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INDIVIDUAL ISSUES

8

Issue 1: Child Tax Credit and Family Tax Credit . . . 236
Issue 2: Tax Issues of Divorce . . . 241
Issue 3: Settlements, Fines, and Penalties . . . 251
Issue 4: Disaster Tax Relief . . . 259
Issue 5: Choice of Filing Status . . . 266
Issue 6: Timeshares . . . 270
Issue 7: Standard or Itemized Deductions . . . 275
Appendix A: 2018 Form 1040, Schedule A . . . 285
Appendix B: 2019 Form 1098 . . . 286

LEARNING OBJECTIVES

After completing this session, participants will be able to do the following:

- ✔ Understand when a taxpayer can claim the child tax credit
- ✔ Understand when a taxpayer can claim the family tax credit
- ✔ Know the tax issues that apply to divorcing or divorced taxpayers
- ✔ Identify the taxable and nontaxable portion of a settlement
- ✔ Understand which penalties and fines may be deductible
- ✔ Explain disaster relief crowdfunding
- ✔ Know the tax relief that is available to a victim of a federally declared disaster
- ✔ Understand how the new law may impact a taxpayer's choice of filing status
- ✔ Report income and expenses for the rental of a timeshare, and gain or loss on the sale of a timeshare
- ✔ Know which deductions are allowed on Schedule A (Form 1040)
- ✔ Help a taxpayer who does not itemize deductions to still benefit from Schedule A (Form 1040)–type deductions

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INTRODUCTION

The Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, expands the child tax credit and creates a new family tax credit for dependents of the taxpayer who do not qualify for the child tax credit. This chapter explains the criteria for claiming the child tax credit and the new family tax credit. This chapter also reviews tax considerations for spouses who are divorcing or divorced, including filing status; allocation of losses, deductions, and credits; and planning with the repeal of the alimony deduction.

The TCJA denies a deduction for settlements based on sexual harassment or sexual abuse (if the settlement is subject to a nondisclosure agreement) and denies a deduction for government penalties and fines. This chapter discusses the taxation of settlements that the taxpayer receives and the deductibility of fines and penalties that the taxpayer pays.

This chapter reviews the tax consequences of disaster relief crowdfunding and recent changes to the rules for personal casualty loss deductions. It also explains new disaster tax relief provisions for victims of hurricanes Harvey, Irma, and Maria; for the victims of the California wildfires; and for victims of other 2018 federally declared disasters.

The TCJA changes tax rates and certain deductions. This section reviews how those changes affect a taxpayer's choice of filing status.

A taxpayer who owns a timeshare may have unique tax issues because of the fractional form of ownership and because timeshares may be used in part for personal purposes, and in part for rental purposes. This chapter reviews deductions for timeshare expenses, limitations on timeshare losses, and the tax consequences of a disposition of a timeshare.

Finally, this chapter reviews the changes to the deductions allowed on Schedule A (Form 1040), Itemized Deductions. With the increased standard deduction and the new limit on the deduction for state and local taxes, many taxpayers will no longer itemize deductions. This chapter explains some ways that a taxpayer who claims the standard deduction can still benefit from deductions that would have been claimed on Schedule A (Form 1040).

ISSUE 1: CHILD TAX CREDIT AND FAMILY TAX CREDIT

The child tax credit is expanded and increased for tax years 2018 through 2025, and there is a new family tax credit.

The Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, changed and expanded the child tax credit (CTC) for tax years 2018 through 2025. The previous CTC was $1,000 for each qualifying child. The additional child tax credit (ACTC) made a portion of the CTC refundable. The new CTC is $2,000 for each qualifying child. Up to $1,400 (indexed for inflation in tax years after 2018) is refundable. The new law also increases the income limits to qualify for the CTC, decreases the earned income threshold for calculating the refundable portion of the CTC, and creates a new family tax credit for dependents.

Qualifying for the CTC

To claim the I.R.C. § 24 CTC, the taxpayer must have a qualifying child. Special rules apply if the child is the qualifying child of more than one taxpayer. The taxpayer's modified adjusted gross income (MAGI) must be below the phaseout threshold, and the taxpayer must meet an earned income test. The qualifying child must have a social security number (SSN).

CROSS-REFERENCE

Due Diligence

I.R.C. § 6695(g) requires a return preparer to exercise due diligence in claiming the CTC (and the earned income credit, American opportunity tax credit, and head of household status). The preparer must properly complete and submit Form 8867, Paid Preparer's Due Diligence Checklist. See the "Ethics" chapter in this book for additional information about the due diligence requirements.

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Qualifying Child

The definition of a qualifying child has not changed. A qualifying child is a child of the taxpayer who is under age 17 and meets the I.R.C. § 152(c) requirements for a dependent. The child must meet a relationship, residence, age, and support test. The child cannot file a joint return (other than a claim for a refund) with his or her spouse.

Relationship

The child must be the taxpayer's child, foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of one of these relatives. A legally adopted child is treated as the taxpayer's own child. An eligible foster child must be placed with the taxpayer by an authorized placement agency, or by court order.

Residence

The child must live with the taxpayer for more than one-half of the year. There are exceptions for divorced or separated parents (discussed later) or special circumstances such as birth, death, kidnapping, or temporary absence. The child must be a US citizen, US national, or US resident.

Age

The child must be under 17 at the end of the year.

Example 8.1 Age Test

Nicole Parker's son Matthew turned 17 on December 30, 2017. He is a citizen of the United States, and Nicole claimed him as a dependent on her return. Matthew is not a qualifying child for the CTC because he was not under age 17 at the end of 2017.

Support

The taxpayer must provide over one-half of the individual's support during the year. Special rules apply to the child of divorced or separated parents (discussed later). Over one-half of the support of an individual is treated as received from the taxpayer if

1. no one person contributed over one-half of the support;
2. over one-half of the support was received from two or more persons each of whom, but for the fact that any such person alone did not contribute over one-half of such support, would have been entitled to claim the individual as a dependent;
3. the taxpayer contributed over 10% of the support; and
4. each person (other than the taxpayer) who contributed over 10% of the support files a written declaration stating that the person will not claim the individual as a dependent.

Qualifying Child of More Than One Person

If the child is the qualifying child of more than one taxpayer, then the tiebreaker rules determine who can claim the CTC. Under the tiebreaker rules, the child is generally treated as a qualifying child of

- the parents if they file a joint return;
- the parent, if only one of the persons is the child's parent;
- the parent with whom the child lived the longest during the tax year; or
- the parent with the highest adjusted gross income (AGI) if the child lived with each parent for the same amount of time during the tax year.

Release of the CTC

A parent who is eligible to claim the CTC can release the CTC to the other parent if

1. the child receives over one-half of the child's support during the calendar year from the child's parents;
2. the parents are divorced or legally separated under a decree of divorce or separate maintenance, are separated under a written separation agreement, or live apart at all times during the last 6 months of the calendar year;
3. the child is in the custody of one or both of the child's parents for more than one-half of the calendar year; and
4. the parent who has the right to claim the CTC releases the right to claim the CTC to the nonqualifying parent using Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent, or a statement like Form 8332.

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PRACTITIONER NOTE

Pre-2009 Divorce Agreement

If the taxpayer has a divorce decree that went into effect after 1985 and before 2009, and the decree states that the noncustodial parent can claim the child as a dependent, the noncustodial parent can attach the pertinent pages of the divorce decree to the tax return instead of Form 8332.

To release the right to claim the CTC for a child, the parent entitled to claim the credit must complete Part I of Form 8332. The noncustodial parent must file a copy of the form with his or her tax return. If the taxpayer releases the claim for one or more future tax years, he or she completes Part II of Form 8332, and the noncustodial parent must attach a copy to each tax return on which he or she claims the CTC.

Revocation of Release

The taxpayer completes Part III of Form 8332 to revoke a previous release. The revocation is effective no earlier than the tax year following the year in which the taxpayer provides the noncustodial parent with a copy of the revocation or makes a reasonable effort to provide the noncustodial parent with a copy of the revocation. In addition, the taxpayer must attach a copy of the revocation to his or her tax return each year that he or she claims the CTC because of the revocation.

PRACTITIONER NOTE

Release of Claims

When the qualifying parent releases the right to claim the child for the tax year, that parent releases the dependency exemption (in years when the dependency exemption is allowed), the CTC, and education credits. The qualifying parent that released the claim still has the right to claim head of household status, the earned income credit, the credit for child and dependent care expenses, and the exclusion for dependent care expenses.

Example 8.2 Releasing the CTC

Mary and Matt Jones were divorced in 2018. They have one child together, Jack (age 12), who lives with Mary. All are US citizens and have SSNs. Mary and Matt provide more than half of Jack's support. Mary's AGI is $31,000, and Matt's AGI is $39,000. Matt, the noncustodial parent, can claim the CTC only if Mary completes and signs Form 8332. If Mary qualifies, she can still claim the earned income credit, head of household status, and the child and dependent care credit for Jack. Their Form 8332, Part I, is shown in **Figure 8.1**.

FIGURE 8.1 Form 8332 for Mary and Matt Jones

Form **8332** (Rev. January 2010) Department of the Treasury Internal Revenue Service

Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent

► Attach a separate form for each child.

OMB No. 1545-0074 Attachment Sequence No. **115**

Name of noncustodial parent: Matt Jones | Noncustodial parent's social security number (SSN) ► 000 00 0000

Part I Release of Claim to Exemption for Current Year

I agree not to claim an exemption for Jack Jones (Name of child) for the tax year 2018.

Mary Jones — Signature of custodial parent releasing claim to exemption | 000 00 0000 — Custodial parent's SSN | 1-1-2018 — Date

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For tax years 2018 through 2025, the TCJA increases the income limit for the CTC to $400,000 MAGI for married filing jointly filers, and to $200,000 MAGI for all other filers. The CTC is reduced by $50 for every $1,000, or part of $1,000, that the taxpayer's MAGI exceeds the limit. Thus, the credit is fully phased out at $440,000 of MAGI for married filing jointly filers with one child, and at $240,000 of MAGI for all other filers with one child. MAGI is AGI increased by any amount excluded from gross income under I.R.C. § 911 (foreign earned income exclusion), I.R.C. § 931 (excluded income from Guam, American Samoa, and the Northern Mariana Islands), or I.R.C. § 933 (excluded income from Puerto Rico).

Example 8.3 CTC Income Limit

Mike and Melissa James file a joint tax return, and their MAGI is $400,001. Their daughter, Jennifer, lived with them all year and was age 16 at the end of the tax year. Jennifer is a US citizen, and Mike and Melissa provided all her support. In 2018, Mike and Melissa can claim a $1,950 ($2,000 − $50) CTC.

Identification Requirement

To claim the CTC, the qualifying child must have an SSN that was issued on or before the due date of the return. The taxpayer cannot claim the CTC using an individual taxpayer identification number (ITIN) or adoption taxpayer identification number (ATIN). However, the taxpayer can claim the new family credit using an ITIN or ATIN (discussed later).

Refundable Part of the CTC

If the taxpayer qualifies for the $2,000 CTC and has at least $2,000 tax due, then there is no limit on the CTC. However, if the taxpayer owes less than $2,000 of tax, the CTC will be limited by the tax due or the refundable part of the CTC. The refundable part of the CTC is a maximum $1,400 per qualifying child (indexed for inflation in tax years after 2018). For taxpayers with one or two qualifying children, the refundable part of the CTC is calculated as a percentage of earned income. For taxpayers with 3 or more qualifying children, there is an alternate calculation.

