THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

February 20, 2019

ENROLLED AGENT RENEWAL PROCESSING DELAY—The current renewal cycle applies to EAs with social security numbers ending in 0, 1, 2, or 3. The deadline for these EAs to submit timely renewals was January 31, 2019. However, renewal processing has been delayed because of the government shutdown. According to Enrolled Agent News, the IRS is automatically extending enrollment card expiration for these EAs. For those who submitted timely renewals, applications will be processed on a first in, first out basis and enrollment will *not* expire March 31, 2019. Those who have not yet submitted a renewal should do so immediately.

TAX NEWS

Safe Harbor Guidance for Taxpayers Claiming 100% Bonus Depreciation for Passenger Automobiles—Rev. Proc. 2019-13 provides a safe harbor method for determining depreciation in years immediately after a taxpayer claims 100% bonus depreciation for a passenger automobile. Otherwise, taxpayers would have to wait until the recovery period was over to write off the remaining adjusted depreciable basis of the vehicle. Under the safe harbor, generally, the taxpayer claims “regular” MACRS depreciation during the recovery period. Page 2

New IRS Forms Designed for Partnerships to Make / Revoke the “Push-Out” Election—The centralized partnership audit rules require any audit assessment to be applied to the partnership in the assessment year, which means that partners are liable for adjustments, penalties, interest, etc. even if they were not partners in the year under review. The partnership can elect to “push out” these liabilities to the partners from the review year. New Form 8988 is used to make the election and Form 8989 is used to revoke the election. Page 3

QUESTION OF THE WEEK

Clients were told by a school advisor that their daughter could pay tax on her Pell Grant to free up the funds for an education credit. Another advisor told them they can’t change a tax-free scholarship to a taxable one. Who is right? If her daughter pays tax on the grant are the funds available for the American opportunity credit? Page 4

SAFE HARBOR GUIDANCE FOR TAXPAYERS CLAIMING 100% BONUS DEPRECIATION FOR PASSENGER AUTOMOBILES

The IRS has issued news release IR-2019-14 and Rev. Proc. 2019-13 providing a safe harbor method for determining depreciation in the years immediately after a taxpayer claims 100% bonus depreciation for a passenger automobile. Without this safe harbor, taxpayers would not be able to claim *any* depreciation until after the end of the automobile's recovery period.

Background

Passenger automobiles, including trucks and vans, are subject to "luxury" automobile limitations under §280F. Limitations apply even if the taxpayer is applying bonus depreciation or the §179 deduction.

The TCJA increased the automobile depreciation caps starting in 2018. For vehicles acquired after September 27, 2017 and first placed in service in 2018, the limits are: $10,000 the first year, $16,000 the second year, $9,600 the third year, and $5,760 for each succeeding year. (See TAX in the News April 25, 2018.)

The TCJA also increased first-year bonus depreciation from 50% to 100% for property acquired and placed in service after September 27, 2017 and before January 1, 2023. (The bonus depreciation percentage phases down in years 2023-2026.) For passenger automobiles eligible for 100% bonus depreciation, the first-year limitation is increased to $18,000.

The §280F paradox and the safe harbor

Under §280F(a)(1)(A)(i), if the unadjusted depreciable basis of an automobile is more than the allowable 100% bonus depreciation deduction, the unrecovered basis, or excess is treated as a deductible expense in the first year succeeding the end of the recovery period.

Under the safe harbor provided in Rev. Proc. 2019-13, taxpayers may figure depreciation deductions during the recovery period based on the applicable optional depreciation table for the depreciation system, depreciation method, recovery period, and convention that applies to passenger automobiles, subject to the §280F limitation amounts. Any adjusted depreciable basis remaining after the recovery period is subject to the applicable annual depreciation limitation, which is $5,760 for automobiles placed in service in 2018.

Without a safe harbor, taxpayers claiming bonus depreciation on an automobile could not write off the rest of the cost until the recovery period was over. The recovery period for a passenger automobile usually spans six tax years, using 5-year MACRS depreciation and the half-year convention. The recovery percentages are:

- 20% in year 1,
- 32% in year 2,
- 19.2% in year 3,
- 11.52% in years 4 and 5, and
- 5.76% in year 6.

(See Table A-1 in Pub. 946.)

Example

Rev. Proc. 2019-13 supplies the following example.

In 2018, Taxpayer X, a calendar year taxpayer, purchases and places in service a new passenger automobile with an unadjusted depreciable basis of $60,000. Assume that X is a calendar year taxpayer, the vehicle qualifies for 100% bonus depreciation and is used only for business, and X does not elect to apply 50% bonus depreciation, or elect out of bonus depreciation, or elect the §179 deduction. The vehicle is 5-year MACRS property subject to the half-year convention.

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Applying the safe harbor rules, X claims $18,000 bonus depreciation in 2018. The remaining adjusted depreciable basis is $42,000 ($60,000 - $18,000). Depreciation for 2019 through 2023 is determined as follows:

2019: $13,440 (lower of $16,000 or $42,000 × .32)

2020: $8,064 (lower of $9,600 or $42,000 × .1920)

2021: $4,838 (lower of $5,760 or $42,000 × .1152)

2022: $4,838 (lower of $5,760 or $42,000 × .1152)

2023: $2,419 (lower of $5,760 or $42,000 × .0576)

The total depreciation claimed for the recovery period is $51,599 and the adjusted depreciable basis at the end of the recovery period is $8,401 ($60,000 - $51,599). In 2024, the depreciation deduction is the applicable §280F limit of $5,760. In 2025, the deduction is $2,641, the lesser of the adjusted depreciable basis or the §280F limit.

