THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

February 27, 2019

Filing Deadline Reminder for Farmers and Fishermen—Farmers and fishers may make one yearly estimated tax payment in January and then file their tax return on the regular due date for individual returns. For tax year 2018, those who paid estimated taxes by January 15, 2019, have until April 15, 2019 to file. Farmers and fishers who did *not* make an estimated tax payment must file by March 1, 2019 and pay all 2018 taxes due by that date.

TAX NEWS

New Home Office Deduction Form Instructions Address TCJA Itemized Deductions Changes—TCJA itemized deduction limitations generally do not apply to the portion of real estate taxes, mortgage interest, and casualty losses that go into the home office deduction calculation. Form 8829, *Expenses for Business Use of Your Home*, and the associated form instructions have been modified for these changes. For taxpayers who itemize and have state and local tax deductions that are more than the $10,000 cap, a new worksheet is provided to allocate the limitation to real estate taxes. Page 2 (Line 11 worksheet on the last page)

Interest Rate Remains at 6 Percent for Second Quarter of 2019—The interest rate for April through June of 2019 remains at 6% for overpayments and underpayments. Page 3

QUESTION OF THE WEEK

A married taxpayer from Mexico was in the U.S. for a short time working on a research project. Her husband and two children live at home in Mexico, where she returned when the project was over. She is filing Form 1040-NR as a nonresident. Instead of filing as MFS, can she use the head of household status or file as single for 2018? Page 3

ORIGINAL INSIGHTS

Back to basics: The effects of federal tax changes on state law — How states respond to federal tax law changes depends on several factors. Full insight. View all insights at www.thetaxinstitute.com/insights/.

NEW HOME OFFICE DEDUCTION FORM INSTRUCTIONS ADDRESS TCJA ITEMIZED DEDUCTION CHANGES

The 2018 version of Form 8829, *Expenses for Business Use of Your Home*, has been modified for TCJA changes to itemized deductions. Under the TCJA:

- The deduction for all state and local taxes is limited to $10,000.
- Casualty losses are allowed only for losses arising from federally declared disasters.
- Deductible mortgage interest is limited to mortgages of $750,000 or less for mortgages acquired December 15, 2017 or later.

The Form 8829 instructions provide guidance on how to calculate the portion of each of these deductions that is attributable to the taxpayer's business use of the home. The instructions provide steps for calculating the deduction for taxpayers who itemize and for those who claim the standard deduction.

State and local taxes

The $10,000 state and local tax limitation does not apply to real estate taxes attributable to the business portion of the taxpayer's home. The Form 8829 instructions includes a worksheet to allocate the limitation to real estate taxes. The deductible portion of real estate taxes is reported on Form 8829, line 11 "real estate taxes." The nondeductible portion, referred to as "excess real estate taxes" is reported on new line 17 of the form.

> **Example:** Joe itemizes deductions on Schedule A and also claims a home office deduction for his home. He uses 20% of his home for business purposes. His 2018 state and local taxes consisted of $7,000 income tax, $4,500 real estate tax, and $1,500 personal property tax, for a total of $13,000.
>
> Using the line 11 worksheet (posted on the last page), Joe reports $0 on line 11 and $900 on line 17.
>
> Because Joe is itemizing deductions, the real estate tax amount reported as an itemized deduction on Schedule A is reduced to $3,600 ($4,500 - $900).

Casualty losses and mortgage interest

As in previous years, taxpayers must allocate the business portion of casualty losses sustained and mortgage interest paid to the home office deduction.

New for 2018, a casualty loss that is not attributable to a federally declared disaster is not deductible on Schedule A, but the business portion of the loss is included in the home office deduction calculation. Similarly, the new $750,000 mortgage limitation does not apply to the business portion of the interest deduction. See the instructions for line 9 and 10.

Caution: Under the TCJA, taxpayers may no longer deduct home equity interest on Schedule A unless the loan can be treated as acquisition debt, i.e. a loan used to buy, build, or substantially improve the taxpayer's home. However, unlike mortgage interest that is limited because of mortgage dollar caps, the interest on a home equity loan that cannot be treated as acquisition debt does *not* figure into the home office deduction. This is not a change from earlier years! Only the interest on acquisition debt may be allocated to the home office deduction.