One or Two Children

The taxpayer can claim a refundable credit of 15% of the taxpayer's earned income that exceeds $2,500, up to a maximum of $1,400 per child. Thus, if there is no tax due, the taxpayer must have at least $11,833 [($1,400 ÷ 15%) + $2,500] of earned income to qualify for the full CTC. The taxpayer claims the refundable part of the CTC on the same line on his or her income tax return as the nonrefundable part of the CTC.

Example 8.4 Refundable Credit Not Allowed

In 2018, Lisa Jensen is eligible to claim the CTC for her daughter, Lilah. Lisa has $2,500 of earned income and no tax due. Lisa cannot claim any CTC because her earned income does not exceed the $2,500 threshold.

Example 8.5 Refundable Credit Partially Allowed

In 2018, Frank Frandsen is eligible to claim the CTC for his daughter, Mackenzie. Frank has $5,100 of earned income and no tax due. Frank's refundable part of the CTC is $390 [($5,100 − $2,500) × 15%].

Example 8.6 Refundable Credit Fully Allowed

In 2018, Sarah Nelson is eligible to claim the CTC for her son, Brett. Sarah has $20,000 earned income and no tax due. Sarah can claim the full $1,400 of the refundable part of the CTC because her $2,625 [($20,000 − $2,500) × 15%] earned income limit exceeds the maximum $1,400 credit. If instead Sarah had two qualifying children, her refundable CTC would be limited to $2,625.

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Three or More Children

Families with three or more children can use an alternate formula to determine the refundable part of the CTC, if it results in a larger credit. Under the alternate formula, the refundable part of the CTC is the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (EIC). Under the TCJA, the same alternative formula described above may be used by taxpayers with three or more qualifying children to determine the refundable portion of the CTC. Thus, if the taxpayer paid social security taxes (or one-half the social security component of self-employment tax) that exceeds the EIC, the taxpayer can claim the excess as the refundable portion of the CTC, up to $1,400 per qualifying child.

Family Tax Credit

The new family tax credit (FTC) is a $500 credit for any person who qualifies as a dependent but is not eligible for the CTC. The FTC is not refundable. Unlike the CTC, the taxpayer can claim the FTC if the dependent has an ITIN or ATIN. To qualify as a dependent, the person must be a qualifying child or a qualifying relative.

Qualifying Child

A qualifying child must meet the tests for a qualifying child to claim the CTC (discussed earlier). However, the child must be under age 19 at the end of the tax year, or a full-time student who is under age 24 at the end of the tax year. Thus, the taxpayer can claim the FTC for a qualifying child who does not qualify for the CTC because he or she does not have an SSN, or because he or she is age 17 or 18 (or age 19 through 23 and a full-time student).

Qualifying Relative

A qualifying relative is any of the following with regard to the taxpayer:

1. A child or a descendant of a child
2. A brother, sister, stepbrother, or stepsister
3. The father or mother, or an ancestor of either
4. A stepfather or stepmother
5. A son or daughter of a brother or sister of the taxpayer
6. A brother or sister of the father or mother of the taxpayer
7. A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
8. An individual (other than an individual who at any time during the tax year was the spouse of the taxpayer) who had the same principal residence as the taxpayer and is a member of the taxpayer's household

The qualifying relative's gross income must be less than the exemption amount, the taxpayer must provide over one-half of the individual's support, and the qualifying relative cannot be the qualifying child of the taxpayer or any other taxpayer.

PRACTITIONER NOTE

Canada and Mexico

Generally, a dependent does not include an individual who is not a citizen or national of the United States unless such individual is a resident of the United States or a country contiguous to the United States. The FTC does not apply to a dependent who is a resident of Canada or Mexico if the dependent is not a US citizen or a US national.

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ISSUE 2: TAX ISSUES OF DIVORCE

This section discusses tax considerations for taxpayers who are divorcing or divorced.

The repeal of the alimony deduction and personal exemptions will impact some of the decisions that divorcing spouses must make. This chapter addresses the tax consequences of divorce and provides guidance for practitioners who are asked to advise divorcing or divorced clients.

CROSS-REFERENCE

Conflict of Interest

Representation of spouses who are divorced or separated may create a conflict of interest. Similarly, representation of one spouse may create a conflict of interest if the tax practitioner formerly represented both spouses. See the discussion of conflicts of interest on pages 13–15 of the *2016 National Income Tax Workbook*.

Filing Status

When spouses are in the process of getting a divorce, they often are still married for tax purposes at the end of the year. Whether a couple is married depends on the laws of the state of residence, and spouses in the process of a divorce are still considered married until the date the divorce is final.

For federal tax purposes, the marriage of a same-sex couple is treated the same as the marriage of a man to a woman. However, individuals who have entered into a registered domestic partnership, civil union, or other similar relationship that is not considered a marriage under state law are not considered married for federal tax purposes.

Spouses who are still married on December 31 can file married filing jointly (MFJ) or married filing separately (MFS). In some cases, one of the spouses can file as head of household (HoH).

Married Filing Jointly

Spouses who are not yet divorced can file their taxes as MFJ. Both spouses must agree to file a joint return, and typically both spouses must sign the return. Spouses who file a joint return will be jointly and individually responsible for the tax on the return (including any interest or penalties). Thus, one spouse may be liable for the full amount of the taxes owed, even if he or she had no income.

CROSS-REFERENCE

Innocent/Injured Spouse

See the "Tax Practice" chapter in this book for a discussion of relief from a joint liability (innocent spouse relief) and how to apply for relief when one spouse's refund is applied to the other spouse's liability (injured spouse relief).

Married Filing Separately

Married spouses can file their taxes as MFS. Each spouse is liable for the tax due on his or her return. Generally, taxpayers who file MFS will incur more taxes because of the following:

1. The tax rate generally is higher than it would be on a joint return.
2. The exemption amount for figuring the alternative minimum tax is half of that allowed on a joint return.
3. The taxpayer cannot take the credit for child and dependent care expenses in most cases, and the amount he or she can exclude from income under an employer's dependent care assistance program is limited to $2,500 (instead of $5,000 on a joint return).
4. The taxpayer cannot take the earned income credit.
5. The taxpayer cannot take the exclusion or credit for adoption expenses in most cases.
6. The taxpayer cannot exclude the interest from qualified savings bonds used for higher education expenses.
7. If the spouses lived together at any time during the tax year, they must include in income a higher percentage (up to 85%) of any social security benefits.
8. The phaseout level for certain credits and deductions is half the level for a joint return.

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9. The capital loss deduction limit is $1,500 (instead of $3,000 on a joint return).
10. If the spouses claim the standard deduction, each spouse's deduction is half the amount allowed on a joint return.
11. The taxpayer cannot take the American opportunity and lifetime learning credits.
12. The taxpayer cannot deduct student loan interest.

Head of Household

A married taxpayer may file as HoH if the spouses are considered unmarried on the last day of the year. See the later discussion of the choice of filing status for the requirements to file as HoH.

Allocation of Losses

For net operating losses (NOLs) arising in tax years ending after December 31, 2017 (with limited exceptions), taxpayers cannot carry back an NOL but can carry it forward indefinitely. If an NOL arises in a year when a joint return was filed and is carried to separate returns, I.R.C. § 172 requires allocation of the NOL carryover to the spouse whose loss or deduction items created the NOL. Similarly, capital loss carryforwards are allocated based on the separate capital gains and losses of each spouse.

Example 8.7 Capital Loss Carryforward

Sylvia and Frank Harris were divorced in July 2018. They have a $45,000 capital loss carryforward for 2018. The loss originated as a $63,000 loss 3 years ago when Sylvia liquidated her stock investment account. Because it originated with an asset owned solely by Sylvia, only Sylvia can use the remaining carryforward.

Allocation of Itemized Deductions

If married individuals file separate returns, both must itemize deductions or both must claim the standard deduction. However, a spouse who is considered unmarried and files as HoH can choose to itemize deductions or claim the standard deduction, regardless of how his or her spouse files. If divorcing spouses file MFS, and they choose to itemize deductions, they must allocate those deductions between them. This section discusses allocation of the deductions for medical expenses and for home mortgage interest.

Medical Expenses

A child of divorced or separated parents can be treated as a dependent of both parents solely for the medical expense deduction. One or both parents must have custody of the child for more than half the year, and one or both parents must provide more than half the child's support. If these conditions are met, each parent can include the child's qualifying medical expense that he or she paid on Schedule A (Form 1040), Itemized Deductions. If the expenses are paid with funds deposited in a joint checking account in which both spouses have an equal interest, they can each claim one-half of the expenses, unless they can show that one spouse paid more than the other.

Example 8.8 Medical Expenses

Henry and Wilma Wabash were divorced in 2016. Their son, Herman, resides primarily with Henry, and Henry claims the child tax credit and earned income credit for Herman. In 2018, Wilma paid $6,000 for Herman's braces and other dental and medical expenses. Wilma may include the $6,000 she paid as part of her medical expenses on Schedule A (Form 1040), Itemized Deductions.

Home Mortgage Interest

For tax years 2018 through 2025, home mortgage interest may be deductible on Schedule A (Form 1040) if the collateral is either the taxpayer's main home or a second residence. The deduction for the two homes combined is limited to the interest allocable to $750,000 of acquisition, construction, or substantial improvement indebtedness ($375,000 for MFS).

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CROSS-REFERENCE

Grandfathered Loans

Special rules apply to certain loans that were incurred on or before December 15, 2018, and certain contracts that were entered into before that date. See the "New Legislation—Individual" chapter in this book for additional information.

A taxpayer does not have to live in a home to treat it as a second home if it is not held out for rental or resale to others. A home occupied by a member of the taxpayer's family or anyone who is not paying a fair rent can qualify as the taxpayer's second home [Temp. Treas. Reg. § 1.163-10T(p)(3)]. If one spouse moves out of the family residence and is making mortgage payments, he or she may still be able to deduct the mortgage interest under the second-home provisions.

Example 8.9 Deductible Mortgage Interest

While James and Margie Kahn were in the process of getting a divorce, James moved out of the house and into an apartment. Margie continued to live alone in the family home. They owned no other homes. James still had a joint interest in the home and was liable on the mortgage, which the court ordered that he continue to pay in full. Although the house was no longer James's principal residence, he could treat it as his second home and deduct the qualifying home mortgage interest.

Charitable Contribution Deduction

The deduction for charitable contributions on Schedule A (Form 1040), Itemized Deductions, is limited to a percentage of AGI without any NOL carryback. Excess charitable contributions may be carried forward for up to 5 years. A charitable contribution carryover from a joint return is divided between the spouses using a ratio based on the separate carryforwards that would exist if the spouses had filed separate returns for the contribution year [Treas. Reg. § 1.170A-10(d)(4)].

The spouses calculate the allowable limit for each spouse on a separate return for the year the contribution was made. They then allocate the total carryover based on the separate contributions and apply the same ratio to the carryover in the first separate return year.

Example 8.10 Charitable Contribution Carryover

Judy and Jim Barth filed a joint return in 2016. Jim's uncle had died leaving them with a large inheritance. They made $110,000 of charitable contributions and had a $100,000 AGI. All the contributions were to 50% organizations, so they deducted $50,000 ($100,000 × 50%) of the contributions and had a $60,000 ($110,000 – $50,000) carryover. They used $20,000 of the carryover on their 2017 joint return, and still had a $40,000 ($60,000 – $20,000) carryover to 2018, when they are filing separate returns.

