THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

March 27, 2019

Two upcoming IRS webinars (one is *this* Thursday); one hour of CE each—Communications & Liaison is presenting:

- How to do a paycheck checkup on Thursday, March 28, at 2:00 PM ET.
- Filing is the thing to do, even if you have a balance due on Thursday April 4, at 2:00 PM ET

One hour of CE each is available for participation. Click on the links to register.

RMD Reminder for April 1—Taxpayers who turned 70½ in 2018 and have not yet taken a required minimum distribution (RMD) from their IRA or retirement plan must do so by April 1, 2019. The requirement pertains to those born July 1, 1947 to June 30, 1948. RMDs must be taken from traditional IRAs, SEPs, SIMPLEs, and employer-sponsored plans such as 401(k)s and 403(b)s. *Exception:* If the plan allows, a taxpayer who is still working does not have to take the first RMD until April 1 after the year he or she retires. The exception applies only to the taxpayer's current employer sponsoring the plan, not to IRAs or other employers' plans. After the first withdrawal, RMDs must be taken annually by December 31 of each year. See IRS news release IR-2019-19.

TAX NEWS

IRS Expands Relief From 2018 Underpayment Penalties—The IRS has further lowered the threshold to qualify for waiver of the §6654 underpayment of estimated tax penalty. Individuals whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 80% of their 2018 tax liability will qualify for the waiver. Those who already paid a penalty because of the previous 85% threshold may apply for a refund. Page 3

Disaster Relief: Iowa and Nebraska—Parts of Iowa and Nebraska have been declared major disaster areas because of recent storms and flooding this March. 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 Iowa and Nebraska DORs have also provided state tax postponements. Page 3

New Schedule K-1 Codes for QBID Calculation—The revised Schedules K-1 for tax year 2018 include new codes that partners, S corporation shareholders, and estate and trust beneficiaries will use to calculate their qualified business income deduction (QBID). Individuals will use the K-1 information and other information provided by the entity to complete either a simplified QBID worksheet or a complex worksheet with accompanying schedules. Page 4

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Seventh Circuit Rules Clergy Housing Allowance *Is* Constitutional—The U.S. Court of Appeals for the Seventh Circuit ruled in *Gaylord v. Mnuchin* that the §107(2) exclusion for the cash housing allowance paid to clergy does *not* violate the Establishment Clause. The decision reverses a District Court's earlier judgment in favor of the Freedom From Religion Foundation, a "nonprophet nonprofit" organization. Page 5

IRS Lowers Fee to Revise Online Installment Agreements—The fee for installment agreement revisions has changed to $10 effective January 1, 2019. The change applies only to online payment agreements. Page 6

QUESTION OF THE WEEK

Our clients have a daughter in college who is their dependent. She has unearned income from investments she inherited from her grandparents. Will this income be subject to the kiddie tax and, if so, can her income be included on her parents' return? Page 6

ORIGINAL INSIGHTS

Back to basics: Education tax benefits help taxpayers pay for college — Some education tax benefits are unchanged after the TCJA. Full insight. View all insights at www.thetaxinstitute.com/insights/.

IRS EXPANDS RELIEF FROM 2018 UNDERPAYMENT PENALTIES

The IRS has issued news release IR-2019-55 and Notice 2019-25 expanding waiver of the underpayment of estimated tax penalty. The waiver applies to individuals whose withholding and estimated tax payments are at least 80% of the tax liability shown on the 2018 tax return.

Background

Individuals are required to meet their annual tax obligations through withholding, or by making estimated tax payment in four equal installments, or a combination of the two. Generally, taxpayers must pay in 90% of the tax shown on their current year's return or 100% of the prior year's tax liability. Those that do not pay sufficient taxes throughout the year are potentially subject to the §6654 underpayment of estimated tax penalty.

In January, the IRS issued Notice 2019-11 waiving the underpayment penalty for individuals whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 85% the individual's tax liability for 2018. See TAX in the News January 23, 2019.

Notice 2019-25

Notice 2019-25 further lowers the threshold to qualify for waiver the underpayment of estimated tax penalty. Individuals will not be subject to the penalty if total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 80% of the individual's tax liability for 2018.

To request the waiver, the taxpayer must file Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts* along with his or her 2018 tax return. The taxpayer should complete Part I of the form and the worksheet provided in the Form 2210 Instructions to determine if the waiver applies. If so, check box A in Part II and show "80% waiver" next to the box. File page 1 of Form 2210 with the tax return to request the waiver.

