



Upcoming IRS webinar; 2 hours of CE—Communications & Liaison is presenting [Understanding Tax Relief for Disasters](#) on Thursday, March 21, 2019 at 2:00 PM ET. Two hours of continuing education are available for participation.

TAX NEWS

Supreme Court Rules Lost Wages Settlement is Subject to RRTA Withholding—In a 7-2 decision, the Supreme Court held that the portion of a settlement paid to a former employee for lost work time is subject to withholding under the Railroad Retirement Tax Act. The employee had been injured on the job and later fired from the company. This decision clarifies that RRTA compensation (as with compensation for FICA purposes) includes both pay for active services and pay for time lost.

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Disaster Relief: Alabama—Parts of Alabama have been declared a major disaster area because of the tornado on March 3. Federal deadlines for affected taxpayers are generally postponed until July 31, 2019. This includes the April 15 deadline for filing 2018 individual tax returns and the deadline for eligible taxpayers to make 2018 IRA contributions. Disaster-related casualty losses may be claimed on 2017 or 2018 tax returns. The Alabama DOR is also allowing postponements to July 31.

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Recipients of Sexual Harassment Settlements May Deduct Attorney Fees—A TCJA provision disallows deductions for certain settlements and related attorney fees if a nondisclosure agreement is involved. An IRS FAQ explains that *recipients* of such settlements are not barred from deducting attorney fees. However, miscellaneous itemized deductions are not available 2018 through 2025 so the fees would be deductible only if the settlement was connected to a business activity.

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QUESTION OF THE WEEK

A U.S. green card holder is married to a citizen of Singapore who was in the U.S. briefly at the end of 2018, after which he returned to Singapore. He does *not* want to be treated as U.S. resident because of his high worldwide income. Since he can't use the standard deduction on his 1040-NR return, will she have to itemize deductions on her separately filed Form 1040? [Page 4](#)

ORIGINAL INSIGHTS

Education benefits & tax reform: What's changed, what hasn't, and what we don't know yet—The TCJA changed some of the rules for education tax benefits. [Full insight](#). View all insights at www.thetaxinstitute.com/insights/.

SUPREME COURT RULES LOST WAGES SETTLEMENT IS SUBJECT TO RRTA WITHHOLDING

Court case: [BNSF Railway Co. v. Loos, U.S., No. 17-1042, 3/4/19](#)

In a 7-2 decision, the Supreme Court of the U.S. ruled that payment to a former railroad employee for lost work time is subject to withholding tax under the Railroad Retirement Tax Act (RRTA).

Background

Michael Loos sued the BNSF Railway Company under the Federal Employer's Liability Act (FELA) for injuries sustained while working at the company's railyard. A jury awarded Mr. Loos \$126,212.78, ascribing \$30,000 of that amount to wages lost during the time he was unable to work. BNSF said the lost wages were taxable "compensation" under the RRTA and asked to withhold \$3,765, which represents the employee's share of those taxes. Both the federal District Court and the Court of Appeals for the Eighth Circuit rejected BNSF's request, holding that a damage award compensating an injured railroad worker for lost wages is not taxable under the RRTA.

Discussion

The RRTA was established in 1937 to provide both pensions and monthly benefits that are similar to those employees who are covered by the Social Security Act would receive. For the latter, the RRTA imposes a payroll tax on employee compensation. The tax mirrors the FICA system in that both employers and employees pay a share of the tax. At issue is what constitutes "compensation" for purposes of RRTA withholding.

The Eighth Circuit maintained that compensation for RRTA purposes means only pay for "services an employee actually renders," that is, pay for active services. Mr. Loos further contended that compensation does not include payments made to compensate for an injury, noting as well that gross income for federal income tax purposes under §104(a)(2) does not include personal injury damages.

The Supreme Court cited two cases involving Social Security withholding. In *Nierotko*, the court found that "wages" included pay for active services and pay received for periods of absence from active service. In [Quality Stores](#) (see TAX in the News April 8, 2014), the court held that severance payments qualified as taxable wages for FICA purposes.

Stressing the similarity between the two Acts, including their definitions of wages and compensation, the court relied on the two Social Security cases in deciding that compensation for RRTA purposes includes not only pay for active services but also pay for periods of absence from active service as long as the pay stems from the employer-employee relationship.

The court rejected the Eighth Circuit's argument that RRTA taxes payment for services while FICA taxes payment for employment, finding that Congressional intent for both systems was to define compensation as remuneration for services rendered as an employee.

The court also rejected Mr. Loos's arguments because compensation for RRTA and FICA purposes is not necessarily the same as compensation for income tax purposes.

Conclusion

The Supreme Court held that payment to an employee for working time lost due to an on-the-job injury is taxable compensation under the RRTA. The decision clarifies that compensation for both RRTA and FICA purposes may include both pay for active services and pay for time lost. It also includes pay made because of a judgment or settlement.