For 2016, Jim's AGI on a separate return would have been $60,000, and Judy's AGI would have been $40,000. Their separate charitable deduction limits would have been $30,000 ($60,000 × 50%) and $20,000 ($40,000 × 50%), respectively. Jim's 2016 charitable contributions (his separate contributions and one-half of their joint contributions) were $36,000, and Judy's were $74,000. Therefore, Jim would have had a $6,000 ($36,000 – $30,000) carryover and Judy would have had a $54,000 ($74,000 – $20,000) carryover if they had filed separate returns in 2016. Jim's portion of the total $60,000 carryover would have been 10% ($6,000 ÷ $60,000), and Judy's portion would have been 90% ($54,000 ÷ $60,000).

This establishes the ratio used to divide the joint carryover when they file separate returns in 2018. In 2018, Jim is entitled to $4,000 ($40,000 × 10%) of the remaining carryover from 2017, and Judy is entitled to $36,000 ($40,000 × 90%) of this amount.

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Allocation of Credits

Divorcing and divorced spouses must allocate exemptions and credits.

PRACTITIONER NOTE

Exemptions Suspended

For tax years 2018–2026, the TCJA suspends the personal and dependency exemptions. However, the suspension of the deduction does not alter the operation of other provisions of the Internal Revenue Code that refer to a taxpayer allowed a deduction for personal exemptions or dependency exemptions.

Under former law, if a child was a qualifying child for both parents, the custodial parent was entitled to the dependency exemption. However, parents could allocate the exemption deductions for their children in a divorce decree, a separate maintenance decree, or a written separation agreement, regardless of which parent had physical custody of the child [I.R.C. § 152(e)(2)]. This allocation is valid if the custodial parent signs an unconditional written declaration (generally on Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent) that he or she will not claim the child as a dependent for the tax year and if all three of the following criteria are met:

1. The parents are divorced or legally separated under a decree of divorce or separate maintenance, are separated under a written separation agreement, or lived apart at all times during the last 6 months of the year.
2. The parents provided more than half of the child's support for the year.
3. One or both parents had physical custody of the child for more than half the year.

If a child is treated as the qualifying child of the noncustodial parent under these rules, only the noncustodial parent can claim the exemption (in years when the exemption is allowed) and the child tax credit for the child.

However, the custodial parent, if eligible, can claim the child as a qualifying child for HoH filing status, the credit for child and dependent care expenses, the exclusion for dependent care benefits, and the earned income credit. If the child is the qualifying child of more than one person for those tax benefits, the tiebreaker rules determine which person can treat the child as a qualifying child. See the earlier discussion (in Issue 1) of the child tax credit, the definition of a qualifying child, and the tiebreaker rules.

PRACTITIONER NOTE

Premium Tax Credit

For tax years after 2018, the TCJA eliminates the individual shared responsibility payment, and there is no penalty for individuals who fail to maintain minimum essential coverage. However, if the taxpayers purchase health insurance coverage through the health insurance marketplace, they may get advance payments of the premium tax credit. The taxpayers must report a change in marital status, as it may affect the amount of the credit.

Allocation of Estimated Tax Payments

The IRS allows spouses to allocate joint estimated tax payments. They can be credited as made on behalf of just one spouse or divided in any way the spouses agree. To allocate payments, the spouses should each write "DIV" on line 66 of Schedule 5 (Form 1040), Other Payments and Refundable Credits, and attach a statement to the return that explains the allocation. If the spouses cannot agree on an allocation, the IRS allocates the payments based on the spouses' separate tax liabilities [Treas. Reg. § 1.6654-2(e)(5)(ii)].

Example 8.11 Allocation of Estimated Tax Payments

Joy and Pat Meyers made $9,000 of joint estimated tax payments for 2018. They separated on September 15, 2018, filed for divorce on October 1, and filed separate returns for 2018. Joy and Pat cannot agree on a division of the estimated tax payments. Joy's separate return shows $6,000 of income tax and $4,000 of self-employment (SE) tax, for a $10,000 total. She has no withholding. Pat's separate return shows $5,000 of income tax with $5,500 of withholding. Because Joy's tax liability is two-thirds ($10,000 ÷ $15,000) of the total liability, she is credited with $6,000

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(⅔ × $9,000) of the estimated tax payments and Pat is credited with $3,000 (⅓ × $9,000). Joy owes $4,000 ($10,000 − $6,000), and Pat receives a $3,500 ($5,000 − $5,500 − $3,000) refund.

PLANNING POINTER

Withholding and Estimated Tax

If spouses divorce during the year, they should review their withholding to ensure that they do not receive an estimated tax penalty. See the "Payroll and Estimated Tax" chapter in this book for additional details about calculating withholding and estimated tax payments.

Allocation of a Refund

If the spouses do not agree on division of an overpayment, the IRS allocates it proportionally to the amount of overpayment each spouse actually generated. Rev. Rul. 80-7, 1980-1 C.B. 296, provides the following formula for calculating the portion of the tax and overpayment that is attributable to each spouse:

1. Calculate each spouse's tax on a separate return.
2. Divide each spouse's tax calculated in step 1 by the total of the separate taxes.
3. Multiply the spouse's allocation percentage from step 2 by the actual liability on the joint return.
4. Subtract the step 3 tax liability calculation from the spouse's withholding and share of estimated tax payments.

PLANNING POINTER

Settlement Agreement

The marital settlement agreement or divorce decree should address the overpayment on a current-year joint return, and the allocation of any prior-year overpayment if there is an audit or a refund created by a carryback. The document may also state which spouse will be responsible for dealing with the IRS. However, an agreement does not override any provision of federal law that requires a specific allocation or holds both spouses liable for tax.

In the past, the IRS issued only one refund check or made one direct deposit for a joint return. I.R.M. § 21.4.3.5.5.2.1 provides that if a taxpayer returns a check payable to joint payees with a copy of the divorce decree dictating how the refund should be allocated, separate checks can be issued to each spouse. Form 8888, Allocation of Refund (Including Savings Bond Purchases), allows a direct deposit to be allocated to as many as three different financial accounts.

Child Support

Child support paid is not deductible, and child support received is not taxable. Child support amounts are typically identified in the divorce or separation agreement, but federal tax law may deem other required payments to be child support. Payments are treated as child support if they will be reduced or eliminated because of a contingency event that relates to the child, or if they will be reduced at a time that is clearly associated with a contingency relating to the child. Such events include a child reaching a specific age, reaching a specified level of income, dying, marrying, graduating from school, living on his or her own, or accepting full-time employment [Treas. Reg. § 1.71-1T(c), Q&A-17].

A rebuttable presumption that payments are child support is established if either a 6-month rule or a multiple reduction rule applies. The 6-month rule applies if payments are to be reduced not more than 6 months before or after the date the child is to reach age 18, 21, or the local age of majority.

The multiple reduction rule applies if the payments are to be reduced on two or more occasions that occur not more than 1 year before or after different children attain a specified age between the ages of 18 and 24, inclusive [Treas. Reg. § 1.71-1T(c), Q&A-18]. The age must be the same for each child.

Example 8.12 Deemed Child Support

Hiram and Milly Pine have one child, Charlie. Their 2012 divorce decree requires Hiram to pay Milly $6,000 each month, and the entire amount is designated as alimony. However, beginning on January 1, 2017, the payment will be reduced to $2,000 per month. Charlie was born January

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13, 1999, and he will be 18 within 6 months of the date that the payments are scheduled to be reduced. Unless Hiram can successfully rebut the 6-month rule, $4,000 of the monthly payments will be treated as child support.

Alimony

For divorce or separation decrees executed on or before December 31, 2018, the payer spouse can deduct alimony paid to or for a spouse or former spouse, regardless of whether he or she itemizes deductions. The payee spouse includes the alimony in his or her income in the year it is received.

PRACTITIONER NOTE

Estimated Taxes—Alimony

Alimony is not subject to tax withholding, so the payee spouse who receives taxable alimony may have to make estimated tax payments to avoid a penalty. Alternatively, the payee spouse can increase the amount of tax withheld from his or her wages. See the "Payroll and Estimated Tax" chapter in this book for additional information.

For divorce or separation decrees executed after December 31, 2018 (and earlier decrees that are modified after 2018 to adopt the new rules), the I.R.C. § 215 deduction for alimony payments is eliminated and the corresponding I.R.C. §§ 61(a)(8), 71, and 682 inclusions of alimony in gross income are eliminated. Thus, income used for alimony payments is taxed at the rates applicable to the payer spouse rather than the payee spouse, and the payee spouse does not have to include alimony in his or her income.

Qualifying Payments

For a payment to qualify as alimony, it must be in cash, and made pursuant to a divorce or separation agreement. It cannot be designated as not alimony. With some exceptions (discussed later), the payer and the payee spouse must reside in separate households. The payer and payee spouses cannot file a joint tax return, and the payments must end upon the death of the payee spouse.

Cash Payment

Only cash payments are treated as alimony. Cash includes currency, personal checks, money orders, and electronic transfers, but it does not include transfers of services or property, the use of property, or debt instruments. Cash payments made to a third party at the request of the payee spouse may qualify, as explained later.

Divorce or Separation Instrument

Only legally enforceable payments that are required by a decree of divorce, a legal separation agreement, a written separation agreement, or a decree of support qualify as alimony. Voluntary payments are not alimony. Changes to a decree can be made only by judicial modification after a court hearing.

Example 8.13 Voluntary Payment Not Alimony

Ella and Tom Peterson were married for 20 years and were divorced in 2017. Ella's earnings have recently increased considerably. Realizing that Tom was having a difficult time financially, Ella offered to increase the alimony payments to Tom by $500 per month. Tom is willing to include the additional amount in his income, but unless they obtain a court order, Ella cannot deduct the additional payment and it is not taxable to Tom.

Not Designated as Not Alimony

A couple may jointly decide that payments that would otherwise qualify as alimony should not be treated as alimony for tax purposes. This can be accomplished by including a provision in the divorce decree or separation agreement that specifically states that the amount to be paid is not alimony. For divorce or separation decrees before 2019, the parties can stipulate that payments are not deductible as alimony by the payer spouse and are excluded from the payee spouse's income.

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OBSERVATION

2019 Divorce Decrees

For divorce decrees entered into before January 1, 2019, the parties could reverse the alimony rules by stating that payments were not alimony. After that date, the TCJA eliminates the deduction for alimony and the mandatory inclusion of alimony in the income of the payee spouse. Thus, for a divorce decree entered into after December 31, 2018, if the parties stipulate that a payment is not alimony, there is still no deduction for the payer spouse, and the payment is still not included in the payee spouse's income.

If the agreement to characterize payments as not alimony is not included in the original order, the spouses can sign an agreement that refers to the previous written separation agreement. The recipient spouse who is excluding the payment from income must attach a copy of the document to his or her tax return each year that the agreement is in effect.

The payment cannot be characterized as child support or a property settlement. If a divorce or separation instrument provides for alimony and child support, and the payer spouse pays less than the total required, the payments apply to child support first. Only the remaining amount is considered alimony.