Taxpayers who previously paid the §6654 penalty because of the higher (85%) threshold for waiver may request a refund by completing Form 843, *Claim for Refund and Request for Abatement*. Include the statement "80% waiver of estimated tax penalty" on line 7 of the form.

If the waiver does not apply, the penalty must be calculated in the usual manner. See "What are the rules for individual estimated income tax payments?" for more information.

Notice 2019-25 supersedes the guidance in Notice 2019-11. Form 2210 instructions will be updated accordingly.

DISASTER RELIEF—Iowa and Nebraska

Parts of Iowa and Nebraska 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

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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.

Iowa disaster: severe storms and flooding starting on March 12, 2019

FEMA disaster declaration announcement: DR-4421 dated March 23, 2019

IRS release: IA-2019-02 dated March 25, 2019

Covered disaster area: Fremont, Harrison, Mills, Monona and Woodbury counties.

Postponement periods: Tax returns and other time-sensitive acts due on or after March 12, 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 12, 2019, and before March 27, 2019, must be deposited by March 27, 2019.

Iowa relief: Information release dated March 26, 2019. Note that the Iowa extension is only 30 days but covers all affected counties and not just the core counties (see the FEMA map).

Nebraska disaster: severe winter storm, straight-line winds, and flooding starting on March 9, 2019

FEMA disaster declaration announcement: DR-4420 dated March 21, 2019

IRS release: NE-2019-02 dated March 22, 2019

Covered disaster area: Butler, Cass, Colfax, Dodge, Douglas, Nemaha, Sarpy, Saunders, and Washington counties.

Postponement periods: Tax returns and other time-sensitive acts due on or after March 9, 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 9, 2019, and before March 25, 2019, must have been deposited by March 25, 2019.

Nebraska relief: See Tax Information for Victims of Natural Disasters. Nebraska follows IRS disaster relief.

NEW SCHEDULE K-1 CODES FOR QBID CALCULATION

The revised Schedules K-1 for tax year 2018 include new codes that partners, S corporation shareholders, and estate and trust beneficiaries will use to calculate their qualified business income deduction (QBID) which they claim on Form 1040, line 9. The codes and corresponding amounts cover five §199A QBID elements:

- Qualified business income (QBI)
- W-2 wages from the qualified tried or business
- Unadjusted basis immediately after acquisition (UBIA) of qualified property
- REIT dividends
- Qualified publicly traded partnership (PTP) income

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See the QBID Schedule K-1 Codes Quick Reference Card for the codes that apply to partners and S corporation shareholders. In addition, the entity (partnership or S corporation) will attach a statement separately identifying each trade or business and identifying any specified service trades or businesses (SSTBs). Estate and trust fiduciaries provide all QBID information to beneficiaries on separate statements.

Schedule K-1 instructions for the three entity types (partnerships, S corporations, estates and trusts) direct the recipient to enter the amounts provided on one of the two 2018 QBID worksheets.

Taxpayers may use the QBID-Simplified Worksheet in the Form 1040 instructions if all three of the following criteria are met:

- The taxpayer has qualified business income, REIT dividends, or PTP income reported on Schedule K-1
- The taxpayer's taxable income before the QBID does not exceed $157,500 ($315,000 MFJ)
- The taxpayer is not a patron in a specified agricultural or horticultural cooperative.

Otherwise, taxpayers must use Worksheet 12-A in IRS Pub. 535, *Business Expenses*, to calculate the QBID. The QBID section of the publication includes four schedules that may be needed to complete Worksheet 12-A. Note that in many cases, the recipient will be able to use the Simplified Worksheet and will use only the first element, qualified business income.

SEVENTH CIRCUIT RULES CLERGY HOUSING ALLOWANCE IS CONSITUTIONAL

Court case: Gaylor v. Mnuchin, No. 18-2177 and No. 18-1280 (7th. Cir., March 15, 2019).

The U.S. Court of Appeals for the Seventh Circuit ruled that the exclusion for the cash housing allowance paid to clergy as part of compensation is constitutional. The decision reversed a District Court's judgment.

Background

The Freedom From Religion Foundation (FFRF) brought suit in a U.S. District Court for the Western District of Wisconsin claiming that §107(2) of the IRC violates the Establishment Clause. The District Court agreed.

This code section provides that gross income does not include "the rental allowance paid to [a minister of the gospel] as part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities." The First Amendment of the Constitution, known as the "Establishment Clause," prohibits the federal government from establishing an official religion or taking action that favors one religion over another.

The issue before the Seventh Circuit was whether allowing members of the clergy to receive tax-free housing is tantamount to making a law "respecting an establishment of religion."

