THE TAX INSTITUTE AT H&R BLOCK

# TAX in the News

Tax Information for Tax Practitioners

June 26, 2019

## TAX NEWS

**New Range of ITIN Renewals Underway**—The next round of ITIN renewals has started. One of the PATH Act compliance provisions calls for renewing ITINs that have not been used in the last three tax years. Also, ITINs issued before 2013 must be renewed on a rolling schedule. The IRS has issued guidance explaining the procedures that will apply to taxpayers with 83, 84, 85, 86, or 87 as the 4th and 5th digits of their ITINs (e.g. 9XX-83-XXXX, etc.). Unlike applications for new ITINs, renewals do not have to be submitted with tax returns. Page 2

**Disaster Relief: Ohio**—Parts of Ohio have been declared a major disaster area because of severe storms, straight-line winds, tornadoes, flooding, and landslides starting on May 27, 2019. Tax deadlines occurring on or after that date are generally postponed to September 30, 2019.

A casualty loss related to this disaster may be claimed on an original or amended 2018 return or on a 2019 return filed next tax season. However, it is not a qualified disaster loss and cannot be used to increase the standard deduction. A personal casualty loss from this disaster may be claimed as an itemized deduction on line 15 of Schedule A. Page 2

**SCOTUS Limits North Carolina's Ability to Tax Trust Income**—In *Kaestner* the Supreme Court ruled that North Carolina could not tax the income of an out-of-state trust simply because trust beneficiaries were North Carolina residents. This ruling is case specific and does *not* invalidate state laws regarding how a trust is taxed based on resident beneficiaries. The ability of a state to tax a trust depends in part on the terms of the trust, especially the relationship between the beneficiaries and the trust's assets. Page 3

**Farmers' and Fishers' Income Averaging Calculations Must Include Related QBID**—Taxpayers with income from a farming or fishing business have an opportunity each year to lower their tax liability by averaging some or all current year income from the business using tax rates from the previous three years. Schedule J is used for this purpose. The amount the taxpayer selects for income averaging is referred to as elected farm / fishing income, or EFI. According to a recent IRS instruction, taxpayers who claim the qualified business income deduction must take it into account when calculating EFI to the extent the QBID is attributable to their farming or fishing business. Page 4

## QUESTION OF THE WEEK

A client with a traditional IRA wants to do a rollover to an HSA. Is this type of transfer allowed and would it be taxable? How much can she roll over from the IRA to the HSA each year? Page 4

## FEATURED INSIGHTS

**Breaking down the TCJA: The future of personal casualty losses**—The TCJA suspended personal casualty and theft losses, except in federally declared disaster areas. Full insight. View all insights at www.thetaxinstitute.com/insights/.

## NEW RANGE OF ITIN RENEWALS UNDERWAY

In IR-2019-118, the IRS provides details on the next round of individual taxpayer identification number (ITIN) renewals. Under the PATH Act, ITINs that have not been used on a federal tax return at least once in the last three years will no longer be valid for use on a tax return unless renewed by the taxpayer. Also, taxpayers with ITINs issued prior to 2013 will need to renew their ITINs on a rolling renewal schedule.

**New renewal cycle**. Taxpayers with 83, 84, 85, 86, or 87 as the 4th and 5th digits of their ITINs (e.g. 9XX-83-XXXX) have ITINs that will expire December 31, 2019. The renewal period for these taxpayers began this June. Taxpayers will need to follow current Form W-7 documentation guidelines to demonstrate identity and foreign status. There is no requirement to submit a tax return with a renewal.

If taxpayers have an expired ITIN and don't renew *before* filing a tax return in TS20, they could face a refund delay until the ITIN is renewed. Taxpayers will continue to use the same ITIN after renewal.

The IRS plans to send letters to impacted taxpayers this summer and has increased staffing to handle the expected influx of renewal applications.