Example 8.14 Child Support Deemed Paid First

Marilyn and Mike Nelson were divorced in 2018. Their divorce decree requires Marilyn to pay Mike $200 a month ($2,400 per year) as child support and $150 a month ($1,800 per year) as alimony. If Marilyn pays the full amount of $4,200 ($2,400 + $1,800) during the year, she can deduct $1,800 as alimony, and Mike must report $1,800 as alimony received. If Marilyn pays only $3,600 during the year, $2,400 is child support. Marilyn can deduct only $1,200 ($3,600 – $2,400) as alimony, and Mike must report $1,200 as alimony received.

Separate Households

For payments to qualify as alimony, the spouses or former spouses usually cannot share the same residence. There are two exceptions to this rule:

1. If one spouse is preparing to leave the household and does leave no later than 1 month after the date of the first payment, that payment can still qualify as alimony.
2. If the couple is not legally separated under a decree of divorce or separate maintenance, but payments are made under a written separation agreement, a support decree, or another court order, the payments can be considered alimony even if the spouses are members of the same household.

Ending at Payee's Death

Qualifying payments must cease upon the death of the payee spouse. Any portion of the payment that will continue is not alimony, even for the payments made before death. Payments can continue after the death of the paying spouse.

Example 8.15 Subsequent Payments to Estate

Albert and Emily Creek divorced in 2018. The divorce decree states that Emily will pay Albert $30,000 a year for 10 years or until her death, if earlier. The decree states that if Albert dies during the 10-year period, Emily will pay his estate $20,000 a year for the remainder of the 10 years. Only $10,000 of Emily's annual payment to Albert is alimony that is deductible for Emily and taxable to Albert. The $20,000 portion is not alimony because it will not end if Albert dies. Payments that must be made after the payee spouse's death are not alimony.

Example 8.16 Subsequent Payments to Trust

Jason and Sharon Richards divorced in 2017. Their three children were ages 6, 8, and 10. The divorce decree stated that Jason will pay Sharon $30,000 each year for 6 years or until Sharon's death if she dies within the 6-year period. If any of the children are still minors when Sharon dies, the divorce decree requires Jason to pay $10,000 into a trust each year until the youngest child reaches age 18. The trust income and principal are to be used for the benefit of the children. Because the payments required after Sharon's death are a substitute for $10,000 of the $30,000 she was receiving, only $20,000 of each annual payment made to Sharon qualifies as alimony.

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Example 8.17 Subsequent Payments to Child

Peter and Jenny Rapids divorced in 2018. They have one child, Sarah. The divorce decree states that Peter will pay Jenny $30,000 each year for 6 years or until Jenny's death if she dies within the 6-year period. If Jenny dies within the 6-year period and Sarah is in college, Peter must pay Sarah $10,000 each year until Sarah graduates or has attended 4 years of college. The payments required after Jenny's death are a substitute for $10,000 of the $30,000 she was receiving, and only $20,000 of the annual payment to her qualifies as alimony.

Example 8.18 Lump Sum Payment Equivalent

Fred and Betty Rock divorced in 2016. Fred is obligated under the divorce decree to pay Betty $30,000 per year for the earlier of 15 years or until her death. The decree also provides that if Betty dies before the 15-year period ends, Fred must pay her estate the difference between $450,000 and the amount paid prior to Betty's death. Betty died after receiving $150,000 (5 annual payments of $30,000), and Fred was obligated to pay her estate $300,000 ($450,000 – $150,000). The intent was to make a total payment of $450,000 as a settlement paid over 15 years. The $30,000 annual payment does not qualify as alimony.

Payments to Third Parties

Payments to a third party on behalf of a spouse or former spouse can be alimony if they are made under the terms of the divorce or separation instrument or if they are made in lieu of alimony and at the written request of the payee spouse. The payments are treated as received by the spouse and then paid to the third party. Payments could include medical expenses, housing costs (if the payee spouse owns all or part of the house), taxes, tuition, and life insurance premiums (if the payee spouse owns the policy).

Example 8.19 Medical and Dental Expenses

James and Margie Bayne were divorced in 2017. The divorce decree requires James to pay Margie's medical and dental expenses, including the cost of her health insurance. James pays the insurance company and medical professionals directly. The payments meet the other rules for alimony, so James may take an alimony deduction, and Margie must report the same amount as income. Margie can include those amounts as medical expenses on her Schedule A (Form 1040), Itemized Deductions.

Example 8.20 Life Insurance

James from Example 8.19 is required to pay premiums for life insurance on his own life, but Margie is now the owner and beneficiary of the policy. The premium payments can qualify as alimony, deductible for James and taxable to Margie.

Example 8.21 Housing Costs for Payee's House

Avery and Mark Brown were divorced in 2017. Their divorce decree requires Avery to pay the real estate taxes, mortgage payments, and insurance premiums on the former family home, which is now owned solely by Mark. If the other rules for alimony are met, Avery can deduct the payments as alimony and Mark includes the payments in his income. Because Mark is treated as paying the housing expenses, he can deduct the real estate taxes and qualified residence interest.

Example 8.22 Housing Costs for Payer's House

Melissa and Marvin Sampson were divorced in 2018. Marvin gave Melissa $150,000 for her equity in the former family home and Marvin is now the sole owner. However, the divorce decree allows Melissa to continue to live in the home rent-free for 3 years. There are no children still at home. Marvin pays the insurance, real estate taxes, mortgage, and utilities.

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Only the utilities are considered alimony that is deductible by Marvin and taxable to Melissa, because the other expenses are normal home ownership expenses. If Marvin itemizes deductions, he can deduct the real estate taxes (subject to limitations under the TCJA), and he may deduct the mortgage interest if the house is treated as his qualified second home. Although Melissa is no longer a family member, her use of the house rent-free is considered personal use by Marvin [Prop. Treas. Reg. § 1.280A-1(e)(1)(iv)].

If the house is jointly owned, and the spouse who is not living in the home is required to pay all the expenses of the home, one-half of the total mortgage payment is treated as alimony. The payer spouse can deduct the interest portion of the nonalimony part of the payment if the house is his or her qualified second home. The payee spouse can deduct the other half of the interest if the house is his or her qualified main home or second home.

If the taxpayers own the home as tenants in common, the payer spouse can deduct one-half of the total payments for homeowners' insurance and taxes as alimony. Each spouse can deduct one-half of the real estate taxes (subject to the limitation on deductions for state and local taxes) and the insurance payment is not deductible. If the taxpayers own the home as joint tenants or tenants by the entirety, none of the payments for taxes and insurance are alimony. The payer spouse can deduct all the real estate taxes, and the insurance payment is nondeductible.

PRACTITIONER NOTE

Property Title

Tenants in common can own different percentages of the property and designate an heir to the property upon the death of the owner. Joint tenants with right of survivorship equally own the property and upon the death of a joint owner, the property automatically passes to the surviving joint owner.

PRACTITIONER NOTE

Child Support

A payment that is specifically designated as child support or treated as specifically designated as child support under a divorce or separation instrument is not alimony. Child support payments are not deductible by the spouse making the payments and are not income to the spouse receiving the payments. See the earlier discussion of child support.

Property Settlement

Under I.R.C. § 1041, no gain or loss is recognized on transfers between spouses; and no gain or loss is recognized on transfers between former spouses if the transfers are incident to divorce.

- A transfer is *incident to divorce* if it occurs within 1 year after the date the marriage ends or if it is related to the end of the marriage.
- A transfer is related to the end of the marriage if it is made under a divorce or separation instrument (original or modified) and occurs within 6 years after the date the marriage ends.

PRACTITIONER NOTE

Related to the End of Marriage

If a transfer occurs more than 6 years after the date the marriage ends, it is presumed to be not related to the end of the marriage. However, the taxpayer can rebut that presumption by showing that the transfer was made to carry out a division of property that the spouses owned at the time that the marriage ended, and business or legal factors prevented an earlier transfer.

These rules apply to real, personal, tangible, intangible, separate, and community property, and they apply to property that is acquired after the end of a marriage and transferred to a former spouse. However, the nonrecognition rules may not apply if the recipient spouse is a nonresident alien, if the transfer is in trust and liabilities exceed basis, if US savings bonds are transferred, and in certain stock redemptions.

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If property is transferred to a third party on behalf of a spouse, the transaction may be treated as two transfers. The first transfer is from one spouse to the other, with no gain or loss recognized because of I.R.C. § 1041. The second transfer is from the recipient spouse to the third party and gain or loss may be recognized. The two-transfer treatment applies if the transfer is made under any of the following conditions:

- A divorce or separation agreement requires the transfer.
- The other spouse requests the transfer in writing.
- The other spouse consents to the transfer in writing and states that both spouses intend the transfer to be treated as a transfer subject to I.R.C. § 1041.

A transferee spouse's basis in property received from a spouse or former spouse incident to a divorce is the same as the transferor spouse's adjusted basis. This applies for determining either gain or loss when the transferee later disposes of the property. It applies whether the property's adjusted basis is less than, equal to, or greater than either its value at the time of the transfer or any consideration paid. It also applies even if the property's liabilities are more than its adjusted basis.

Retirement Benefits

Generally, a participant's qualified retirement plan benefits are protected from assignment, and subject to a penalty for early withdrawal, but an exception applies to benefits covered by a qualified domestic relations order (QDRO) [I.R.C. § 414(p)]. Special rules may apply to an IRA of a separated or divorced taxpayer.

Qualified Domestic Relations Order

A QDRO is a judgment, decree, or other court order, pursuant to a state's domestic relations law, that establishes an alternate payee's right to benefits accumulated in a qualified retirement plan. The benefits can be treated as payments for child support, alimony, or marital property rights, and they can be paid to a spouse, a child, or another dependent of the participant. A valid QDRO must contain specific information, including the name and last-known mailing address of the participant and each alternate payee, and the amount or percentage of the participant's benefits to be paid to each alternate payee.

If a plan participant takes a distribution from his or her retirement plan without a QDRO and transfers the funds to his or her spouse, the distribution is taxed to the participant. If the participant is under age 59½, the 10% early distribution penalty also applies if there is no QDRO and no other exception to the penalty applies. When the alternate payee is the participant's spouse or former spouse, the tax liability for the distribution transfers to the alternate payee. However, when QDRO benefits are paid to an alternate payee who is the plan participant's child or dependent, the plan participant is still treated as receiving the distribution. The 10% early withdrawal penalty does not apply if the distribution is made to an alternate payee under a QDRO, regardless of the participant's or the alternate payee's age. If the participant has after-tax contributions to the plan (basis), a pro rata share of those contributions is assigned to the QDRO distribution.

The alternate payee's access to the funds may be restricted until the participant attains a certain age or separates from service, if earlier. If a plan permits distributions at any age upon termination of service, the maximum age limit for QDRO distributions is age 50.

A spouse or former spouse who receives an interest in a retirement plan under a QDRO reports any distributions as if he or she were a plan participant. The recipient spouse may roll over an eligible distribution. If the plan permits loans, the spouse or former spouse may be able to borrow from his or her vested balance without taking a distribution.

Transfer of IRA

A transfer of an IRA from one spouse to another is tax-free if the transfer is required by a divorce or separate maintenance decree or a written document related to such a decree [I.R.C. § 408(d)(6)].

However, there is no QDRO exception from the early withdrawal penalty for IRAs. If a recipient spouse who is under age 59½ withdraws funds after the IRA is transferred, the early withdrawal penalty applies, unless an exception applies.

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If the entire IRA balance is transferred, the trustee may be able to change the owner's name on the IRA. If only a portion of the IRA balance is transferred, the trustee must transfer that amount to a new or existing IRA in the name of the recipient spouse.

