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TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

Tax Court Rules Entire Social Security Lump-Sum Payment Is Included in MAGI for Premium Tax Credit Eligibility—This is the first of two ACA-related court cases for discussion this week. In *Johnson*, the full Tax Court ruled that all social security benefits received in tax year 2014 were includable in MAGI for purposes of calculating the §36B PTC, even though the taxpayer made a "lump-sum" election to treat some of the benefits as received in 2013. The court made a distinction between the §86(e) election, which merely determines how much social security is taxable, and the components of MAGI. Page 2

District Court Rules ACA Shared Responsibility Payment *Is* Entitled to IRS Priority Treatment in Bankruptcy; Reverses Lower Court's Decision—In this second ACA-related court case, a U.S. District Court in Louisiana ruled in *Chesteen* that a taxpayer's §5000A shared responsibility payment has the characteristics of a tax and, as such, is not dischargeable in bankruptcy. A Bankruptcy Court had previously ruled that the payment is a penalty and not eligible for IRS priority status. Page 3

IRS Provides Penalty Relief to Partnerships That Omit Partners' Negative Tax Basis on Schedule K-1—Partnerships are now required to supply additional information to the IRS if the partnership does not report partners' tax basis capital accounts on Schedule K-1 *and* partners have negative tax basis capital at the beginning or end of the year. Because partnerships may not be aware of this new requirement, the IRS will waive applicable penalties. To qualify for this relief, generally, the partnership must timely file and furnish Schedule K-1s and supply the needed information to the IRS in the time and manner covered in Notice 2019-20. Page 4

QUESTION OF THE WEEK

A client sustained a disaster-related casualty loss in 2018. The loss occurred in a federally-declared disaster area (Hurricane Florence in Florida). Can he claim this loss as an additional standard deduction on his 2018 return? Page 4

FEATURED INSIGHTS

The ABCs of ACA, Part 1: Form 1095-A will help taxpayers spell out their insurance coverage—Part 1 of this series outlines why the Form 1095-A is important for many taxpayers. Full insight. View all insights at www.thetaxinstitute.com/insights/.

TAX COURT RULES ENTIRE SOCIAL SECURITY LUMP-SUM PAYMENT IS INCLUDED IN MAGI FOR PREMIUM TAX CREDIT ELIGIBILITY

Court case: Johnson, 152 T.C. No. 6, 3/11/19

The U.S. Tax Court ruled that a taxpayer's modified AGI for purposes of the ACA premium tax credit (PTC) includes all social security benefits received for 2014, even though the taxpayer made a lump-sum election to determine the taxable portion of the benefits attributable to 2013.

Background

In 2014, Levon Johnson received $26,180 in social security benefits. $11,902 of the total amount was attributable to 2013 benefits and the balance was attributable to 2014. Mr. Johnson also applied for and received a total of $4,460 in advance premium tax credits (APTCs) for 2014. On his timely filed return for 2014, he reported $24,450 of wages and $7,509 of taxable social security benefits. He did not file Form 8962, *Premium Tax Credit*, as required to reconcile the APTC with his actual PTC.

The IRS issued a notice of deficiency requiring him to repay the entire $4,460 APTC. Mr. Johnson later filed an amended return for 2014 to make an §86(e) election to treat part of benefits as having been received in 2013. He also completed Form 8962 and reported an excess APTC repayment of $1,250. The court record does not include calculations but states that Mr. Johnson included only the portion of his social security benefits attributable to 2014 in the reconciliation.

Discussion

For §36B PTC purposes, MAGI includes AGI plus "an amount equal to the portion of the taxpayer's social security benefits (as defined in §86(d)) which is not included in gross income under §86 for the taxable year)." In other words, MAGI for PTC purposes includes both the taxable and nontaxable portions of the taxpayer's social security benefits.

The issue before the court is what, exactly, needs to be included in MAGI when a taxpayer makes the §86(e) "lump-sum" election. Because the taxability of social security benefits depends on a taxpayer's income in a particular tax year, the election allows a taxpayer who receives a large, retroactive payout to attribute some of the benefits to a previous tax year or years. The election reduces the amount of taxable social security benefits in the year the benefits are received.