**Other taxpayers may need to renew their ITINs.** In addition to affected taxpayers in the current renewal group, there are two other groups of ITIN holders who may need to renew an ITIN so it will be in effect for returns filed in TS20:

- *Taxpayers with unused ITINs*. ITINs that have not been used on a federal tax return at least once in the last three tax years (here, 2016, 2017, or 2018) will no longer be valid for use on a tax return unless renewed by the taxpayer.
- *Taxpayers with previously expired ITINs that never renewed*. Taxpayers with 70 through 82 as the 4th and 5th digits of their ITINs have expired ITINs from earlier waves unless they already renewed.

Only ITIN holders who have a tax return filing requirement or who will be filing to request a refund need to renew their ITINs. Taxpayers who have an ITIN but are not required to file tax returns (such as taxpayers who use an ITIN for banking) do not have to renew. However, if they later need to file a return, they will need to renew at that time.

**Family renewal option available.** If any individual receives an ITIN renewal notice from the IRS, they can choose to renew the ITINs of all of their family members at the same time rather than renewing them separately over several years. Family members include the tax filer, the spouse and any dependents claimed on their tax return.

*Note.* Under the TCJA, some tax benefits, such as dependent exemptions, are not available 2018-2025. Family members who are not U.S. citizens or resident aliens and who are residing outside the U.S. need not renew if there is no tax benefit available. For example, a dependent child who is a citizen of Mexico and living in Mexico would not need to renew because the taxpayer cannot claim the child tax credit or other dependent credit for this child.

## DISASTER RELIEF—Ohio

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

Affected taxpayers have the option of claiming a casualty loss related to this disaster on their 2019 tax return filed next tax season or on an original or amended tax return for 2018. **Note:** this is *not* a qualified disaster loss and cannot be used to increase the standard deduction. A personal casualty loss related to this disaster may be claimed only as an itemized deduction on line 15 of Schedule A.

*(Continued on page 3)*

 

*(Continued from page 2)*

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

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.

**Ohio disaster:** severe storms, straight-line winds, tornadoes, flooding, and landslides starting on May 27, 2019

**FEMA** disaster declaration announcement: DR-4447 dated June 18, 2019

**IRS** release: OH-2019-01 dated June 19, 2019; check the link for future updates

**Covered disaster area (as of publication date)**: Auglaize, Darke, Greene, Hocking, Mercer, Miami, Montgomery, Muskingum, Perry, and Pickaway Counties.

**Postponement periods**: Tax returns and other time-sensitive acts due on or after May 27, 2019, and before September 30, 2019 are postponed until **September 30, 2019.** This includes quarterly estimated income taxes due June 17 and September 16, 2019, and employment and excise tax returns due July 31, 2019.

Employment and other excise tax deposits due on or after May 27, 2019, and before June 11, 2019, must have been deposited by June 11, 2019.

## SCOTUS LIMITS NORTH CAROLINA'S ABILITY TO TAX TRUST INCOME

**Court case:** Kimberly Rice Kaestner 1992 Family Trust v. N. C. Dep't of Revenue, No. 18-457 (U.S. Jun. 21, 2019)

The U.S. Supreme Court ruled that North Carolina could not tax the income of a trust set up and administered out-of-state solely because the trust has resident beneficiaries. In this case, the trust's income had not been distributed, the North Carolina beneficiaries had no right to demand that income, and they could potentially not receive any income at all.

As applied to the Kaestner Trust, the Court found that the North Carolina law violated the Due Process Clause, but it declined to invalidate all state income tax laws that impose tax on a trust based on the residence of the beneficiary. In other words, whether a state can tax a trust with a resident beneficiary depends on the relationship between that beneficiary and the trust's assets.

### Application

Since the ruling in this case is so specific to the facts at hand, it's unlikely to directly impact most state laws or require states to substantially modify their income tax codes. The states that could most likely see their tax codes affected are North Carolina (the statute at issue in this case) and California (which has a similar rule allowing it to tax trust income where there is a California resident beneficiary). Nonetheless, the ruling does place constitutional limits on the scope of the state's taxing power over the trust where there are sufficient barriers in place between the resident beneficiary of that trust and its income.