IRA Contributions and Deductions

If the taxpayers receive a final decree of divorce or separate maintenance by the end of the tax year, they cannot deduct any contributions made to the former spouse's traditional IRA. Each taxpayer may be able to deduct contributions that he or she makes to his or her own traditional IRA. Taxable alimony is treated as compensation for the contribution and deduction limits for traditional IRAs.

ISSUE 3: SETTLEMENTS, FINES, AND, PENALTIES

This issue explains when a settlement is taxable and when a fine or penalty may be deductible.

This section discusses the taxation of settlements, fines, and penalties, including the new denial of a deduction for settlements based on sexual harassment or sexual abuse (if those settlements are subject to a nondisclosure agreement) and the new denial of a deduction and required reporting for government penalties and fines.

Settlements

A settlement payment may consist of multiple elements that have been allocated by the parties. For example, an agreement may allocate the settlement funds to back pay, emotional distress, and attorneys' fees. Generally, the IRS will not challenge an allocation if it is consistent with the substance of the settled claims.

I.R.C. § 61 states all income from whatever source derived is taxable, unless specifically excluded by another code section. I.R.C. § 104 excludes a settlement from taxable income if it is derived from personal physical injuries or physical sickness. For settlements attributable to nonphysical injury, such as discrimination, fraud, or wrongful discharge, amounts excludable for emotional distress are limited to actual out-of-pocket medical costs. Punitive damages are generally not excludable, even if they are received in connection with a physical injury.

OBSERVATION

Judgments and Settlements

A judgment is a court order issued after adversarial proceedings before a judge (and sometimes a jury). Many lawsuits are settled prior to entry of a court judgment. Generally, the same rules apply to the taxation of amounts received pursuant to a settlement agreement, and amounts received as a judgment, and the discussion of settlements in this section also applies to judgments.

Lost Wages or Lost Profits

If the taxpayer receives a settlement in an employment-related lawsuit, for example, for unlawful discrimination or involuntary termination, the portion of the proceeds that is for lost wages is taxable and subject to employment tax (discussed later). For a self-employed taxpayer, a settlement for lost profits from a trade or business is net earnings subject to self-employment tax. See the later discussion of lost wages received in a settlement for physical injuries or physical sickness.

Loss in Value of Property

Property settlements for loss in property value that are less than the adjusted basis of the property are not taxable and generally do not have to be reported on a tax return. However, the taxpayer must reduce his or her basis in the property

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by the amount of the settlement. If the property settlement exceeds the taxpayer's adjusted basis in the property, the excess is income.

Personal Physical Injuries or Physical Sickness

Generally, amounts paid in a settlement for personal physical injuries or physical sickness (except punitive damages) are nontaxable.

Medical Expenses

If the taxpayer receives a settlement for personal physical injuries or physical sickness and did not take an itemized deduction for medical expenses related to the injury or sickness in prior years, the full amount is nontaxable. However, if the taxpayer receives a settlement for personal physical injuries or physical sickness, he or she must include in income that portion of the settlement that is for medical expenses that the taxpayer deducted in any prior year to the extent the deduction provided a tax benefit. The taxpayer reports the tax benefit amount as "Other Income" on Form 1040, U.S. Individual Income Tax Return.

CROSS-REFERENCE

New Form 1040

On the new 2018 Form 1040, other income is reported on Schedule 1, Additional Income and Adjustments to Income, and then carried to line 6 of Form 1040. See the "New Legislation—Additional" chapter in this book for more information about the new form.

Lost Wages

The IRS has consistently held that compensatory damages, including lost wages, received because of a personal physical injury are excludable from gross income (except punitive damages, which are discussed later) [Rev. Rul. 85-97, 1985-2 C.B. 50].

Example 8.23 Amounts Received for Discrimination in the Workplace

Erich Schleier was fired from his job at United Airlines when he turned age 60. He sued the airlines for age discrimination. The parties settled and designated the settlement award as back pay and liquidated damages. Eric must include the back pay and the liquidated damages in income. The payments were not made because of personal injury or sickness. If instead Eric had been injured in a car accident and suffered lost wages, a recovery for lost wages is excludable as being "on account of personal injuries," if the lost wages resulted from time in which Eric was out of work because of his injuries [*Commissioner v. Schleier*, 515 U.S. 323 (1995)].

Injury to a Third Party

If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that come from that action are treated as payments because of physical injury or physical sickness, even if the recipient of the damages is not the injured party. For example, damages received by a taxpayer for a claim for loss of consortium due to the physical injury or physical sickness of the taxpayer's spouse are excluded from gross income.

Emotional Distress or Mental Anguish

The taxation of the portion of a settlement that is allocated to emotional distress or mental anguish depends on the nature of the underlying claim.

Claims Based on Physical Injury or Sickness

The proceeds that a taxpayer receives for emotional distress or mental anguish originating from a personal physical injury or physical sickness are treated the same as proceeds received for personal physical injuries or physical sickness (discussed earlier). Such amounts are not included in income.

Claims Based on Nonphysical Injury or Sickness

A taxpayer who receives lawsuit proceeds from a nonphysical injury claim cannot exclude any amount of payment for the intangible value of emotional distress. The taxpayer can only exclude an amount for actual out-of-pocket medical costs that the taxpayer had not previously deducted. Specifically, if the proceeds for emotional distress or mental anguish do not originate from a personal physical injury or physical sickness,

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the taxpayer must include them in income. The amount that the taxpayer must include is reduced by

1. amounts paid for medical expenses attributable to emotional distress or mental anguish not previously deducted, and
2. previously deducted medical expenses for such distress and anguish that did not provide a tax benefit.

The taxpayer must attach a statement to his or her return showing the entire settlement amount less related medical costs not previously deducted and medical costs deducted for which there was no tax benefit. The taxpayer reports the net taxable amount as "Other Income" on line 21 of Schedule 1 (Form 1040), Additional Income and Adjustments to Income.

Employment-Related Lawsuits

An employee may have a claim against his or her employer for wrongful discharge, discrimination, or breach of contract. As discussed earlier, damages received to compensate a taxpayer for economic loss–for example, lost wages, business income, and benefits–are not excludable from gross income unless a personal physical injury caused the loss. Similarly, damages for intangible emotional distress are not excluded from income. The taxpayer can exclude only damages for actual out-of-pocket medical costs paid to treat any emotional distress (if not previously deducted).

Example 8.24 Emotional Distress—Employment Discrimination

Teri Davis was denied a promotion at work. Teri claimed that the denial was because she was a woman. All the men in her office who had been there for the same amount of time as Teri were promoted. Teri also claimed that the gender discrimination in the workplace made her emotionally distressed. She could not sleep and suffered from anxiety at work. Teri went to a doctor, who prescribed medication for her anxiety.

Teri's employer settled the discrimination claim by paying Teri $10,000, which the parties allocated entirely to Teri's emotional distress claim. Teri must include the $10,000 in income to the extent that it exceeds the amounts that she spent on medical bills and prescriptions.

Damage to Reputation

Libel, slander, and defamation of character can result in an award for damages to one's reputation. Damage to reputation is a nonphysical injury, and the taxpayer can exclude only compensation for out-of-pocket costs to treat emotional distress (if not previously deducted). Any other compensatory and punitive damages arising from these cases are taxable.

Example 8.25 Emotional Distress—Claim for Damage to Reputation

Paul Lindsey acquired an interest in Empire Gas Corp. A dispute arose regarding the acquisition of another company, and certain management issues. Paul claimed that the dispute caused injury to his personal and professional reputation and emotional distress, humiliation, and embarrassment. The dispute was resolved by a $2,000,000 payment to Paul. While injury to reputation, humiliation, and embarrassment are similar to emotional distress, the settlement was not for reimbursement of any actual medical expenses. Paul must include the full settlement amount in his taxable income because it was not received because of physical injury or sickness [*Lindsey v. Commissioner*, T.C. Memo. 2004-113, *aff'd* 422 F.3d 684 (8th Cir. 2005)].

Punitive Damages

Punitive damages are additional damages that are imposed where the defendant acted recklessly, with malice or deceit, or in any other manner that would justify penalizing the wrongdoer or making an example to others. Punitive damages are usually taxable, and the taxpayer must report them as Other Income on line 21 of Schedule 1 (Form 1040), Additional Income and Adjustments to Income, even if the punitive damages were received in a settlement for personal physical injuries or physical sickness.

I.R.C. § 104(c) provides a limited exception to the tax treatment of punitive damages awarded in certain civil wrongful death cases. Claims for wrongful death usually include compensatory damages for physical and mental injury, as well as punitive damages for reckless, malicious, or reprehensible conduct. Both claims may generate settlement amounts. Any amounts determined to be compensatory for the personal physical

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injuries are excluded from gross income under section 104(a)(2).

Historically, the courts have looked to the state statute under which the wrongful death claim was litigated to determine whether there could be compensatory and/or punitive damages awarded. If the state statute allows only punitive damages in wrongful death claims, then they are excluded from income. If state statute allows both compensatory and punitive damages, the punitive damages are included in income.

Interest

Interest on any settlement is generally taxable and should be reported on line 2b, Taxable interest, of Form 1040, U.S. Individual Income Tax Return. If state law requires defendants to pay judgment interest in tort actions, and the parties settle an appeal of a verdict, the IRS will allocate a portion of the settlement proceeds to interest [*Delaney v. Commissioner*, 99 F.3d 20 (1st Cir. 1996)].

Attorney's Fees

Generally, the taxpayer must look to the underlying lawsuit to determine whether attorneys' fees are deductible. Attorney's fees may be deductible under I.R.C. § 162 if they are trade or business expenses. Attorney's fees may also be deductible under I.R.C. § 212 if they are incurred for production of income. However, if the ultimate recovery in a settlement is excludable from gross income, the attorney's fees allocable to exempt income are not deductible [I.R.C. § 265(a)(1)]. Absent strong support to the contrary, legal fees relating to a settlement that is partially taxable will be allocated based on the ratio between the taxable settlement and the total settlement. Fees that are for a personal, living, or family expense are nondeductible under I.R.C. § 262.

Example 8.26 Allocating Attorney's Fees

In 2017, Sarah Carlton was fired from her job. She sued her employer for wrongful termination and emotional distress, and in 2017 the court awarded Sarah $100,000. Of the total proceeds, $20,000 was allocated to Sarah for her actual medical costs (not taxable) and $80,000 was allocated to her for lost wages (taxable). Sarah's legal fees and court costs were $52,000. Sarah's taxable income is 80% ($80,000 ÷ 100,000) of the total settlement. Sarah's deductible fees and costs are $41,600 ($52,000 × 80%). The deductible fees and costs are subject to the 2%-of-AGI limit as a miscellaneous itemized deduction.

Reporting Attorney's Fees

Typically, attorney's fees will be a Schedule A (Form 1040) miscellaneous itemized deduction, subject to the 2%-of-AGI floor (if miscellaneous itemized deductions are allowed) and AMT. However, in rare cases, such as a compensatory recovery of self-employment income, fees may be reported on Schedule C (Form 1040), Profit or Loss From Business (Sole Proprietorship). In *Guill v. Commissioner*, the Tax Court held that a self-employed taxpayer could deduct legal fees allocable to the recovery of punitive damages on Schedule C (Form 1040), rather than as a miscellaneous itemized deduction on Schedule A (Form 1040) [*Guill v. Commissioner*, 112 T.C. 325 (1999)].

