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TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

Final QBID Regulations Clarify Relationship of Above-the-Line Self-Employed Deductions to QBI—Final qualified business income deduction (QBID) regulations released last month clarify that all deductions attributable to a trade or business are taken into account in computing QBI. These include above-the-line adjustments such as the deductions for one-half of S/E tax, self-employed health insurance, and retirement plan contributions. Page 2

IRS Provides Guidance on TCJA Changes to §179 and ADS—The TCJA increased the maximum §179 expense deduction and expanded the types of property eligible for expensing. The new law also made changes to the alternative depreciation system, which is a slower depreciation that taxpayers must use in certain circumstances. A recent IRS revenue procedure provides guidance on these two changes. Page 2

QUESTION OF THE WEEK

A client's return was rejected from e-filing because her children's SSNs were already used by another taxpayer. She believes it was her ex-spouse who claimed them, but she is the custodial parent. How does she go about claiming the children on her own return? Page 3

ORIGINAL INSIGHTS

Spoiler alert: Television families demonstrate complex tax situations — How would the fictional families of Modern Family file returns? Full insight. View all insights at www.thetaxinstitute.com/insights/.

FINAL QBID REGULATIONS CLARIFY RELATIONSHIP OF ABOVE-THE-LINE SELF-EMPLOYED DEDUCTIONS TO QBI

In the final qualified business income deduction (QBID) regulations released in January, the Treasury Department and IRS clarify that all deductions attributable to a trade or business are taken into account in computing QBI.

These include above-the-line adjustments such as:

- The deduction for one-half of self-employment tax (§164(f))
- The self-employed health insurance deduction (§162(l))
- Deductible contributions to self-employed retirement plans (§404)

This guidance is also included in the Form 1040 Instructions (page 34).

The following examples illustrate the QBID calculation. Assume that the taxpayer's taxable income is not over the beginning phaseout range of $157,500 ($315,000 for joint filers).

Example 1: Marc has $100,000 of net self-employment income from his business. Self-employment tax is $14,130. Marc claims the standard deduction for a single filer and has no other income.

- Marc's QBI is $92,935 [($100,000 net self-employment - $7,065 S/E tax adjustment).
- His QBID before the income limitation is $18,587 ($92,935 × 20%)
- His income limitation is $16,187 [($92,935 AGI - $12,000) × 20%)]
- Result: Marc's QBID is $16,187 (the smaller of the two calculations)

Example 2: The facts are the same as Example 1, except that Marc also has wage income of $20,000.

- Marc's QBI is $92,935 [($100,000 net self-employment - $7,065 S/E tax adjustment).
- His QBID before the income limitation is $18,587 ($92,935 × 20%)
- His income limitation is $20,187 [($112,935 AGI - $12,000) × 20%)]
- Result: Marc's QBID is $18,587 (the smaller of the two calculations)

Example 3: The facts are the same as Example 1, except that Marc contributed $2,500 to a SEP and paid $5,000 in health insurance premiums.

- Marc's QBI is $85,435 ($100,000 net self-employment - $7,065 S/E tax adjustment - $2,500 SEP - $5,000 SEHID).
- His QBID before the income limitation is $17,087 ($85,435 × 20%).
- His income limitation is $14,687 [($85,435 AGI – $12,000) × 20%)]
- Result: Marc's QBID is $14,687 (the smaller of the two calculations)

If the taxpayer has more than one eligible trade or business, the self-employment tax deduction, retirement plan deduction, and SEHID would be allocated proportionately to each trade or business based on each business's gross income. See TAX in the News October 17, 2018 on the QBID calculation for multiple business and aggregation rules.

IRS PROVIDES GUIDANCE ON TCJA CHANGES TO §179 AND ADS

IRS news release IR-2018-257 and Rev. Proc. 2019-08 provide guidance on TCJA changes to the §179 expense deduction and the §168(g) alternative depreciation system (ADS).

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Section 179 Changes under TCJA

The TCJA increased the maximum §179 expense deduction from $500,000 to $1 million and the phaseout threshold from $2 million to $2.5 million. These amounts will be adjusted for inflation after 2018. (The 2019 maximum expense and phaseout thresholds are $1,020,000 and $2,550,000 respectively. See TAX in the News November 21, 2018, for 2019 inflation adjustments.)

