THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

ACA Health Care Penalty and Exemption Roundup Update—This is a reprint of an article in the December 12, 2018 edition of TITN. The article covers new hardship exemptions and changes in the exemption process for the 2019 filing season. We've also included some updated links and other reminders. Starting in tax year 2019 (returns filed in 2020) the individual health care penalty is $0 for all taxpayers. Page 2

IRS Provides "Safe Harbor" Allowing Certain Rental Real Estate Activities to Qualify for the QBID—IRS Notice 2019-07 provides a safe harbor in which a property may be treated as a "real estate enterprise" and thus meet the trade or business requirement for the qualified business income deduction. Guidelines include both activity levels and record-keeping requirements. Taxpayers using the safe harbor must attach a signed statement to the return attesting that the safe harbor requirements have been met. Page 3

IRS Provides Relief From 2018 Underpayment Penalties to Eligible Individuals—For tax year 2018, a special waiver is available for the underpayment of estimated tax penalty for taxpayers who did not pay in sufficient estimated taxes by January 15, 2019. The waiver applies if combined withholding and estimated tax payments are at least 85% of the taxpayer's 2018 tax liability. The taxpayer must complete Form 2210 and a new 85% Exception worksheet included in the 2018 form instructions. Note that the §6654 underpayment penalty is different from late filing and late payment penalties. Page 5

QUESTION OF THE WEEK

A head of household client with two children qualifies for the child tax credit and the new credit for other dependents. Her tax will be less than the total of the two credits. How does the other dependent credit impact the refundable child tax credit? Does she reduce taxes by the other dependent credit first or must she start with the nonrefundable child tax credit? Page 6 (examples follow the QOTW)

ACA HEALTH CARE PENALTY AND EXEMPTION ROUNDUP UPDATE

(This is a reprint of an article published in TAX in the News December 12, 2018)

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.

See the ACA Penalty Exemptions QRC quick reference card in the Tax Research Center.

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.

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.

Reminder: Taxpayers may continue to claim hardship exemptions directly on Form 8965 for the following:

- The taxpayer's aggregate self-only coverage is considered unaffordable. Generally, self-only employer-sponsored coverage must be more than 8.05% of household income.
- The taxpayer's income was below 138% of the FPL and the taxpayer resides in a state that did not expand Medicaid.

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.

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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.

IRS PROVIDES "SAFE HARBOR" ALLOWING CERTAIN RENTAL REAL ESTATE ACTIVITIES TO QUALIFY FOR THE QBID

The IRS released Notice 2019-07 with a proposed revenue procedure laying out a "safe harbor" allowing taxpayers with a rental real estate enterprise to treat the activity as a business for purposes of the qualified business income deduction (QBID). To qualify as a trade or business under the safe harbor, the rental real estate enterprise must satisfy the safe harbor requirements. However, a rental real estate enterprise could still be treated as a trade or business for purposes of the QBI deduction if it otherwise meets the definition of trade or business under §162.

Note: "*Qualified Business Income Deduction – Part 7: Residential Rental Activities*" in the Tax Research Center has been updated for Notice 2019-07.

The IRS also released final regulations and other guidance on the QBID which we will cover in future editions of TAX in the News.

Rental Real Estate Enterprise

A rental real estate enterprise is an interest in real property held for the production of rents. An enterprise may consist of an interest in multiple properties. The interest must be held directly by the taxpayer or through an entity disregarded from its owners, such as a single-member LLC. Taxpayers may either:

1. Treat each property held for the production of rents as a separate enterprise, or
2. Treat all similar properties held for the production of rents as a single enterprise.

Commercial and residential real estate may not be part of the same enterprise.

Taxpayers may not vary their treatment of properties in subsequent years unless there is a significant change in facts and circumstances. For example, a taxpayer who has a property with net income in 2018 but a loss in 2019 may not, given the same level of activity, treat the property as a real estate enterprise only in 2018 in order to avoid reducing 2019 QBI from other activities by the rental loss.

Rental Real Estate Safe Harbor Requirements

A rental real estate enterprise qualifies for the safe harbor, which means it qualifies as a trade or business for QBI purposes, if the following conditions are met:

- Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;
- 250 hours of rental services (defined below) are performed with respect to the enterprise during the year; and

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- The taxpayer maintains contemporaneous records, including time reports, logs or similar documents regarding the following:
  - hours of all services performed;
  - description of all services performed;
  - dates on which such services were performed; and
  - who performed the services.