## FARMERS' AND FISHERS' INCOME AVERAGING CALCULATIONS MUST INCLUDE RELATED QBI DEDUCTION

The IRS has updated its instruction to farmers and fishers who calculate their income tax by averaging income from their farming or fishing trade or business and who claim the Qualified Business Income Deduction (QBID).

Famers and fishers may be able to lower their tax liability by electing to average some or all of their farming or fishing income using tax rates from the three previous tax years, referred to as "base years." Income averaging may be beneficial if the taxpayer's farming or fishing income is high and taxable income from one or more of the base years was low.

The election and calculations are reported on Schedule J, *Income Averaging for Farmers and Fishermen*. Specifically, elected farm / fishing income (EFI) is reported on line 2a of the form. EFI includes income, gains, losses, and deductions pertaining to the taxpayer's farming or fishing business. See the instructions to Schedule J for definitions of farming and fishing business activities and what items are included in EFI.

According to the IRS instruction, taxpayers who claim the QBID must take it into account when calculating the EFI amount entered on line 2a, but only to the extent that the QBID is attributable to the taxpayer's farming or fishing business. For example, if the taxpayer is claiming a QBID of $800, but only 25% of the QBID is attributable to a farming or fishing business, then the taxpayer would subtract $200 from the EFI calculation.

This instruction supersedes any previous release on the subject.

## QUESTION OF THE WEEK

**Q.** A client has a traditional IRA and would like to roll over some of the funds to an HSA. Can she make rollovers like this and, if so, would the rollovers be taxable (like a rollover to a Roth IRA)? How much can she move from her IRA to the HSA each year?

**A.** The type of rollover your client is referring to is called a "qualified HSA funding distribution." It is a one-time trustee-to-trustee transfer that can be made from a traditional or Roth IRA. It cannot be from a SEP or SIMPLE IRA if an employer is contributing to those accounts for the plan year. An HSA funding distribution is non-deductible and tax-free (unlike a Roth conversion) but there are many rules and requirements that your client must understand and follow.

*Initial eligibility*. Your client must be eligible to make HSA contributions in order to make a qualified HSA funding distribution. That is, she must be enrolled in a qualifying high-deductible health plan (HDHP) and not be enrolled in Medicare.

*Maximum distribution*. The maximum HSA funding distribution depends on:

- The type of HDHP coverage your client has in the month she makes the contribution
- Her age at the end of the year
- Whether other contributions have already been made or will be made for the year.

For example, if she has self-only HDHP coverage in 2019, she can make an HSA funding distribution of $3,500, or $4,500 if she will be at least age 55 on December 31, 2019. If she is planning to or has already made contributions to her HSA this year, the HSA funding distribution reduces the amount she can directly contribute (and vice versa).

*(Continued on page 5)*

 

*(Continued from page 4)*

*One lifetime distribution*. In general, a qualified HSA funding distribution can be made only once in a taxpayer's lifetime. If your client does not initially transfer the maximum possible HSA funding distribution, she cannot roll over the balance in a later month or year.

- *Exception*. If your client is enrolled in self-only HDHP coverage and later switches to family HDHP coverage in the same year, she can make an additional HSA funding distribution up to the family maximum for the year. The family maximum is $7,000 for 2019.

*Testing period*. Your client must remain HSA eligible during the testing period. For this purpose, the testing period runs from the month the contribution is made to the last day of the 12th month following that month. However, the "last month rule" that applies to other contributions does not apply to the HSA funding distribution testing period. A second 12-month testing period would apply to the incremental amount transferred if she makes a second distribution because she switches to family coverage.

Continuing with the example, if your client makes the HSA funding distribution during July of this year, she must remain eligible through June 30, 2020. If your client were to lose HDHP coverage and HSA eligibility before the testing period is up, the distribution would be included in income and subject to the 10% additional tax in the year the distribution is made.

A qualified HSA funding distribution provides an opportunity for taxpayers to add funds to an HSA without making an out-of-pocket contribution. Qualified HSA funding distributions are reported on line 10 of Form 8889, *Health Savings Accounts*. See "Qualified HSA funding distributions" in IRS Pub. 969, *Health Savings Accounts and Other Tax-Favored Health Plans*.