Non-itemizers

Taxpayers who claim the standard deduction will not use lines 10 and 11 of Form 8829 for deductible mortgage interest and real estate taxes. Instead, they will use lines 16 and 17 of Form 8829 to claim the entire business use of the home portions of these deductions. See the form instructions for taxpayers who are claiming a net qualified disaster loss as an increased standard deduction.

INTEREST RATE REMAINS AT 6 PERCENT FOR SECOND QUARTER OF 2019

The IRS announced in IR-2019-21 and Rev. Rul. 2019-05 that interest rates for the second calendar quarter of 2019 (beginning April 1) will remain at 6 percent. 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.

QUESTION OF THE WEEK

Q. A client from Mexico spent about four months in the U.S. last summer on a research project. She has a J-1 visa. Her husband lives in their home in Mexico with their two children and she returned there when the project was completed. She'll file a Form 1040-NR as a nonresident for 2018. Can she file as head of household or use the single filing status for 2018? Her husband is not a U.S. taxpayer and has no U.S filing requirement.

A. Your client must file using the married filing separately filing status.

Form 1040-NR filers who are married and have children may not file as head of household. But, in limited circumstances, married persons who live apart may use the single filing status on Form 1040-NR.

To use the single filing status, the taxpayer must:

1. Be a married resident of Canada, Mexico, or South Korea or must be a U.S. national.
2. File a separate return from her spouse
3. Pay over half the cost of keeping up her home for 2018.
4. Live apart from her spouse for the last six months of 2018. Temporary absences for special circumstances, such as for business, count as time lived in the home.
5. Share the same main home with her son, daughter, stepson, stepdaughter, or foster child for more than half of 2018.
6. Claim or be able to claim the child as a dependent.

Note that these criteria are the same as those for married U.S. citizens and residents to be considered unmarried for head of household filing purposes. Of particular importance here is the requirement for the spouses to live apart at all times during the last six months of the year.

Your client lived apart from her husband for only four months during 2018. However, even if they had lived apart for the last six months, the circumstances point to a temporary absence rather than a permanent separation. She was in the U.S. for a research project and apparently intended to and did return home when the project was finished. Thus, if she had been a U.S. citizen or resident and Form 1040 filer she would not have qualified to use the head of household filing status and, for the same reasons, will not qualify to use the single filing status on Form 1040-NR.

See "*Married persons who live apart*" on page 14 of the Form 1040-NR instructions.

Lines 9, 10, and 11

Use lines 9, 10, and 11 for business use of the home expenses that would have been deductible as a personal expense if you had not used your home for business. These expenses include certain casualty losses, mortgage interest, and real estate taxes.

Taxpayers claiming the standard deduction. If you claim the standard deduction, you will not include any mortgage interest or real estate taxes on lines 10 and 11; instead, you will claim the entire business use of the home portion of those expenses using lines 16 and 17. If you are not increasing your standard deduction by a net qualified disaster loss, then you will not include any casualty losses on line 9; instead, you will claim the entire business use of the home portion of your casualty losses on line 29. If you are filing Schedule A to increase your standard deduction by a net qualified disaster loss, see *Casualty losses reported on line 9*, later.

TIP *You may prefer to itemize your deductions on Schedule A to claim amounts on lines 9, 10, and 11, even if your total personal deductions are less than the standard deduction.*

Casualty losses reported on line 9. Figure the amount to include in column (b) of line 9 as follows.

Step 1. Complete a worksheet version of Section A of Form 4684 treating all your casualty losses (and gains) as personal expenses. If you are itemizing your deductions, when completing line 17 of this worksheet version of Form 4684, enter 10% of your adjusted gross income excluding the gross income and deductions attributable to the business use of the home. Do not file this worksheet version of Form 4684; instead, keep it for your records. You will complete a separate Form 4684 to attach to your return using only the personal portion of your casualty losses (and gains) for Section A.

Step 2. Include in column (b) of line 9 the loss amounts from lines 15 and 18 of this worksheet version of Form 4684 that are attributable to the home in which you conducted the business and are the result of a federally declared disaster. If you are claiming an increased standard deduction instead of itemizing your deductions, only use a net qualified disaster loss on line 15 of the worksheet version of Form 4684 for this Step 2.