LAW CHANGE

Miscellaneous Itemized Deductions

Effective for tax years beginning after December 31, 2017, and before January 1, 2026, miscellaneous itemized deductions that are subject to the 2%-of-AGI floor are suspended.

Discrimination and Whistleblower Suits

Under I.R.C. § 62(a)(20), the taxpayer can claim an above-the-line deduction for attorney's fees and court costs paid in connection with discrimination and certain other suits. To be eligible for the deduction, the taxpayer must pay attorney's fees and court costs with respect to a claim that involves unlawful discrimination, certain claims against the federal government, or a private cause of action under a Medicare secondary payer statute.

I.R.C. § 62(a)(21) allows an above-the-line deduction for attorney's fees and court costs associated with suits involving whistleblower claims. To be eligible for the deduction, the taxpayer must pay attorney's fees or court costs in connection with a whistleblower award for providing information regarding the following violations:

- Tax laws, as specified in I.R.C. § 7623(b)
- Federal securities laws

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- False claims against a state
- Section 23 of the Commodity Exchange Act

The deductions allowed under sections 62(a)(20) and 62(a)(21) are limited to the amount of the award that is includible in the taxpayer's gross income for the tax year in which the taxpayer claims the deduction.

Employment Tax

To the extent that damages are excludable from gross income, they are not subject to employment taxes. Whether a taxable settlement is subject to employment tax depends on the how the settlement funds are characterized.

Back Pay

A settlement payment made by an employer or former employer for back pay for services by the employee is wages for employment tax purposes. For employment tax purposes *back pay* includes amounts paid under several workers' rights and civil rights statutes [for example, the Back Pay Act, the Age Discrimination in Employment Act (ADEA), Title VII of the Civil Rights Act of 1964, and various state and local discrimination statutes].

Back pay may be wages for federal employment tax purposes, even if the employee performed no services during the period for which back pay was awarded. For example, if an employer illegally terminates an employee, a back pay award will relate to a period when the employee performed no services because of the illegal termination. The back pay is wages for employment tax purposes, even though it is attributable to a period during which no actual services were performed. However, in *Churchill*, the court held that an employer could not withhold FICA or income taxes from damages awarded for a violation of the Family and Medical Leave Act because the employee was not performing services for the employer during the period for which the damages were awarded [*Churchill v. Star Enterprises*, 3 F. Supp. 2d. 622 (E.D. Pa. 1998)].

Front Pay

Front pay is pay awarded to the employee for future services (services on or after the date of the settlement). Usually front pay is awarded for services the employee would have performed if the employer had not taken illegal action. Generally, it is the IRS's position that front pay is also wages for federal employment tax purposes. Some courts have disagreed with this position. It is also the IRS's position that settlements including cash payments made to employees by employers in lieu of providing benefits under employer plans (for example, paid in lieu of health insurance or qualified pension plan benefits) are wages for federal employment tax purposes.

PRACTITIONER NOTE

Year of Payment

Back pay and front pay are wages subject to employment taxes in the year paid and are subject to the tax rates and FICA and FUTA wage bases in effect in the year the amounts are paid.

Severance Pay

Generally, dismissal pay, severance pay, or other payments for involuntary termination of employment are wages for federal employment tax purposes [*United States v. Quality Stores, Inc.*, 134 S. Ct. 1395 (2014)]. However, Rev. Rul. 90-72, 1990-2 C.B. 211, holds that supplemental unemployment compensation benefits (SUB) pay is excluded from wages for FICA and FUTA purposes if the receipt of SUB pay is linked to the receipt of state unemployment compensation. It also holds that lump sum payments are not linked to state unemployment compensation because the amount of the benefit received is the same regardless of the length of the individual's unemployment.

Example 8.27 Supplemental Unemployment Compensation Benefits

Mega Corp established a plan to provide weekly benefits to its former employees who were involuntarily separated from service due to a plant closing, layoff, or reduction in force. The plan benefits are designed to supplement the receipt of state unemployment compensation and are not attributable to services performed by the employees. The benefits are not payable in a lump sum. The duration of the benefits depends in part on the fund level and the employee's seniority.

Duane Robertson is a former employee who was laid off from Mega Corp. Duane is unemployed and meets the requirements to receive

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state unemployment compensation benefits. Benefits paid under the Mega Corp plan are designed to supplement Duane's receipt of state unemployment compensation and are not wages for FICA and FUTA purposes.

Self-Employment Tax

In contrast to the broad definition of wages for federal employment tax purposes, courts have adopted narrow interpretations of what constitutes self-employment (SE) income for SE tax purposes. SE income must arise from some actual (whether present, past, or future) income-producing activity of the taxpayer.

Example 8.28 No SE Tax on Business Interruption Insurance

Max Newberry owned and operated a grocery store in Georgia. The store was destroyed in a fire. Max's insurance company paid him $11,000 for his lost earnings. The payment was calculated based on Max's profits from the store. Max must include the payment in income, but it is not subject to SE tax because it was not derived from a trade or business that Max carried on [*Newberry v. Commissioner*, 76 T.C. 441 (1981)].

Example 8.29 No SE Tax on Termination Payments

William Jackson worked as an insurance agent for State Farm Insurance Companies. He was an independent contractor. After his retirement, State Farm paid William approximately $43,000 in termination payments. The payments were made pursuant to William's contract with State Farm, and the amount of the payments was based on William's prior-year compensation. William must include the payments in income, but they are not subject to SE tax because the payments were not derived from carrying on the insurance business [*Jackson v. Commissioner*, 108 T.C. 130 (1997)].

Cross-Reference

Estimated Tax—Settlements

Some settlement recipients may need to make estimated tax payments if they expect their tax to be $1,000 or more after subtracting credits and withholding. See the "Payroll and Estimated Tax" chapter in this book for more information about calculating and paying estimated tax.

Reporting Settlement Awards

Settlement awards are typically reported in box 3 of Form 1099-MISC, Miscellaneous Income. Generally, this includes all punitive damages (even if they relate to physical injury or physical sickness), any damages for nonphysical injuries or sickness, liquidated damages received under the ADEA, and any other taxable damages. It also generally includes all compensatory damages for nonphysical injuries or sickness (for example, emotional distress) arising from employment discrimination or defamation. If a taxpayer receives an award that constitutes wages, it is usually reported on Form W-2, Wage and Tax Statement, not Form 1099-MISC.

The following damages (other than punitive damages) are *not* reported in box 3 of Form 1099-MISC:

1. Damages received because of personal physical injuries or physical sickness
2. Damages that do not exceed the amount paid for medical care for emotional distress
3. Damages received because of nonphysical injuries (for example, emotional distress) under a written binding agreement, court decree, or mediation award in effect on or issued on or before September 13, 1995

Damages received because of emotional distress due to nonphysical injury or sickness, including physical symptoms such as insomnia, headaches, and stomach disorders, are reportable unless described in items 2 or 3 of the previous list. However, damages received because of emotional distress due to physical injuries or physical sickness are not reportable.

The amount of damages reflected on the Form 1099-MISC is not reduced by attorney's fees.

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Example 8.30 Reporting Attorney's Fees

Katherine Block filed a lawsuit against a local convenience store, claiming that they discriminated against her based on her race, and caused her emotional distress. The store settled the claim for $100,000 and wrote a check naming Katherine and her attorney as joint payees. The attorney retained $40,000 in fees for her services and gave the remaining $60,000 to Katherine. The amount of damages reportable on Form 1099-MISC, Miscellaneous Income, is $100,000.

Sexual Harassment or Sexual Abuse Settlements

A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business. However, the new I.R.C. § 162(q) denies a deduction for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement.

Government Fines and Penalties

Former I.R.C. § 162(f) applies to government fines and penalties paid or incurred under any binding order or agreement entered into before December 22, 2017. New section 162(f) applies to amounts paid or incurred on or after December 22, 2017. New I.R.C. § 6050X reporting requirements have the same statutory effective date, but the IRS has postponed application of those requirements until at least January 1, 2019.

Former I.R.C. § 162(f)

I.R.C. § 162(f) provided that no deduction is allowed under I.R.C. § 162(a) for any fine or similar penalty paid to a government for the violation of any law. Treas. Reg. § 1.162-21(b)(1) provides that a fine or similar penalty includes an amount

1. paid pursuant to conviction or a plea of guilty or nolo contendere for a crime (felony or misdemeanor) in a criminal proceeding;
2. paid as a civil penalty imposed by federal, state, or local law;
3. paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or
4. forfeited as collateral posted in connection with a proceeding that could result in imposition of such a fine or penalty.

Compensatory damages paid to a government do not constitute a fine or penalty [Treas. Reg. § 1.162-21(b)(2)]. A nondeductible fine or penalty is generally imposed to enforce the law and as punishment for violation of the law. Some payments, although labeled as civil penalties, are deductible if they are imposed to encourage prompt compliance with a requirement of the law or as a remedial measure to compensate another party. Thus, the tax treatment depends on whether the payment is punitive (nondeductible) or compensatory (deductible).

In C.C.A. 201748008 (November 17, 2017), the IRS concludes that I.R.C. § 162(f) prohibits a deduction under I.R.C. § 162(a) for an amount paid as disgorgement for violating a federal securities law. *Disgorgement* is the repayment of funds that were illegally obtained. These payments are penalties and are not compensatory in nature, and therefore are not deductible.

New I.R.C. § 162(f)

The Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, amended I.R.C. § 162(f) to deny a deduction for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. The provision applies only where a government (or other entity treated in a manner like a government) is a complainant or investigator with respect to the violation or potential violation of any law.

An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry. Restitution or remediation of property does not include reimbursement of government investigative or litigation costs. For the exception to apply,

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the restitution, remediation, or amounts required to come into compliance must be identified in the court order or settlement agreement. The IRS can challenge that identification. An exception also applies for taxes, and restitution for failure to pay any tax under the Internal Revenue Code is deductible to the extent it would have been allowed as a deduction if it had been timely paid.

In Notice 2018-23, 2018-15 I.R.B. 474, the IRS states that it intends to publish proposed regulations under section 162(f) and I.R.C. § 6050X (discussed later). The notice provides transitional guidance regarding the exceptions for restitution, remediation, and compliance payments. To qualify for the restitution, the taxpayer must do the following:

1. Establish that the amount paid or incurred constitutes restitution (including remediation of property) for damage or harm that was or may be caused by violation of any law or the potential violation of any law or is paid to come into compliance with any law that was violated or otherwise involved in the investigation or inquiry into the potential violation of any law (the “establishment requirement”).
2. Identify the amount paid or incurred as restitution or as an amount paid to come into compliance with such law in the court order or settlement agreement (the “identification requirement”).

The transitional guidance delays the reporting requirement (discussed later) and clarifies that the identification requirement applies to amounts paid or incurred on or after December 22, 2017, unless the amounts were paid or incurred under any binding order or agreement entered into before that date. Until proposed regulations under section 162(f) are issued, the identification requirement is treated as satisfied for an amount if the settlement agreement or court order specifically states on its face that the amount is restitution, remediation, or for coming into compliance with the law. However, even if the identification requirement is treated as satisfied, taxpayers must also meet the establishment requirement to qualify for the section 162(f)(2) exception.

New Section 6050X Reporting

Under new I.R.C. § 6050X, government agencies [or entities treated as such agencies under section 162(f)(5)] must report to the IRS and to the taxpayer the amount of each settlement agreement or order where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as the IRS may specify). The report must state the amount paid and separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The report must be made at the time the agency enters into the agreement.