By making the §86(d) election, Mr. Johnson contended that social security benefits attributable to the 2013 tax year are not includable in MAGI for the 2014 tax year.

The Tax Court held that the election determines only the amount of social security benefits included in the taxpayer's gross income for the year. The court stressed that gross income for social security taxability purposes is not the same thing as MAGI for PTC eligibility purposes.

The court found the meaning of the statute to be unambiguous: "for the taxable year" literally references the taxpayer's taxable year, which is calendar year 2014 in this case. The definitive factor is the year of receipt and thus all social security benefits received are included in MAGI. The §86(e) election is not relevant for the MAGI calculation.

Conclusion

The Tax Court held that Mr. Johnson must include in 2014 MAGI the entire $26,180 of social security benefits received in that year, regardless of the lump-sum selection. As a result, his MAGI was over 400% of the applicable federal poverty line and he was not eligible for the PTC in 2014.

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Application

Unfortunately for this taxpayer, the additional social security amount included in MAGI put him just over the FPL and he had to repay the entire APTC. In other situations, the taxpayer making the election may end up with a smaller PTC but still entitled to some portion of it. Note that this is a decision by the full Tax court and applies to all taxpayers.

DISTRICT COURT RULES ACA SHARED RESPONSIBILITY PAYMENT *IS* ENTITLED TO IRS PRIORITY TREATMENT IN BANKRUPTCY; REVERSES LOWER COURT'S DECISION

Court case: U.S. v. Chesteen, No. 18-2077 (E.D. La. Feb. 2, 2019)

A U.S. District Court for the Eastern District of Louisiana ruled that a taxpayer's shared responsibility payment was a tax rather than a penalty and thus not dischargeable in bankruptcy. This decision reverses a 2018 decision by a U.S. Bankruptcy Court.

Background

In 2017, John D. Chesteen, Jr. filed for relief under Chapter 13 of the Bankruptcy Code. The sole issue before the bankruptcy court was whether the $695 shared responsibility payment assessed by the IRS on Mr. Chesteen was properly characterized as a penalty or a tax. The bankruptcy court concluded that the payment was not a tax within the meaning of §507(a)(8) of the Bankruptcy Code and so not entitled to IRS priority status. See the *Chesteen* case discussion in the February 28, 2018 edition of TAX in the News.

The IRS appealed the decision to the district court.

Discussion

Under §507 of the Bankruptcy Code, certain unsecured claims of the government are entitled to priority status. Generally, taxes assessed within the three-year period prior to the bankruptcy petition receive priority status. This status means the tax debts cannot be discharged in bankruptcy and are thus collectible by the creditor, i.e. the IRS. The Bankruptcy Court agreed with Mr. Chesteen that the individual mandate obligation was a penalty designed to deter citizens from living without health insurance and not a tax eligible for priority treatment.

Mr. Chesteen argued that the ACA refers to the IRC §5000A payment as a "penalty" eighteen times but does not refer to it as a "tax." The District Court disagreed.

The District Court maintained that it is the purpose or function of a payment, rather than its label, that controls for bankruptcy purposes. Despite its name, the shared responsibility payment does not punish an individual for an unlawful activity. Aside from the fee itself, there is no negative consequence for failing to purchase health insurance and no criminal prosecution for failing to pay the fee.

In contrast, citing case history, the District Court found the payment to have the characteristics of a tax, which is a "pecuniary burden laid upon individuals or property for purposes of supporting the government." The court also noted that in the landmark *National Federation* case, the Supreme Court said that the individual mandate penalty was a tax for constitutional purposes.

Conclusion

Both the District Court and the Bankruptcy Court analyzed definitions of "tax" and "penalty" as they apply to the §5000A payment but reached different conclusions. The District Court held that the $695 ACA penalty assessed on Mr. Chesteen is a tax that is eligible for IRS priority treatment. It is not dischargeable in bankruptcy. The District Court ordered that the Bankruptcy Court's earlier order denying priority status of the debt is to be reversed.