See the instructions for line 35, later, for the business use the home casualty losses that you must include in Section B of the separate Form 4684 you attach to your return.

Casualty losses reported on Schedule A. Use only the personal portion of your casualty losses (and gains) when completing Section A of the separate Form 4684 you attach to your return. The separate Form 4684 you attach to your return is used to figure the casualty losses you can include on line 15 of Schedule A and the net qualified disaster losses you can include on line 16 of Schedule A.

Excess casualty losses. See the instructions for line 29, later, to deduct the part of your casualty losses for business use of your home not allowed because of the limits on deducting casualty losses as a personal expense, including any losses that are not the result of a federally declared disaster.

Mortgage interest reported on line 10. If you are claiming the standard deduction, do not report an amount on line 10. If you itemize your deductions, figure the amount to include in column (b) of line 10 as follows.

Step 1. Treat all the mortgage interest you paid as a personal expense and figure the amount that would be deductible as an itemized deduction on Schedule A. See Pub. 936 for more information about figuring the home mortgage interest deduction and the limits that may apply.

Step 2. Include in column (b) of line 10 the amount of deductible mortgage interest figured in Step 1 that is attributable to the home in which you conducted the business.

Because the limits on deducting mortgage interest as a personal expense are figured using all loans secured by your home(s), do not claim mortgage interest in column (a) as a direct expense, even if you use a separate structure in your home in connection with your trade or business.

Mortgage interest reported on Schedule A. When you figure your itemized deduction for mortgage interest on Schedule A, include the following amounts of deductible mortgage interest that you figured in Step 1 to the extent they are not deducted on another form, such as Schedule E as a rental expense.

- The amount of deductible mortgage interest you figured in Step 1 that is not attributable to the home in which you conducted the business.
- The personal portion of deductible mortgage interest you included in column (b) of line 10. For example, if your business percentage on line 7 is 30%, 70% of the amount you included in column (b) of line 10 is deductible as an itemized deduction on Schedule A.

Excess mortgage interest. See the instructions for line 16, later, to deduct the part of your mortgage interest from loans used to buy, build, or substantial improve the home in which you conducted business that is not allowed on line 10 because of the limits on deducting home mortgage interest as a personal expense.

Real estate taxes reported on line 11. If you are claiming the standard deduction, do not report an amount on line 11. If you itemize your deductions, figure the amount to include on line 11 as follows.

Step 1. If the total of your state and local income (or, if elected on your Schedule A, general sales) taxes, real estate taxes, and personal property taxes is not more than $10,000 ($5,000 if married filing separately), enter all the real estate taxes attributable to the home in which you conducted business in column (b) of line 11.

Step 2. If you do not meet the condition of Step 1, use the following worksheet to figure the amount to include in column (a) of line 11.

Line 11 Worksheet

1.	Enter your state and local income taxes (or, if you elect on Schedule A, your state and local general sales taxes) that are personal expenses	1.	7,000
2.	Enter all the state and local real estate taxes you paid on the home in which you conducted business	2.	4,500
3.	Enter any other state and local real estates taxes you paid that are a personal expense and not included in line 2	3.	0
4.	Enter your state and local personal property taxes that are a personal expense	4.	1,500
5.	Add lines 1 through 4	5.	13,000
6.	Multiply line 2 by the percentage on Form 8829, line 7	6.	900
7.	Subtract line 6 from line 2	7.	3,600
8.	Subtract line 6 from line 5	8.	12,100
9.	Subtract line 8 from $10,000 ($5,000 if married filing separately). If zero or less, enter -0-	9.	0
10.	**Real estate taxes reported on line 11.** Enter the smaller of line 6 or line 9 here and in column (a) of Form 8829, line 11	10.	0
11.	**Excess real estate taxes reported on line 17.** Subtract line 10 from line 6	11.	900

Real estate taxes reported on Schedule A. When you figure your itemized deduction for state and local taxes on Schedule A, only include the personal portion of your real estate taxes on line 5b of Schedule A.

Excess real estate taxes. See the instructions for line 17, later, to deduct the part of your real estate taxes for the home in which you conducted business that is not allowed on line 11