The reporting agency must also furnish a statement to each person who is a party to the suit or the agreement showing the name of the government agency, and the information furnished to the IRS.

Under Notice 2018-23, to ensure efficient administration of this new reporting provision, reporting will not be required under section 6050X until the date specified in the proposed regulations (when they are published). The specified date will not be earlier than January 1, 2019, and will not be earlier than the date of publication of the proposed regulations. Reporting will not be required with respect to any amounts required to be paid or incurred under a binding court order or settlement agreement entered into before the specified date.

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ISSUE 4: DISASTER TAX RELIEF

This issue discusses tax consequences of disaster relief crowdfunding and recent changes to the rules for personal casualty loss deductions. It also reviews the disaster tax relief provisions for victims of hurricanes Harvey, Irma, and Maria and for the victims of the California wildfires.

Donation-based crowdfunding is used to raise money for individuals affected by various disasters. For tax years beginning after December 31, 2017, and before January 1, 2026, the Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, generally disallows the personal casualty loss deduction unless the casualty is attributable to a federally declared disaster.

Disaster relief is available in many forms. The Disaster Tax Relief and Airport and Airway Extension Act of 2017 (DTRA), Pub. L. No. 115-63, provides tax relief for victims of hurricanes Harvey, Irma, and Maria. The Bipartisan Budget Act of 2018 (BBA), Pub. L. No. 115-123, provides similar tax relief for victims of the California wildfire disaster.

The IRS has announced tax relief for taxpayers impacted by 2018 federally declared disasters. Relief includes extended filing deadlines, and abatement of certain penalties.

Disaster-Related Crowdfunding

Crowdfunding websites provide a platform for people to raise money for personal expenses, business expenses, and charitable endeavors. An individual, business, or charity sets up an online fundraising campaign. The website host processes online payments, takes a share of the receipts, and may charge a setup fee, a monthly fee, and fees for accepting credit card payments.

GoFundMe claims to be the number-one site for natural disaster fundraising. As of the time of this writing, there are over 80,000 campaigns to aid hurricane victims [www.gofundme.com/mvc.php?route=category&term=hurricane]. A campaign to rebuild the Virgin Islands damaged by Hurricane Irma has raised $277,756, and a campaign to help a young family whose home was destroyed in California floods has raised $150,200.

The tax consequences to the contributor and the recipient vary depending on the type of crowdfunding and the use of the funds.

Information Letter 2016-0036

In IRS Information Letter 2016-0036 (March 30, 2016), the IRS provides very basic guidance on the treatment of amounts recipients of crowdfunding receive from contributors. It notes that I.R.C. § 61(a) includes all income (from whatever source derived) in gross income. However, Congress provides specific exclusions for certain benefits that it chooses not to tax.

Information Letter 2016-0036 summarizes the application of the basic rules for crowdfunding as follows:

> Crowdfunding revenues generally are includible in income if they are not 1) loans that must be repaid, 2) capital contributed to an entity in exchange for an equity interest in the entity, or 3) gifts made out of detached generosity and without any “quid pro quo.” However, a voluntary transfer without a “quid pro quo” is not necessarily a gift for federal income tax purposes. In addition, crowdfunding revenues must generally be included in income to the extent they are received for services rendered or are gains from the sale of property.

Information Letter 2016-0036 concludes that the income tax consequences of crowdfunding depend on all the facts and circumstances and reminds taxpayers that they can request a private letter ruling that applies the law to the taxpayer’s particular facts and circumstances.

Donation-Based Crowdfunding

Donation-based crowdfunding is typically used for personal or charitable purposes. People make contributions because the cause appeals to them, and they do not expect anything in return.

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Generally, the campaign organizer establishes the crowdfunding site and withdraws and distributes the donated funds to the recipient(s). If the donor does not receive anything in return for the contribution, the contribution is likely a gift. There are no gift tax consequences for the donor if the gift does not exceed the annual gift tax exclusion ($15,000 in 2018). There are no tax consequences for the recipient.

The donor is not entitled to a charitable deduction if the contribution is to an individual. In Ltr. Rul. 2017-01-021 (October 11, 2016), the IRS stated that a crowdfunding site that benefits a preselected individual is not an I.R.C. § 501(c)(3) exempt organization.

Example 8.31 Crowdfunding for an Individual Recipient

Hurricane Harvey destroyed Chris Johnson's family home. Chris started a GoFundMe campaign to raise money to help rebuild his home. A total of 400 people contributed to the campaign, and he raised $16,000.

The donors did not receive anything in exchange for their donation, and the donations will likely be treated as gifts that qualify for the annual exclusion. The donors cannot deduct their contributions because the funds went to an individual. If instead the donors contributed the funds to a qualified public charity that provides services for hurricane victims, the donors could claim a charitable deduction.

The funds were a gift to Chris. He does not owe any tax on the receipt of the funds.

The donor is not entitled to a charitable deduction if the contribution is to a for-profit business, but the donor will be entitled to a charitable deduction if the contribution is to a qualified charitable organization. An organization that provides an internet crowdfunding platform to clients for a fee so that they may fundraise for charitable programs that they support is not a section 501(c)(3) exempt organization [Ltr. Rul. 2018-24-009 (January 8, 2016)].

Example 8.32 Crowdfunding for Tax Exempt Recipients

Fires destroyed many structures and caused numerous deaths in Napa, Sonoma, and surrounding counties in October 2017. Several fire and rescue organizations set up a GoFundMe site to raise money to help people recover and rebuild. All the recipient organizations are qualified 501(c)(3) exempt organizations. The donors are entitled to a charitable contribution deduction provided they meet the substantiation requirements for their donations.

PRACTITIONER NOTE

Fake Charities

Fake charities made the IRS Dirty Dozen list in 2018. Scam groups masquerade as charitable organizations, luring people to make donations to groups or causes that do not actually qualify for a tax deduction. Following major disasters, it is common for scam artists to impersonate charities to get money or private information from well-intentioned taxpayers. The IRS encourages taxpayers to donate to recognized charities established to help disaster victims. To verify whether an organization is a tax exempt organization, see www.apps.irs.gov/app/eos/.

Agency

Someone other than the beneficiary may set up a fundraising campaign. The person who sets up the campaign is acting as the agent for the beneficiary, and contributions should be treated as being contributed to the beneficiary. However, to ensure a charitable deduction for contributors, if the intended beneficiary is a charitable organization, the person who sets up the campaign should indicate that he or she is setting up the campaign for the beneficiary, indicate on the website that the charity is the beneficiary, and ensure that all contributed funds go directly to the charity (not to the person who established the campaign, and then the beneficiary).

When setting up a GoFundMe account, the program asks whether the person setting up the account is raising money for "Myself" or "Someone Else." If the person setting up the account selects the "Someone Else" option, he or she

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can enter the beneficiary's name and email address to send the beneficiary an invitation. Once the beneficiary accepts the invitation, a separate beneficiary account is created for them and the beneficiary has sole access to withdraw donations [support.gofundme.com/hc/en-us/articles/204993267-Inviting-Someone-Else-to-Withdraw].

Information Returns

Payment cards (debit and credit cards) and third-party networks (e.g., PayPal) that collect more than $20,000 in a single year for the recipient and have more than 200 transactions in a single year for a recipient must send Form 1099-K, Payment Card and Third Party Network Transactions, to the recipient and the IRS to report the gross amount collected for the recipient (not reduced by any handling fee).

Issuance of a Form 1099-K does not necessarily indicate taxable income, and nonissuance of a Form 1099-K cannot be relied on to show that there was no taxable income. Donation-based crowdfunding Form 1099-K recipients should file a statement with their income tax return explaining that the amounts reported on the Form 1099-K were gifts and not income.

PRACTITIONER NOTE

Reportable Transactions

Under I.R.C. § 6050W, a third-party payment network is an agreement or arrangement under which an organization settles transactions for the provision of goods and services. Providers of goods and services settle transactions through the network. Some crowdfunding websites that provide donation-based crowdfunding have taken the position that their users do not provide goods and services, and they are not required to send Form 1099-K.

Modification of Personal Casualty Loss Deduction

In tax years before 2018, I.R.C. § 165(h) allowed taxpayers to deduct a net personal casualty or theft loss as an itemized deduction to the extent it exceeded a $100 per-casualty floor plus 10% of the taxpayer's AGI.

The TCJA generally eliminates the deduction for personal casualty or theft losses for tax years beginning after December 31, 2017, and before January 1, 2026, unless the casualty loss is related to a federally declared disaster (defined later). However, a taxpayer who has personal casualty gains may deduct these personal casualty and theft losses not related to a federally declared disaster to the extent of the gains.

Casualty Loss

A casualty is a sudden, unexpected, and unusual event that causes damage or destruction of property. A sudden event is swift, not gradual or progressive. An unexpected event is ordinarily unanticipated and unintended. An unusual event is atypical, and not a day-to-day occurrence.

Examples of a casualty include hurricanes, tornadoes, earthquakes, fires, floods, car accidents, sonic booms, terrorist attacks, vandalism, and volcanic eruptions. A casualty also includes the government-ordered demolition of a home rendered unsafe by a disaster.

The character and the amount of gain or loss resulting from a disaster depends on several factors, including whether the asset was only damaged or was completely destroyed, and whether it was used in a trade or business, held for production of income (investment property, such as stocks, bonds, gold, works of art, and vacant lots), or used for personal purposes.

Generally, a casualty loss deduction is limited to the lesser of the property's adjusted tax basis or the decrease in its FMV that results from the casualty. For personal use property losses, that amount is further reduced by the following:

1. The loss from each casualty event is reduced by $100.
2. The sum of all personal casualty losses (after the $100 reductions) incurred during the tax year is reduced by 10% of the taxpayer's adjusted gross income (AGI).

The taxpayer reports the resulting loss on Schedule A (Form 1040), Itemized Deductions. If the taxpayer's total itemized deductions are less than the allowable standard deduction, there is no tax benefit from the casualty loss.

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CROSS-REFERENCE

Casualty Losses and Gains

See pages 304–317 in the *2016 National Income Tax Workbook* for additional discussion of the rules that are generally applicable to casualty gains and losses and examples of how to report casualty losses and gains.

Losses Offset Gains

If a taxpayer has personal casualty gains, the taxpayer can deduct a personal casualty loss not attributable to a federally declared disaster to the extent the loss does not exceed the gains.

If the taxpayer has both personal casualty gains and personal casualty losses for a tax year, the taxpayer must first reduce the personal casualty gains by the taxpayer's casualty losses that are not attributable to a federally declared disaster. Any remaining personal casualty gains then reduce the taxpayer's casualty losses attributable to a federally declared disaster.

Example 8.33 Personal Casualty Loss

Phillip Peterson's 2018 AGI was $85,000. In 2018, he had a $10,000 personal theft loss. He had no other casualty gains or losses. Phillip cannot deduct any portion of the loss on his 2018 tax return.

Example 8.34 Personal Casualty Loss Offsets Casualty Gain

Assume Phillip in Example 8.33 also had a $16,000 personal casualty gain. Phillip can net the $10,000 personal theft loss with the casualty gain and has a $6,100 [$16,000 – ($10,000 – $100 per casualty)] net casualty gain.