A statement must also be attached to the return each year the safe harbor is used.

Rental Services

Rental services include:

- advertising to rent or lease the real estate;
- negotiating and executing leases;
- verifying information contained in prospective tenant applications;
- collection of rent;
- daily operation, maintenance, and repair of the property;
- management of the real estate;
- purchase of materials; and
- supervision of employees and independent contractors.

The term rental services does *not* include:

- financial or investment management activities, such as arranging financing;
- procuring property;
- studying and reviewing financial statements or reports on operations;
- planning, managing, or constructing long-term capital improvements; or
- hours spent traveling to and from the real estate.

For tax years beginning after 2022, the 250 hours of service requirement is met if in any three of the five consecutive taxable years that end with the taxable year, 250 or more hours of rental services are performed per year for the enterprise.

Property Used as a Personal Residence Is Disqualified from the Safe Harbor

Real estate used by the taxpayer (including an owner or beneficiary of a disregarded entity relying on this safe harbor) as a residence for any part of the year under §280A is not eligible for this safe harbor.

Real estate rented or leased under a triple net lease is also not eligible for this safe harbor. Here, a triple net lease includes a lease agreement that requires a tenant or lessee to pay all or a portion of the taxes, fees, and insurance, and to be responsible for maintenance activities for a property in addition to rent and utilities.

Statement Required to Elect Safe Harbor

Notice 2019-07 also requires a signed statement to be included with the return stating the safe harbor requirements have been met. The individual or individuals who sign must have personal knowledge of the facts and circumstances related to the statement.

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The following language must be included in the statement signed by the taxpayer:

"Under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete."

IRS PROVIDES RELIEF FROM 2018 UNDERPAYMENT PENALTIES TO ELIGIBLE INDIVIDUALS

The IRS has issued news release IR-2019-03 and Notice 2019-11 waiving the underpayment of estimated tax penalty for certain individuals who would otherwise have to make all 2018 estimated tax payments no later than January 15, 2019. The waiver is limited to individuals whose withholding and estimated tax payments are at least 85% of the tax liability shown on the 2018 tax return.

Underpayment of estimated tax penalty (§6654)

In general, individuals are required to meet their annual tax obligations as they earn income, either through withholding, which is considered to be paid evenly throughout the year, or by making estimated tax payments in four equal installments, or a combination of the two methods. For most taxpayers, the total required to be paid in is the lesser of:

1) 90% of the tax shown on the 2018 return, or

2) 100% of the 2017 year's tax liability (110% if the prior year's AGI was more than $150,000).

Those that fail to make sufficient and timely payments of tax are subject to an underpayment of estimated tax penalty unless an exception or waiver applies. Note that this penalty is different from the late filing and late payment penalties. If taxes are not paid throughout the year as required, the underpayment of estimated tax penalty may apply even if taxes are paid in full with a return filed on the original due date.

Two common exceptions to the underpayment penalty are:

- The taxpayer owes less than $1,000 in tax.
- The taxpayer did not have any tax liability for the previous year (as long as the taxable year was at least 12 months) and the taxpayer was a U.S. citizen or resident throughout the year.

Also, the Secretary is authorized to waive the penalty because of casualties, disasters, and "unusual circumstances."

Notice 2019-11 and the TCJA

Following the enactment of the TCJA, the IRS released an updated withholding calculator and a new version of Form W-4. The idea was to help taxpayers determine their 2018 tax liability and make up any shortfall through additional withholding and/or estimated payments. However, some taxpayers may have been unable to accurately calculate their tax liability and required estimated tax payments.

Accordingly, the IRS is providing additional relief to taxpayers.

Under Notice 2019-11, the §6654 underpayment penalty is waived for any individual whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 85% of the individual's tax liability for tax year 2018.

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To request the waiver, the taxpayer must file Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts* along with his or her 2018 tax return. The taxpayer should complete Part I of the form and the new 85% Exception Worksheet included on page 3 in the Form 2210 Instructions to determine if the waiver applies.

If so, check box A in Part II and show “85% waiver” next to the box. File page 1 of Form 2210 with the tax return to request the waiver.

If the waiver does not apply, the penalty must be calculated in the usual manner. See “What are the rules for individual estimated income tax payments?” for more information.