In addition to tangible personal property and certain computer software, taxpayers may elect the §179 deduction for qualified real property. Under the TCJA, qualified real property consists of:

- Qualified improvement property, that is, interior improvements to nonresidential real property made after the building was first placed in service. Improvements do not qualify if they're attributable to enlargement of the building, an elevator or escalator, or the internal structural framework of the building.
- Specific improvements to nonresidential real property: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

The TCJA also allows the deduction for tangible personal property used to furnish lodging, or in connection with furnishing lodging. For example, a taxpayer may elect the §179 deduction for furniture and appliances purchased for a furnished rental apartment.

See the instructions to Form 4562, Depreciation and Amortization for §179 election procedures. The TCJA changes to §179 generally apply to tax years beginning after 2017 (beginning January 1, 2018 for calendar year taxpayers).

ADS Changes under TCJA

As its name suggests, ADS is an alternative, slower depreciation system that taxpayers must use in certain circumstances to spread out costs instead of the faster general depreciation system (GDS).

The TCJA changes the ADS recovery period from 40 years to 30 years for residential rental property required to use ADS (such as foreign rental property). The change applies to property placed in service after December 31, 2017. Rev. Proc. 2019-08 includes an optional depreciation table that taxpayers may use under ADS for straight-line, mid-month convention, 30-year recovery property.

The TCJA also expands the businesses that must use ADS. Farming businesses that elect out of the new §163(j) interest deduction limitation must use ADS for property with a recovery period of 10 years or more. Real property trades or businesses that elect out of the §163(j) limitation must use ADS for nonresidential real property, residential rental property, and qualified improvement property. The revenue procedure explains that the required change to ADS for property placed in service before 2018 is not a change in accounting methods.

See TAX in the News December 12, 2018, for a discussion of the new interest deduction limitation. Note that the opt-out election would not apply if the farming or real property business qualifies for the small business exception (i.e., average annual gross receipts of less than $25 million).

QUESTION OF THE WEEK

Q. A client's tax return was rejected from e-filing because her ex-spouse claimed her children on his tax return. They have been separated since 2017 and their divorce was finalized in 2018. Aside from a few weeks spent with their father last summer, the children lived with her nearly all year and she paid for most of their support. She thinks that he claimed the children so that he could get the child tax credit and the EITC. How can she claim the children on her return?

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A. Unfortunately, there is no easy or fast way for her to claim the children on her return.

First, make sure that your client is in fact the children's custodial parent and eligible to claim them.

Divorce decrees usually name the custodial and noncustodial parents and indicate if the noncustodial parent may claim the children. For tax purposes though, the custodial parent is the parent with whom the children lived for the greater number of nights during the year. Also, regardless of the language in the decree, the custodial parent must release the children's exemptions using Form 8332 in order for the noncustodial parent to claim them.

The custodial parent must provide the noncustodial parent with a signed Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, for each affected child. Although the exemption amount is $0 in 2018, and despite the name of the form, a properly executed exemption release allows the noncustodial parent to claim the child tax credit (or other dependent credit if the qualifying child is 17 or older or does not have an SSN). However, it does not allow a noncustodial parent to claim the EITC.

In the divorce proceeding, it is possible that your client did sign Form 8832 and gave it to her ex-spouse. She may want to double check with her attorney and see if there are any records of this happening. If she signed it, she cannot revoke the release for tax year 2018. See the instructions with the form for revocation procedures and the timeline for revoking the release.

Assuming that your client is the custodial parent and did not release the children's exemptions, she'll have to file a paper return to claim the children. The return should include a statement that your client is the children's custodial parent and provide details on where the children have lived throughout the year. The statement should also show that her return was initially rejected in e-file because the children were already included on another return, possibly the children's father's return, but your client has not given him signed exemption releases. Your client should also offer to provide any needed documentation, such as school and health records, upon request.

It will take some time to sort this out, but the IRS should contact both your client and the taxpayer who claimed the children with their decision.