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TAX in the News

Tax Information for Tax Practitioners

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TAX NEWS

IRS Technical Advice Explains Interplay Between $10,000 SALT Cap and Business Use of Home Deductions—A recent Program Manager Technical Advice provides guidance on how the TCJA limitation on state and local taxes works when a taxpayer allocates some real estate taxes to the business use of a dwelling unit. Taxpayers meeting certain criteria can increase the business deduction for real estate taxes by the difference between the $10,000 cap and state and local taxes actually deducted after the allocation. The PMTA provides examples illustrating this concept. Page 2

General Motors Reaches Plug-In Electric Vehicle Limitation; Phaseout Starts in April of 2019—General Motors's sales of qualified plug-in electric drive motor vehicles reached the 200,000-mark in the fourth quarter of 2018. Under the phaseout rules of §30D, taxpayers who purchase and place a vehicle in service during the second and third quarters of 2019 will be eligible for a 50% ($3,750) credit. For the fourth quarter of 2019 and first quarter of 2020 the credit is $1,875. Starting April 1, 2020, General Motors vehicles will no longer be eligible for the credit. Page 3

Allowable Living Standards Updated—An essential part of determining a taxpayer's eligibility for an offer in compromise is the process of calculating disposable income (gross income less allowable living expenses). These are amounts needed to cover a taxpayer's basic living expenses and ability to produce income. The IRS has updated allowable living expense tables with standard amounts that apply effective March 25, 2019. Page 3

QUESTION OF THE WEEK

After separating last year, a client and her husband agreed to file MFS and claim the standard deduction. He has contacted her to say he intends to amend his return and itemize deductions. Does that mean the client is required to amend her return and itemize deductions too? Will the IRS assess penalties and interest on the additional taxes she'll owe? Page 4

ORIGINAL INSIGHTS

Back to basics: U.S. taxes for international students— Learn more about the tax rules for international nonresident students on different visas. Full insight. View all insights at www.thetaxinstitute.com/insights/.

IRS TECHNICAL ADVICE EXPLAINS INTERPLAY BETWEEN $10,000 SALT CAP AND BUSINESS USE OF HOME DEDUCTIONS

An IRS Program Manager Technical Advice (PMTA 2019-001) provides additional guidance on the interplay between the $10,000 ($5,000 if MFS) limitation on state and local taxes and deductions for state and local taxes allocated to the business use of a dwelling unit.

Deductions for expenses connected with a dwelling unit used as the taxpayer's personal residence are generally disallowed under §280A(a). There are two exceptions to the general disallowance rule:

- §280A(b) allows taxpayers to claim an itemized deduction on Schedule A for taxes, mortgage interest, casualty losses, etc. connected to the taxpayer's personal residence. Taxes deducted under this exception are subject to the $10,000 SALT deduction limitation under §164(b)(6).
- §280A(c) allows taxpayers to claim business deductions for expenses connected to the business use of the taxpayer's residence, such as a home office, a home rented for part of the year, a daycare, etc. Expenses deducted under this code section are subject to the gross income from the trade or business limitation under §280A(c)(5).

The PMTA explains that the taxpayer can include the difference between the $10,000 limitation and the amount of taxes actually deducted on Schedule A as a business expense if a taxpayer:

1) allocates a portion of real estate taxes to business use, *and*
2) itemized deductions, *and*
3) has state and local tax deductions that are less than the $10,000 SALT cap.

The additional deduction is a §280A(b) deduction and thus not subject to the gross income limitation. The PMTA provides three examples of this principle.

Example 1. The taxpayer has $12,000 in real estate taxes and rents out his home for 1/3 of the year. $8,000 of the amount ($12,000 × 1/3) is allocated to itemized deductions and $4,000 is allocated to rental use of the home. The taxpayer also has $5,000 in state and local income taxes for total SALT paid of $13,000. The taxpayer itemizes deductions; his itemized deduction for SALT is limited to $10,000. If the taxpayer had not allocated the $4,000 to rental expenses, the taxpayer's SALT deduction would still have been $10,000 so the taxpayer does not get an additional §280A(b) deduction for real estate taxes allocated to the rental.

Example 2. Same facts as Example 1 except the taxpayer rents out his home for 2/3 of the year. Therefore, $4,000 of the amount ($12,000 × 2/3) is allocated to itemized deductions and $8,000 is allocated to rental use of the home. The taxpayer itemizes deductions; his itemized deduction for SALT is $9,000 ($4,000 real estate tax + $5,000 income tax), which is under the $10,000 limitation. If the taxpayer had not allocated the $8,000 to rental use, the taxpayer's SALT deductions would have been $10,000. The taxpayer may allocate the $1,000 difference ($10,000 allowed less $9,000 actual deduction) to business use of the home. This amount is not subject to the gross income limitation of §280A(c)(5).

Example 3. Same facts as Example 2 except that the taxpayer does not itemize deductions. Because the taxpayer is taking the standard deduction there is no excess amount to allocate to the business use of the taxpayer's home.

The intent here is for the taxpayer to not lose a deduction just because some of the real property tax is allocated to the business use of the taxpayer's home.

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- In Example 1, the taxpayer would get a $10,000 itemized SALT deduction whether or not there was any business use of the home.
- In Example 3, the taxpayer is claiming the standard deduction so the business allocation doesn't change anything.
- But in Example 2, the taxpayer would otherwise lose $1,000 of deductions if the $1,000 was not re-allocated to business use.