IRS PROVIDES PENALTY RELIEF TO PARTNERSHIPS THAT OMIT PARTNERS' NEGATIVE TAX BASIS ON SCHEDULE K-1

The IRS has issued Notice 2019-20 providing penalty relief to partnerships that fail to report information about partners' negative tax basis capital accounts as required under 2018 instructions. The relief is generally effective for tax year 2018 only.

Part II, Item L on Schedule K-1 (Form 1065) is an analysis of partners' capital accounts. The partnership may report capital account information to the partner using:

- tax basis,
- GAAP,
- Section 704(b) book, or
- another method.

The 2018 Form 1065 instructions and Schedule K-1 (Form 1065) Instructions for Item L now require a partnership to supply additional information if:

- the partnership does not report tax basis capital accounts, and
- the partner has negative tax basis capital at either the beginning or end of the year.

See the Form 1065 instructions, page 30 for the definition of "tax basis capital." If required, the partnership must report that additional information in box 20 using new code "AH" for "Other Information."

The Treasury Department and IRS are aware that some partnerships may be unable to comply with this requirement on a timely basis. Accordingly, the IRS will waive penalties for failure to furnish a correct payee statement and failure to file a partnership return. These penalties would otherwise apply to a partnership that fails to report negative tax basis in accordance with the new requirements.

To qualify for the relief:

- The partnership must timely file (including extensions) Schedules K-1 that have all other required information and furnish them to partners.
- The partnership must provide a schedule to the IRS with tax basis information about affected partners no later than March 15, 2020 (for calendar year partnerships) or 180 days after the six-month extended due date (for fiscal year partnerships). See Notice 2019-20 for the required information in the schedule and the mailing address.

The penalty relief applies to partnerships' taxable years beginning after December 31, 2017 and before January 1, 2019 (2018 for calendar year partnerships). Partnerships should not delay issuing partner Schedules K-1 as timely filing a Schedule K-1 is a requirement to obtain the penalty waiver.

QUESTION OF THE WEEK

Q. Our client had a casualty loss from Hurricane Florence in Florida in 2018. He didn't want to claim the loss until he had resolved his insurance claim, appraisal, etc. so he's ready to claim it on his 2018 return. Can he claim the loss as an additional standard deduction on his 2018 return?

A. Your client's casualty loss *is* deductible as an itemized deduction on Schedule A but it is *not* a "qualified disaster loss" that would allow for an additional standard deduction and other special treatment.

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Under the TCJA, for tax years 2018-2025, taxpayers may only deduct disaster-related casualty losses sustained in federally-declared disaster areas as an itemized deduction on Schedule A. A major disaster was declared for Hurricane Florence in Florida on October 11, 2018. Your client can thus claim the loss on Schedule A (Form 1040), line 15. The loss is subject to the 10% of AGI and $100 per incident limitations.

The Disaster Relief and Airport and Airway Extension Act of 2017, the TCJA, and the Bipartisan Budget Act of 2018 provide special casualty loss treatment for disaster-related losses from Hurricanes Harvey, Irma, and Maria, California wildfires, and federally-declared disasters that occurred in 2016. The special rules allowed a “qualified disaster loss” to be claimed as an itemized deduction or as an additional standard deduction if the taxpayer did not itemize deductions. Also, the 10% of AGI limitation was waived and the per incident limitation was increased from $100 to $500. See “Qualified Disaster Losses” on page 16 of IRS Pub. 947, *Casualties, Disasters, and Thefts*.

A “net qualified disaster loss” is a qualified disaster loss reduced by casualty gain. Net qualified disaster loses are claimed on Schedule A (Form 1040), line 16. If the taxpayer itemizes deductions, the loss is added to other miscellaneous deductions. If the taxpayer does not itemize, the regular standard deduction is listed on line 16 and the two amounts are added together. Either way, a net qualified disaster loss is not reported on line 15. See the Schedule A instructions for line 16.

Because your client’s loss was not one of the specified losses, the special rules for qualified disaster losses do not apply. For your client, although the Hurricane Florence loss is a deductible casualty loss, it does not get qualified disaster loss treatment that would allow an additional standard deduction.