THE TAX INSTITUTE AT H&R BLOCK

TAX in the News

Tax Information for Tax Practitioners

August 14, 2019

Upcoming IRS webinar; 1 hour of CE--Ethical Guidelines for Tax Professionals Under Circular 230. Thursday, August 29 at 2:00 PM ET. Registration.

Click on the link to register. Contact the IRS at cl.sl.web.conference.team@irs.gov if you need assistance.

TAX NEWS

Private Letter Ruling Explains How the EIC Ban Applies When the Credit Is Partially Disallowed— An IRS private letter ruling advises that a taxpayer who knowingly claims the earned income credit (EIC) for a child who isn't her qualifying child risks losing the credit for future years even though she has other children who did qualify for the credit. If the IRS makes a final determination that the EIC claim was due to reckless or intentional disregard for the rules and regulations, the two-year ban applies to EIC claims for qualifying children too. Page 2

Partnerships Allowed to Make Post-Filing CPAR Corrections Under New IRS Procedures—The IRS has issued Rev. Proc. 2019-32 providing relief to partnerships that have timely filed their 2018 tax returns but still need to make corrections based on Centralized Partnership Audit Regime (CPAR) rules. Partnerships may file a superseding Form 1065 and furnish corresponding Schedule K-1s (Form 1065) to partners before the expiration of the extended deadline. Page 2

QUESTION OF THE WEEK

A client received Form 1099-DIV with amounts in several boxes, including nondividend distributions in box 3. Are nondividend distributions taxable? Where are they reported? Page 3

ORIGINAL INSIGHTS

Putting a Cap Back on the Salt Deduction—The IRS caps state-level SALT deduction limitation workarounds involving charitable donations in exchange for state tax credits. Full insight. View all insights at www.thetaxinstitute.com/insights/.

PRIVATE LETTER RULING EXPLAINS HOW THE EIC BAN APPLIES WHEN THE CREDIT IS PARTIALLY DISALLOWED

An IRS private letter ruling (PLR 201931008) explains that a taxpayer who knowingly claims the EIC for a child who is not her qualifying child risks losing the credit for future years despite having children who *are* her qualifying children for the credit.

Taxpayers who improperly claim the earned income credit may be subject to restrictions on claiming the credit.

- EIC claims will be disallowed for two years if the IRS makes a final determination that the EIC claim was due to reckless or intentional disregard for the rules and regulations.
- The disallowance period is 10 years if it is determined that the claim was due to fraud.

The PLR request involves a taxpayer who claims three children for the EIC, one of whom is disallowed. The taxpayer continues to claim that child for EIC in subsequent years, knowing that she is not entitled to do so. Could she still be subject to the two-year ban if she is entitled to the EIC for the other two children?

The response is "yes." The PLR explains that the IRS is not prohibited from imposing the EIC ban under §32(k)(1)(B)(ii) because of a partial disallowance. If a final determination is made that this taxpayer's improper claim for the one child was due to reckless and intentional disregard of the rules, the two-year ban applies for any EIC claim, even though the taxpayer's claim for the other two children was not improper, and even if the taxpayer would otherwise qualify for the childless EIC. Put another way, there is no partial ban of the EIC.

> **Note:** The disallowance period begins in the year after the year for which the final determination was made. After the disallowance period ends the taxpayer must complete Form 8862, *Information to Claim Certain Credits After Disallowance*, to claim the credit again. Under the PATH Act, restrictions may also apply to taxpayers who make reckless or fraudulent claims for the child tax credit and American opportunity credit.

PARTNERSHIPS ALLOWED TO MAKE POST-FILING CPAR CORRECTIONS UNDER NEW IRS PROCEDURES

The IRS has issued Rev. Proc. 2019-32 to provide relief to partnerships that have timely filed returns but need to make corrections because of Centralized Partnership Audit Regime (CPAR) rules.

New centralized audit procedures went into effect for tax years starting after December 31, 2017 (January 1, 2018 for calendar year partnerships). See TAX in the News January 10, 2018 for a discussion of the CPAR final regulations. Many partnerships filed a timely extension to allow sufficient time to ensure all the new rules were followed.