GENERAL MOTORS REACHES PLUG-IN ELECTRIC VEHICLE LIMITATION; PHASEOUT STARTS IN APRIL OF 2019

Taxpayers who purchase a qualified plug-in electric drive motor vehicle are eligible for a nonrefundable credit up to $7,500. The credit is claimed on Form 8936 *Qualified Plug-In Electric Drive Motor Vehicle Credit*.

The §30D credit phases out for a manufacturer's vehicles over a one-year period beginning with the second calendar quarter following the quarter in which 200,000 vehicles made by a manufacturer have been sold for use in the U.S. Vehicles acquired in the first two quarters of the phase-out period are eligible for 50% of the credit. The credit drops to 25% for vehicles purchased in the last two quarters. After that, the vehicle is not eligible for the credit.

According to IRS news release IR-2019-57 and Notice 2019-22, General Motors, Inc. reported that cumulative sales of qualified vehicles reached the 200,000 vehicle limit during the calendar quarter ending December 31, 2018. Therefore, the phase-out period for General Motors is April 1, 2019 through March 31, 2020. Taxpayers who purchased and placed a qualifying vehicle in service by March 31, 2019 are eligible for the full $7,500 credit. For the period April 1, 2019 through September 30, 2019 the credit is $3,750. For the period October 1, 2019 through March 31, 2020 the credit is $1,875.

General Motors vehicles will not be eligible for the credit starting April 1, 2020. Qualifying vehicles include the Chevrolet Volt (2011-2019) and Chevrolet Bolt (2017-2019). Go to the Index to Manufacturers for a full listing of General Motors's and other manufacturer's qualified vehicles.

ALLOWABLE LIVING STANDARDS UPDATED

Collection Financial Standards are used by the IRS to determine taxpayers' ability to repay tax debts for purposes of offers in compromise (OICs) and some types of installment agreements. To establish a repayment agreement, the IRS must first calculate the taxpayer's disposable income. In general, disposable income is equal to the taxpayer's gross income less allowable living expenses.

Allowable living expenses are expenses that are necessary to provide for the taxpayer's (and his or her family's) health and welfare and/or production of income, as determined by the IRS. Some expenses, such as food, are based on national standards. Taxpayers are allowed the total national standard amount for these items, regardless of what they actually spent. Other types of expenses, such as housing, are based on local standards. For each of these items, taxpayers are generally allowed the smaller of the local standard or the amount actually spent.

The IRS has updated the allowable living expense tables providing standard amounts that apply effective March 25, 2019. Applicable amounts are per month and also vary by family/household size. The higher an allowed expense, the less disposable income available to the taxpayer. Conversely, the lower an allowed expense, the more disposable income the taxpayer has and the harder it is to establish an OIC.

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National Standards: Food, Clothing and Other Items. Standards are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. The miscellaneous allowance may be used to cover substantiated amounts spent over the standard amounts and certain other expenses such as school supplies.

National Standards: Out-of-Pocket Healthcare. Standards are derived from Medical Expenditure Panel Survey data for out-of-pocket expenses for medical services, prescription drugs, and medical supplies. Per person monthly standard amounts are given for individuals under 65 and those 65 and older.

Local Standards: Housing and Utilities. Standards for each state down to the county level are derived from U.S. Census Bureau, American Community Survey, and BLS data. Expenses include mortgage, rent, property taxes, interest, insurance, maintenance and repairs, gas, electric, water, heating oil, telephone service (landline and cellular), cable TV, and internet.

Local Standards: Transportation. Standards are derived from Census Region and Metropolitan Statistical Area data for vehicle operating costs such as maintenance and repairs, insurance, fuel, license and registration, inspections, parking and tolls. An additional amount is added to allowable transportation expenses if the taxpayer has a loan or lease payment. *Note:* taxpayers who commute by public transportation may use a single nationwide allowance based on BLS data for mass transit fares.

Most installment agreements are streamlined agreements requiring little or no financial analysis or substantiation of expenses. However, taxpayers who don't qualify for streamlined agreements may find it difficult to determine disposable income using standard amounts. Based on facts and circumstances, the IRS may determine that standard amounts leave a taxpayer with inadequate means of providing basic living expenses. The taxpayer must be able to document that his or her actual allowable living expenses are higher than national and local standards. In some cases, a taxpayer may qualify for a "six-year rule" which allows for payment of living expenses over the standard amounts plus payment of other expenses such as student loans. The taxpayer does not have to substantiate reasonable expenses but must provide enough financial information to show the full tax liability, including penalties and interest, can be fully paid within six years.

QUESTION OF THE WEEK

Q. My client separated from her husband late in 2018. They did not divorce before the end of the year and neither one qualifies to file as head of household. They did agree, at least verbally, to file separate returns and to claim the standard deduction, which they both did. He just contacted her to say he intends to file an amended return and itemize deductions because it is more beneficial to him. She has very little to itemize, certainly nothing near the $12,000 MFS standard deduction. Is she required to amend her return and itemize? Will she have to pay penalty and interest on the additional tax?

A. Your client does not have to amend her return to itemize deductions if she does not want to and her husband's amended return will not be accepted.

Changes in the election to itemize deductions are covered under §63(e)(3). In general, a taxpayer may amend a return to switch from the standard deduction to itemizing deductions, or the other way around. However, if a married taxpayer files a separate return, the change is not allowed unless 1) the other spouse also changes her election, and 2) both spouses consent, *in writing*, to any additional taxes assessed.

In your client's situation, if she does not agree to amend her return to itemize deductions and pay any additional taxes due, her husband's amended return will not be allowed. Note that the same would hold true if they both had initially itemized deductions and one of them wished to switch to the standard deduction. See "Married persons who filed separate returns" on page 156 of IRS Pub. 17, *Your Federal Income Tax*.