Note that in this example regular MACRS depreciation yielded lower deductions than the §280F limitations. If the §280F limitation had been lower, it would apply instead of the MACRS amount.

By applying the safe harbor, the taxpayer has recouped the cost of the automobile over 8 years. Without the safe harbor, the taxpayer could not claim depreciation for the rest of the 6-year recovery period and would have to apply the limitation that applies to Year 7, or $5,760. At that rate it would take 8 years *after* the recovery period (14 years in total) to fully recoup the remaining $42,000 cost of the automobile.

Application and effective date

Taxpayers may adopt the safe harbor by using the applicable optional depreciation table to determine depreciation deductions during the recovery period. Rev. Proc. 2019-13 is effective on February 13, 2019.

NEW IRS FORMS DESIGNED FOR PARTNERSHIPS TO MAKE / REVOKE THE "PUSH-OUT" ELECTION

The IRS has released Form 8988, *Election for Alternative to Payment of the Imputed Underpayment - IRC Section 6226*, and Form 8989, *Request to Revoke the Election for Alternative to Payment of the Imputed Underpayment*.

These two forms provide a means for partnerships to make or revoke the "push-out election" under the centralized partnership audit rules (CPAR) that went into effect January 1, 2018.

The CPAR rules require any audit assessment to be applied to the partnership in the assessment year, which results in partners in that year bearing the liability of the assessment. These partners may or may not be the same taxpayers who were partners in the year under review.

The partnership can make an election to "push out" adjustments, penalties, interest, etc. to the partners in the reviewed year. The election is beneficial to partners that do not wish to be liable for an assessment that resulted from a year in which these partners did not own an interest in the partnership.

The partnership representative is responsible for filing Form 8988 on behalf of the partnership within 45 days of the date the IRS mails the Notice of Final Partnership Adjustments (FPA). After making the election, the partnership must send statements to the reviewed year partners explaining their share of the assessment and any other amounts. The partnership has 60 days from the date the adjustments become final to send these statements.

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Once the partnership has furnished the statements to the reviewed year partners, it must file the statements with the IRS. If the partnership decides that the above election should not have been made, the partnership representative can file Form 8989. This will effectively revoke the prior election, but the form must be filed before any statements are sent to reviewed year partners. If the revocation is accepted, the partnership becomes liable for the assessed value which means the partners in the assessment year, rather than the reviewed year, are liable.

For more information on these rules and important rules under CPAR see, "Revised Partnership Return Reflects CPAR Opt-Out Procedure in the Tax Research Center Also, see the TTI Insights article: "Partnerships, Part III: Partnership Audit Procedures."

QUESTION OF THE WEEK

Q. My clients and their daughter have received conflicting advice about her Pell Grant. One school advisor told their daughter she could pay tax on the grant and then use the funds to claim an education credit. Another advisor told the family they cannot claim a credit with tax-free scholarship funds, even if she pays tax on the scholarship. Can their daughter pay tax on the Pell Grant so that funds are available for the American opportunity credit (AOC)? She is a 20-year-old college junior. Aside from the grant she has a small amount of income from a part-time job.

A. Actually, both of these advisors have given correct, but incomplete information.

Generally, under Reg. §1.25A-5(c), the amount of qualified expenses used to claim an education credit must be reduced by any excludable scholarship or other excludable educational assistance. Including a tax-free scholarship in income will only result in unnecessary tax and not in a larger education credit. See "Tax-free Scholarships and Fellowship Grants" in IRS Pub. 970, *Tax Benefits for Education*, to determine if a scholarship is fully-, partly-, or non-taxable.

A Pell Grant may be allocated to tuition and fees and/or to living expenses. If it is allocated principally to qualified education expenses (tuition and fees), then little or nothing may be available to calculate the AOC or lifetime learning credit. As explained above, under the education expense ordering rules for education credits, qualified education expenses are treated as first paid by any tax-free educational assistance.

Alternately, any amount of the Pell grant may be allocated to nonqualified education expenses (such as room and board). The amount allocated to nonqualified expenses is included in the taxable income of the student, not the parent.

A Treasury Department fact sheet Interaction of Pell Grants and Tax Credits: Students May be Foregoing Tax Benefits by Mistake explains that taxpayers may treat a Pell Grant and, if allowed, other scholarship funds as having been used for living expenses *simply by including the funds in income*.

- Under Reg. §1.25A-5(c), the allocation is available as long as the scholarship is allowed to be used for nonqualified expenses – which is the case for Pell Grants – even if the educational institution has applied the grant to tuition and fees.
- The amount allocated to living expenses cannot be more than the student's actual living expenses.

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For example, suppose your clients' daughter has a $6,095 Pell Grant, and $6,500 in qualified tuition expenses. By allocating $4,000 of the grant to living expenses (and thus including it in income), she (or more likely her parents) would be eligible for the maximum AOC. The $2,095 portion of the Pell grant allocated to tuition and fees is tax-free.

Treating part of a Pell Grant as taxable income may provide tax benefits to the clients but could create or increase your clients' daughter's tax liability. Other complications to consider:

- Pell Grants and other scholarships included in income because they are allocated to nonqualified expenses are treated as the student's unearned income, which could subject the student to the kiddie tax and, in some cases, to AMT as well.
- Depending on a student's situation, including taxable scholarships in income could impact other tax benefits, including the EITC and the premium tax credit under the ACA.
- In cases such as this where parents will be claiming the education tax credit and the child will be including the Pell grant in taxable income, there may be a conflict of interest if a tax professional represents both the parent and the child.

For more information, see "Coordination with Pell Grants and Other Scholarships" in Pub. 970.