on the MSRRA.

Veterans Benefits and Transition Act of 2018

The Veterans Benefits and Transition Act of 2018 (VBTA) was signed into law on December 31, 2018. Although the Act largely covers education, health, and other veterans' benefits, one part of the Act (§302(a)(2)(B)) amends the MSRRA by adding an election that applies to the servicemember's spouse:

> "For any taxable year of the marriage, the spouse of a servicemember may elect to use the same residence for purposes of taxation as the servicemember regardless of the date on which the marriage of the spouse and the servicemember occurred."

Under this provision, for tax year 2018 and forward, the spouse of a servicemember may elect to use the servicemember's residence for tax purposes even though the two did not previously share the same residence or domicile.

> **Example:** Major Hannah Jones is a legal resident of New Hampshire. Major Jones receives PCS orders relocating her to California. In 2018, Major Jones marries Carl Price who is a resident of Vermont. Carl relocates to live with Major Jones and takes a job in California. Prior to the VBTA amendment, Carl could not apply the MSRRA because his domicile was not the same as Major Jones's domicile prior to moving to the duty state with his spouse. Depending on when he moved, Carl would likely be considered a part-year resident of both California and Vermont and, in any case, would have to pay tax to California on that state's source income. Under the VBTA, Carl may elect to treat New Hampshire as his state of residence.

QUESTION OF THE WEEK

Q. In our area there are several Native Americans, including Tribal members who are children, who receive per capita payments. Under what circumstances may a child claim the full standard deduction to offset the per capita income?

A. A child may claim the full standard deduction if he or she is not a dependent, that is, if the child cannot be claimed as a qualifying child or qualifying relative by his or her parents or anyone else in the home.

Under the TCJA, even though taxpayers may no longer claim dependent exemptions, the dependency rules and the requirements pertaining to all dependent-connected tax issues remain the same.

For a qualifying child, in addition to the age, relationship, abode, joint return, and U.S. residency tests, the child must not provide more than half of his or her own support. If all qualifying child tests are met with respect to parents or other adults in the home, the child *is* a dependent and may not claim the full standard deduction.

If a child is not a qualifying child of any taxpayer in the home, for example, a 19-year old who is not a student, the relevant tests are the support and gross income tests. Here, the parent or other adult relative must provide more than half of the child's support and the child's gross income must be less than $4,150 (for 2018). If all qualifying relative tests are met with respect to parents or other adults in the home, the child *is* a dependent and may not claim the full standard deduction.

If the child is a dependent, the standard deduction (for 2018) is equal to the greater of $1,050 or earned income plus $350 to a maximum of the regular standard deduction amount (generally, $12,000).

As with any income of a child, whether earned or unearned, it is best to complete a support worksheet to determine the child's support needs and how the child's income, savings, or other sources of support are being used. If it is determined that the child is not a qualifying child or qualifying relative with respect to anyone in the household, then the child may claim the full standard deduction.

Also, note that even if a child is not a dependent, the child may still be subject to kiddie tax if the child has at least one living parent and doesn't provide more than half of his or her support from earned income.