QUESTION OF THE WEEK

Q. A client is a head of household filer with two children, ages 15 and 18. Her 2018 income is $28,500, so with the new standard deduction her tax will be less than the child tax credit plus the other dependent credit. How will the calculation of the additional child tax credit work? Can she use the $500 other dependent credit against the tax first, so that she gets the highest refundable credit? Or, does she have to use up the tax with the child tax credit first, so that she gets a smaller refundable credit? The client does not have any other nonrefundable credits.

A. To figure the additional child tax credit (ACTC) in this situation, the other dependent credit (ODC) is used to offset the tax liability before the CTC is applied.

Using your figures, and assuming that your client will not have any adjustments or deductions other than the standard deduction, her taxable income will be $10,500 ($28,500 - $18,000) and her tax will be $1,053. Since her total nonrefundable credits of $2,500 ($2,000 CTC + $500 ODC) are more than this amount, her tax liability after applying the credits is $0, leaving a credit balance of $1,447 ($2,500 - $1,053).

Her ACTC is $1,400, the smaller of the refundable maximum or the unused credit. Another way of viewing the calculation is that the ODC is subtracted first, leaving a balance of $553 ($1,053 - $500). The CTC is applied next leaving a CTC balance of $1,447 ($2,000 - $553). Again, the ACTC is the maximum $1,400.

The calculation is illustrated on sample Form 8812-Example 1. Notice that line 4 serves to limit the ACTC to the $1,400 per qualifying child. Suppose, for example, that your client had three qualifying children over 16 and one child under 17. In that case, the total nonrefundable credit would be $3,500 ($2,000 CTC + $1,500 ODC). The total credit reduces tax to $0 but the ACTC is still limited to $1,400. The $447 excess ODC ($1,500 - $1,053) is lost, i.e. it is not included in the refundable credit or carried forward to another year. This calculation is illustrated in the sample Form 8812-Example 2.

SCHEDULE 8812 (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Additional Child Tax Credit

► Attach to Form 1040 or Form 1040NR.

► Go to *www.irs.gov/Schedule8812* for instructions and the latest information.

OMB No. 1545-0074

2018

Attachment Sequence No. 47

Name(s) shown on return: Hedda Household - Example 1

Your social security number

Part I All Filers

Caution: If you file Form 2555 or 2555-EZ, **stop here;** you cannot claim the additional child tax credit.

1	If you are required to use the worksheet in Pub. 972, enter the amount from line 10 of the Child Tax Credit and Credit for Other Dependents Worksheet in the publication. Otherwise: **1040 filers:** Enter the amount from line 8 of your Child Tax Credit and Credit for Other Dependents Worksheet (see the instructions for Form 1040, line 12a). **1040NR filers:** Enter the amount from line 8 of your Child Tax Credit and Credit for Other Dependents Worksheet (see the instructions for Form 1040NR, line 49).			1	2500
2	Enter the amount from Form 1040, line 12a, or Form 1040NR, line 49			2	1053
3	Subtract line 2 from line 1. If zero, **stop here;** you cannot claim this credit			3	1447
4	Number of qualifying children under 17 with the required social security number: 1 X $1,400. Enter the result. If zero, **stop here;** you cannot claim this credit. **TIP:** The number of children you use for this line is the same as the number of children you used for line 1 of the Child Tax Credit and Credit for Other Dependents Worksheet.			4	1400
5	Enter the **smaller** of line 3 or line 4			5	1400
6a	Earned income (see separate instructions)	6a	28500		
b	Nontaxable combat pay (see separate instructions) 6b 0				
7	Is the amount on line 6a more than $2,500? ☐ **No.** Leave line 7 blank and enter -0- on line 8. ☑ **Yes.** Subtract $2,500 from the amount on line 6a. Enter the result	7	26000		
8	Multiply the amount on line 7 by 15% (0.15) and enter the result			8	3900

Next. On line 4, is the amount $4,200 or more?

☑ **No.** If line 8 is zero, **stop here;** you cannot claim this credit. Otherwise, skip Part II and enter the **smaller** of line 5 or line 8 on line 15.

☐ **Yes.** If line 8 is equal to or more than line 5, skip Part II and enter the amount from line 5 on line 15. Otherwise, go to line 9.