DISASTER RELIEF—Alabama

Parts of Alabama have been declared a major disaster area eligible for federal disaster aid to individuals and businesses.

Affected taxpayers have the option of claiming 2018 disaster-related casualty losses on their 2018 tax return filed this tax season or on an original or amended tax return for 2017 if their 2018 return isn't yet ready to file. In addition, the IRS has postponed deadlines for affected taxpayers to file returns, pay taxes, and perform other time-sensitive acts.

Affected taxpayers are those who:

- Live in the covered disaster area
- Have a main place of business located in the covered disaster area
- Have books and records needed to complete the return located in the disaster area
- Assist government or qualified non-profit organizations in relief efforts
- Were injured or killed while visiting the area

Note: Generally, the IRS identifies affected taxpayers located in the disaster area and automatically applies filing and payment relief. Affected taxpayers outside the disaster area should call the IRS at 1-866-562-5227 to request tax relief.

Alabama disaster: tornadoes and severe storms on March 3, 2019

FEMA disaster declaration announcement: [DR-4419](#) dated March 3, 2019

IRS release: [IR-2019-31](#) dated March 7, 2019

Covered disaster area: Lee County, AL. Other counties (including those in other states) that are added to the covered disaster area will be eligible for the same relief.

Postponement periods: Tax returns and other time-sensitive acts due on or after March 3, 2019, and before July 31, 2019 are postponed until **July 31, 2019**. This includes individual income tax returns and payments due April 15, 2019 and the April 15 and June 17, 2019 estimated tax deadlines. Eligible taxpayers have until July 31, 2019 to make 2018 IRA contributions.

Employment and other excise tax deposits due on or after March 3, 2019, and before March 18, 2019, must be deposited by March 18, 2019.

Alabama extension relief: March 11 [release](#) (Alabama follows federal relief)

RECIPIENTS OF SEXUAL HARASSMENT SETTLEMENTS MAY DEDUCT ATTORNEY FEES

The IRS posted an [FAQ](#) to its website clarifying a provision of the TCJA.

Under new §162(q), a business expense deduction is not allowed for:

1. Any settlement or payment related to sexual harassment or abuse if such settlement or payment is subject to a nondisclosure agreement, and
2. Attorney's fees related to such a settlement or payment.

The provision is effective for amounts paid or incurred after December 22, 2017.

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The FAQ explains that *recipients* of settlements or payments related to sexual harassment or abuse are not precluded by the new law from deducting associated attorney's fees, even if the settlements or payments are subject to a nondisclosure agreement.

Reminder. For tax years 2018 through 2025, no deduction is allowed on Schedule A for miscellaneous itemized deductions subject to the 2%-of-AGI floor. This includes legal fees. Thus, unless the suit was in connection with a business activity (a free-lance contractor, for instance), the fees would not be deductible for those years.

QUESTION OF THE WEEK

Q. My client is a resident alien (green card holder). Her husband is a citizen and resident of Singapore. He was here on a work (H-1B) visa almost four months in the late fall of 2018, after which he returned to Singapore. He will be filing as a nonresident alien. He doesn't want to be treated as a resident because he'd have to report his Singapore income, which was considerable, at least \$250K.

Since he cannot use the standard deduction on Form 1040-NR, and my client's only choice is to file MFS on Form 1040, will she have to itemize deductions too? Both spouses have state income taxes and some donations, but none of these amounts are anywhere near the \$12,000 standard deduction for MFS filers.

A. Yes, given this set of facts, your client will not be able to take the standard deduction. Under §63(c)(6)(A), if a married individual files a separate return and either spouse itemizes, the standard deduction for the other spouse is \$0. The rule applies the same way to a resident alien and a nonresident alien spouse, as in this case, or to two U.S. citizens or residents.

If a U.S. citizen or resident alien is married to a nonresident alien, they may elect to treat the nonresident alien spouse as a full-year resident. By doing so they could take advantage of the full MFJ standard deduction and the more favorable MFJ tax brackets. See "Nonresident Spouse Treated as a Resident" starting on page 9 of IRS [Pub. 519, U.S. Tax Guide for Aliens](#) for the procedure to make the election.

The negative side of making the election is that the nonresident alien spouse must report and pay tax on worldwide income. However, it appears that he could exclude at least some of his Singapore income under the physical presence test. For instance, assuming he can count at least 330 days of presence in Singapore in the 12 months before he came to the U.S., he could exclude up to \$103,900 of foreign income earned earlier in 2018. See [What is the physical presence test for the foreign earned income exclusion?](#) in the [Tax Research Center](#).

For this couple it may be that *not* making the election, even with the loss of the standard deduction and less favorable MFS brackets, is still a better choice than reporting worldwide income. Married couples in this situation should carefully consider the pros and cons of both options.