Partnerships that did *not* file an extension because they filed on or before the original due date, March 15, 2019, are facing a confusing problem if they subsequently discover an error on Form 1065. That is because the new rules prohibit partnerships from filing amended Schedule K-1s if the due date for the partnership return has passed and no extension has been filed. Many of these partnerships either made errors or omitted required information on previously issued Schedule K-1s and, under the CPAR rules, the only way to fix these errors if the deadline has passed is to file an Administrative Adjustment Request (AAR) asking the IRS to make the correction.

In order to provide some relief to impacted partnerships, Rev. Proc. 2019-32 provides a way to correct errors for a limited period of time. This new procedure allows partnerships that meet certain requirements to file a superseding Form 1065 and issue corresponding K-1s before the extension due date, September 16, 2019, without requesting an AAR.

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The requirements are as follows:

1. The partnership has not opted-out of the centralized audit procedures under §6221(b)
2. The partnership timely filed its 2018 Form 1065, and
3. All Schedule K-1s were timely issued to the partners.

If a partnership meets all the requirements, filing the superseding Form 1065 and corresponding Schedule K-1s is treated as a timely filed extension. The previously filed Form 1065 and K-1s are replaced for determining partnership related items. The partnership should write "*Superseding Form 1065 Pursuant to Revenue Procedure 2019-32*" at the top of the superseding return and file it by September 16, 2019 for calendar year partnerships (or the six-month extended due date for fiscal year partnerships).

To illustrate, ABC partnership filed its 2018 Form 1065 without opting out of the new audit procedures and issued Schedule K-1s to all its partners prior to March 15, 2019. On June 1, 2019 the Partnership Representative (PR) discovered that the 2018 K-1s contained errors and omitted certain information required under the CPAR rules. The partnership did not file an extension, so the PR cannot issue amended K-1s to fix the errors. Rather than going through AAR procedures, the PR can file a superseding Form 1065 and issue corresponding Schedule K-1s with the correct information by September 16, 2019. By doing so, ABC may avoid an audit in the future.

This new procedure is only available for partnership tax years that ended prior to the date the IRS issued Rev. Proc. 2019-32 and for which the extended due date for the partnership tax return is after July 25, 2019. Going forward, partnerships must follow the AAR procedures to fix errors after the due date for their return has passed.

QUESTION OF THE WEEK

Q. A client received Form 1099-DIV from a mutual fund showing amounts for ordinary and qualified dividends (boxes 1a and 1b), capital gain distributions (box 2a), and nondividend distributions (box 3). The nondividend distribution is about $5,000. Is this amount taxable? Where is it reported on the tax return? The client inherited the mutual fund from an aunt five years ago.

A. The nondividend distribution may be fully, partly, or nontaxable, depending on your client's basis in the mutual fund. Unlike ordinary dividends, nondividend distributions are *not* paid out of the earnings and profits of the company or fund. For the recipient, nondividend distributions represent a return of costs or capital. To the extent your client's basis in the mutual fund is at least $5,000, the distribution is not taxable and does not have to be reported.

Your client inherited the mutual fund, so her basis would be the value of the fund shares on the date of her aunt's death, assuming she hasn't purchased additional shares or reinvested dividends over the years. For example, if her basis in the fund is $8,000, the nondividend distributions reduce her basis to $3,000.

Once basis is reduced to $0, nondividend distributions represent capital gain. Continuing with the example, if your client again receives $5,000 nondividend distributions in a future year, $2,000 ($5,000 distribution - $3,000 remaining basis) would be taxable. When it is taxable, the nondividend distribution is reported on Form 8949, *Sales and Other Dispositions of Capital Assets*. Since this is an inherited security, the gain is long-term capital gain and is reported in Part II. Box F should be checked.

See "Nondividend Distributions" in IRS Pub. 550, *Investment Income and Expenses*, and the nondividend distribution discussion on page 4 of the instructions to Form 8949.