Part II Certain Filers Who Have Three or More Qualifying Children

9	Withheld social security, Medicare, and Additional Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If your employer withheld or you paid Additional Medicare Tax or tier 1 RRTA taxes, see separate instructions	9			
10	**1040 filers:** Enter the total of the amounts from Schedule 1 (Form 1040), line 27, and Schedule 4 (Form 1040), line 58, plus any taxes that you identified using code "UT" and entered on Schedule 4 (Form 1040), line 62. **1040NR filers:** Enter the total of the amounts from Form 1040NR, lines 27 and 56, plus any taxes that you identified using code "UT" and entered on line 60.	10			
11	Add lines 9 and 10	11			
12	**1040 filers:** Enter the total of the amounts from Form 1040, line 17a, and Schedule 5 (Form 1040), line 72. **1040NR filers:** Enter the amount from Form 1040NR, line 67.	12			
13	Subtract line 12 from line 11. If zero or less, enter -0-			13	
14	Enter the **larger** of line 8 or line 13			14	

Next, enter the **smaller** of line 5 or line 14 on line 15.

Part III Additional Child Tax Credit

15	**This is your additional child tax credit**	15	1400

Enter this amount on Form 1040, line 17b, or Form 1040NR, line 64.

SCHEDULE 8812 (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Additional Child Tax Credit

► Attach to Form 1040 or Form 1040NR.
► Go to *www.irs.gov/Schedule8812* for instructions and the latest information.

1040 / 1040NR / 8812

OMB No. 1545-0074

2018

Attachment Sequence No. 47

Name(s) shown on return: Hedda Household - Example 2

Your social security number

Part I — All Filers

Caution: If you file Form 2555 or 2555-EZ, **stop here;** you cannot claim the additional child tax credit.

1	If you are required to use the worksheet in Pub. 972, enter the amount from line 10 of the Child Tax Credit and Credit for Other Dependents Worksheet in the publication. Otherwise: **1040 filers:** Enter the amount from line 8 of your Child Tax Credit and Credit for Other Dependents Worksheet (see the instructions for Form 1040, line 12a). **1040NR filers:** Enter the amount from line 8 of your Child Tax Credit and Credit for Other Dependents Worksheet (see the instructions for Form 1040NR, line 49).			1	3500
2	Enter the amount from Form 1040, line 12a, or Form 1040NR, line 49			2	1053
3	Subtract line 2 from line 1. If zero, **stop here;** you cannot claim this credit			3	2447
4	Number of qualifying children under 17 with the required social security number: 1 X $1,400. Enter the result. If zero, **stop here;** you cannot claim this credit. **TIP:** The number of children you use for this line is the same as the number of children you used for line 1 of the Child Tax Credit and Credit for Other Dependents Worksheet.			4	1400
5	Enter the **smaller** of line 3 or line 4			5	1400
6a	Earned income (see separate instructions)	6a	28500		
b	Nontaxable combat pay (see separate instructions) 6b: 0				
7	Is the amount on line 6a more than $2,500? ☐ **No.** Leave line 7 blank and enter -0- on line 8. ☑ **Yes.** Subtract $2,500 from the amount on line 6a. Enter the result	7	26000		
8	Multiply the amount on line 7 by 15% (0.15) and enter the result			8	3900
	Next. On line 4, is the amount $4,200 or more? ☑ **No.** If line 8 is zero, **stop here;** you cannot claim this credit. Otherwise, skip Part II and enter the **smaller** of line 5 or line 8 on line 15. ☐ **Yes.** If line 8 is equal to or more than line 5, skip Part II and enter the amount from line 5 on line 15. Otherwise, go to line 9.				

Part II — Certain Filers Who Have Three or More Qualifying Children

9	Withheld social security, Medicare, and Additional Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If your employer withheld or you paid Additional Medicare Tax or tier 1 RRTA taxes, see separate instructions	9			
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11	Add lines 9 and 10	11			
12	**1040 filers:** Enter the total of the amounts from Form 1040, line 17a, and Schedule 5 (Form 1040), line 72. **1040NR filers:** Enter the amount from Form 1040NR, line 67.	12			
13	Subtract line 12 from line 11. If zero or less, enter -0-			13	
14	Enter the **larger** of line 8 or line 13. **Next,** enter the **smaller** of line 5 or line 14 on line 15.			14	

Part III — Additional Child Tax Credit

15	**This is your additional child tax credit**	15	1400

1040 / 1040NR ← *Enter this amount on Form 1040, line 17b, or Form 1040NR, line 64.*