Discussion

The court discussed at length the legislative and judicial history of §107(2) and the FFRF's challenge. The discussion concentrated on several relevant tests in case law. One such example is the "secular legislative purpose" test in Lemon v. Kurtzman, 403 U.S. 602 (1971).

FFRF argued that §107(2) confers special benefits to members of the clergy that are not available to other taxpayers. The court found that while §107(2) is "overinclusive" it is not necessarily broader than other code sections, such as §911 which permits U.S. taxpayers living abroad to exclude or deduct housing expenses.

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Ultimately, the court held that §107(2) has a secular legislative purpose, that its principal effect is neither to endorse nor to inhibit religion, and that it does not cause excessive government entanglements.

Conclusion

The Seventh Circuit disagreed with the FFRF's claim that the clergy housing exclusion "renders unto God that which is Caesar's," finding that the provision "falls into the play between the joints of the Free Exercise Clause and the Establishment Clause; neither commanded by the former, nor proscribed by the latter." The court concluded §107(2) is constitutional and ordered the District Court's judgment reversed.

We do not know if FFRF plans to pursue further litigation on the clergy housing allowance.

IRS LOWERS FEE TO REVISE ONLINE INSTALLMENT AGREEMENTS

The IRS posted an information release stating that the fee for installment agreement revisions has changed to $10 effective January 1, 2019. Users will pay $10 to restructure an existing agreement or reinstate an agreement after default. This change applies *only* to agreements that were initially established through an online payment agreement (OPA). Otherwise, the fee to revise an agreement is $89.

Click on "What does it cost?" on the Apply Online for a Payment Plan page for other OPA prices. See the Form 9465, *Installment Agreement Request* instructions for fees that apply to agreements that are not OPAs and reduced fee and waiver information for qualifying low-income taxpayers.

QUESTION OF THE WEEK

Q. Our clients have a 20-year old daughter who is their dependent and a college student. She has approximately $6,000 in unearned income, all of which comes from mutual funds and other investments she inherited from her grandparents. Her income consists of interest, qualified dividends and capital gain distributions. She does not have any earned income. Is she subject to the kiddie tax and, if so, can her income be included on her parents' return?

A. Yes, based on this information, your clients' daughter is subject to the §1(g) tax on unearned income of children, called the "kiddie tax." The income may be included on her parents' return but that may not be the best option for them.

The kiddie tax potentially applies for 2018 if the child:

- Had more than $2,100 in unearned income
- Is required to file a tax return
- Was under 18 at the end of the year, or was 18 and didn't have earned income that was more than half of her support, or was a full-time student age 19-23 and didn't have earned income that was more than half of her support
- Had at least one living parent at the end of the year
- Did not file a joint return

Although children subject to kiddie tax are usually dependents, as in your clients' case, it is not necessarily so. The kiddie tax can apply even if a college student provides more than half her own support and is not a dependent if that support is not from earned income.

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Under the TCJA, children's unearned income over a threshold amount ($2,100 for 2018) is taxed using the brackets and rates that apply for estates and trusts. The parents' tax situation and siblings' unearned income do not have to be considered in the calculation. If applicable, the capital gain rates for estates and trusts apply to the child's net capital gain.

Parents still have the option of including their child's unearned income on their return and the rules are essentially the same as they were before the TCJA:

- The child is otherwise required to file a return and has only unearned income from interest and dividends (including capital gain distributions and Alaska permanent fund dividends).
- The child's gross income was less than $10,500 (for 2018).
- The child did not pay estimated taxes or have federal income tax withheld under the backup withholding rules.

The election is made by filing Form 8814, *Parents' Election to Report Child's Interest and Dividends*. See IRS Pub. 929, *Tax Rules for Children and Dependents* for information on the election and additional requirements for doing so.

Although the tax brackets for estates and trusts are generally less favorable than the tax brackets for joint filers, there are some disadvantages to making the election, even if eligible to do so:

- Parents may pay up to $105 more in tax because the child's income between $1,050 and $2,100 is taxed at 10% on the parents' return, but not taxed on the child's return.
- Depending on the parents' situation, the child may lose some preferential capital gain treatment. For instance, the child's qualified dividends may be taxed at 0% while the parents' qualified dividends may be taxed at 15% or 20%.
- Although not common, the child may lose some deductions, such as itemized deductions for charitable contributions.

It is best to compare outcomes between including the child's income on the parents' return or having the child complete her own return and calculate the tax on Form 8615, *Tax for Certain Children Who Have Unearned Income*.