Example 8.35 Federally Declared Disaster Loss

Assume Phillip in Example 8.34 also had a $20,000 personal casualty loss in a federally declared disaster area. He offsets $6,100 of the loss with his $6,100 net casualty gain. After applying the $100 per-casualty loss and the 10%-of-AGI floor, Phillip has a deductible loss of $5,300 [($20,000 – $100) – $6,100 net casualty gain – $8,500 10%-of-AGI floor].

CROSS-REFERENCE

Safe Harbors

Rev. Proc. 2018-8, 2018-2 I.R.B. 286, provides safe harbor methods for valuing a casualty or theft loss of a personal residence or personal property. It also provides a safe harbor method for valuing the loss of this property due to a federally declared disaster. Rev. Proc. 2018-9, 2018-2 I.R.B. 290, provides a safe harbor method for valuing a casualty loss to a personal residence as a result of the 2017 hurricanes. See the "New Legislation—Additional" chapter in this book for more details.

Federally Declared Disaster Area

Following a request from the governor of a state where residents are suffering hardships caused by a natural catastrophe, the president of the United States may declare an area to be eligible for federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. § 68). In 2018, as of the time of this writing, there were federally declared disasters in the following states:

- Alabama
- Alaska
- California
- Hawaii
- Indiana
- Kentucky
- Maine
- Maryland
- Massachusetts
- Nebraska
- New Hampshire
- New Jersey
- North Carolina
- Ohio
- Oklahoma
- Texas
- West Virginia

For an updated list see www.fema.gov/disasters.

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Hurricane Disaster Tax Relief

The Disaster Tax Relief and Airport and Airway Extension Act of 2017 (DTRA), Pub. L. No. 115-63, provides tax relief for victims of hurricanes Harvey, Irma, and Maria. The *disaster zones* are the portion of the disaster area that the president determined to warrant individual or individual and public assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act). Hurricane *disaster areas* are areas with respect to which the president declared a major disaster before October 17, 2017, under the Stafford Act.

Use of Retirement Funds

The DTRA provides special rules for retirement plan distributions made

- on or after August 23, 2017, and before January 1, 2019, to an individual whose main home on August 23, 2017, was in the Hurricane Harvey disaster area;
- on or after September 4, 2017, and before January 1, 2019, to an individual whose main home on September 4, 2017, was in the Hurricane Irma disaster area; and
- on or after September 17, 2017, and before January 1, 2019, to an individual whose main home on August 23, 2017, was in the Hurricane Maria disaster area.

These special rules include the following:

1. The I.R.C. § 72(t) 10% additional tax on early retirement withdrawals does not apply to a qualified hurricane distribution from an eligible retirement plan for an aggregate distribution that does not exceed the excess of $100,000 over prior-year qualified hurricane distributions.
2. The taxpayer can repay the amounts to the plan over a 3-year period that begins on the day after the distribution.
3. Unless the taxpayer elects out, any distribution that is included in the taxpayer's gross income is included ratably over a 3-year period beginning with the year of distribution.

Example 8.36 Retirement Plan Distribution

Joe Parker (age 50) was living in the Harvey disaster area at the time of the hurricane. He withdrew $60,000 from his 401(k) plan on January 15, 2018, to help him recover from the hurricane damages. Joe had not taken any previous qualified hurricane disaster distributions. The withdrawal is not subject to the additional 10% penalty even though Joe has not reached age 59½. Unless Joe elects out, $20,000 ($60,000 ÷ 3 years) of the distribution is included in Joe's income for 2018, 2019, and 2020. Instead of including the distribution as income, Joe can choose to repay the $60,000 distribution to his 401(k) over a 3-year period beginning in 2018.

In addition, the taxpayer can recontribute withdrawals received after February 28, 2017, and before September 21, 2017, for home purchases cancelled because of the eligible disaster. To avoid tax on the plan withdrawal, the taxpayer must recontribute the amount by February 28, 2018.

The DTRA also allows a taxpayer whose main home is located in the Hurricane Harvey, Irma, or Maria disaster areas to borrow $100,000 (up from $50,000) from a retirement plan and to delay the first and subsequent repayments by 1 year.

Employment Relief

The DTRA provides an employee retention credit to eligible employers as part of the I.R.C. § 38 general business credit. The maximum credit is 40% of up to $6,000 of qualified wages paid to an eligible employee for the tax year.

An *eligible employer* is an employer that conducted an active trade or business in the Hurricane Harvey, Irma, or Maria disaster zone on a specified date and the trade or business was inoperable on any day after this date and before January 1, 2018. The specified dates are August 23, 2017 (Harvey), September 4, 2017 (Irma), and September 16, 2017 (Maria).

An *eligible employee* is an employee whose principal place of employment on the specified date was with an eligible employer. *Qualified wages* are wages paid to an eligible employee while the business is inoperable during the specified dates.

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Example 8.37 Employee Retention Credit

Trail Company, a retail store located in the Hurricane Irma disaster zone, was flooded by the hurricane and forced to temporarily close. Trail Company continued to pay its employees, Louis Langford and Paula Pridmore, until it reopened on December 11, 2017. Trail Company paid Louis $4,400 and Paula $6,200 in wages from September 5, 2017, to December 10, 2017. The maximum qualified wages paid to a qualified employee is $6,000 for purposes of the employee retention credit. Therefore, Trail Company could claim a $4,160 [(40% × $4,400 wages) + (40% × $6,000)] employee retention credit on its 2017 tax return.

Suspension of Limitations on Charitable Contributions

I.R.C. § 170 provides a deduction for charitable contributions to a qualifying organization. The deduction for an individual taxpayer is limited to 50%, 30%, or 20% of the taxpayer's contribution base, depending on the type of contributed property and the type of recipient organization. A corporate taxpayer's charitable contribution deduction is limited to 10% of its taxable income. Excess contributions can be carried forward 5 years.

The DTRA temporarily suspends the income limitations for qualified charitable contributions. *Qualified contributions* are cash contributions made to a qualified organization for the period beginning on August 23, 2017, and ending on December 31, 2017. A *qualified organization* is an organization described in I.R.C. § 170(b)(1)(A) that provides relief efforts in the Hurricane Harvey disaster area, the Hurricane Irma disaster area, or the Hurricane Maria disaster area.

Hurricane-Related Personal Casualty Losses

For uncompensated personal casualty losses arising in the disaster areas, there is no requirement that the deductible net disaster loss amount exceed 10% of the taxpayer's AGI. The $100 per-casualty deduction is increased to $500. Taxpayers that do not itemize deductions can increase their standard deduction by the net disaster loss (the excess of qualified disaster losses over casualty gains). The net disaster loss is also deductible for AMT purposes.

Example 8.38 Personal Casualty Loss

Marvin Morris (age 55) was living in the Harvey disaster area at the time of the hurricane. His unreimbursed $40,000 hurricane-related casualty loss was his only casualty loss for 2017. Marvin files as a single taxpayer and claims the standard deduction. His 2017 standard deduction was $45,850 [$6,350 standard deduction + ($40,000 – $500) net casualty loss].

PRACTITIONER NOTE

Amended Return

Taxpayers can claim a casualty loss from a federally declared disaster on the return for the year of the loss or on an amended return for the prior year.

Determining Earned Income

A qualified individual with earned income that is less than the preceding year can elect to substitute the individual's earned income from the preceding year for purposes of calculating the earned income credit and the child tax credit. A *qualified individual* is an individual whose main home was in the disaster zone or in the disaster area on the specified date and was displaced from the main home because of the hurricane. The specified dates for Hurricanes Harvey, Irma, and Maria are August 23, 2017; September 4, 2017; and September 16, 2017, respectively.

PRACTITIONER NOTE

Filing Deadlines

The IRS extended deadlines that apply to filing returns, paying taxes, and performing certain other time-sensitive acts for taxpayers affected by Hurricane Maria in Puerto Rico and the US Virgin Islands. See www.irs.gov/newsroom/help-for-victims-of-hurricanes-irma-and-maria.

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California Wildfire Relief

The Bipartisan Budget Act of 2018 (BBA), Pub. L. No. 115-123, provides tax relief for victims of the California wildfires. The *disaster zones* are the portion of the disaster area that the president determined to warrant individual or individual and public assistance from the federal government under the Stafford Act. The wildfire *disaster areas* are areas with respect to which the president declared a major disaster between January 1, 2017, and January 18, 2018, under section 401 of the Stafford Act.

Use of Retirement Funds

The BBA provides the following special rules for retirement plan distributions made due to the California wildfires on or after October 8, 2017, and before January 1, 2019:

1. The I.R.C. § 72(t) 10% additional tax on early retirement withdrawals does not apply to a qualified wildfire distribution from an eligible retirement plan for an aggregate distribution that does not exceed the excess of $100,000 over prior-year qualified wildfire distributions.
2. The taxpayer can repay the amounts to the plan over a 3-year period that begins on the day after the distribution.
3. Unless the taxpayer elects out, any distribution that is included in the taxpayer's gross income is included ratably over a 3-year period beginning with the year of distribution.

In addition, the taxpayer can recontribute qualified distributions received after March 31, 2017, and before January 15, 2018, for home purchases cancelled as a result of the eligible disaster. To avoid tax on the plan withdrawal, the taxpayer must recontribute the amount by June 30, 2018.

The BBA also allows a taxpayer whose main home is located in the California wildfires disaster area to borrow $100,000 (up from $50,000) from a retirement plan and to delay the first and subsequent repayments by 1 year.

Employment Relief

The BBA provides an employee retention credit to eligible employers as part of the I.R.C. § 38 general business credit. The maximum credit is 40% of up to $6,000 of qualified wages paid to an eligible employee for the tax year.

An *eligible employer* is an employer that conducted an active trade or business in the California wildfires disaster zone on October 8, 2017, and the trade or business was inoperable on any day after this date and before January 1, 2018. An *eligible employee* is an employee whose principal place of employment on October 8, 2017, was with an eligible employer. *Qualified wages* are wages paid to an eligible employee while the business was inoperable from October 8, 2017 to January 1, 2018.

Suspension of Limitations on Charitable Contributions

The BBA temporarily suspends the income limitations for qualified charitable contributions for relief efforts in the California wildfires disaster area. Qualified contributions are cash contributions made to a qualified organization for the period beginning on October 8, 2017, and ending on December 31, 2018.

Wildfire-Related Personal Casualty Losses

For uncompensated personal casualty losses arising in the disaster areas, there is no requirement that the deductible net disaster loss amount exceed 10% of the taxpayer's AGI. The $100 per-casualty deduction is increased to $500. Taxpayers that do not itemize deductions can increase their standard deduction by the net disaster loss (the excess of qualified disaster losses over casualty gains). This net disaster loss is also deductible for AMT purposes.

Determining Earned Income

A qualified individual with earned income that is less than the preceding year can elect to substitute the individual's earned income from the preceding year for purposes of calculating the earned income credit and the child tax credit. A *qualified individual* is an individual whose main home was in the disaster zone or in the disaster area on October 8, 2017, and was displaced from this main home because of the California wildfires.

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ISSUE 5: CHOICE OF FILING STATUS

This section discusses how the new tax law may affect a taxpayer's choice of filing status.

The Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, may impact how an individual taxpayer chooses his or her filing status. This section gives an overview of the criteria to select a filing status. It then reviews how the choice of filing status impacts tax rates, the deduction for state and local income taxes, and the qualified business income (QBI) deduction.

Note that the information presented in this issue is for educational purposes only and is not intended to advocate for or against any decision to get married or get divorced. Also, the discussion is limited to how the TCJA may impact the choice of filing status and may not be generally applicable. For example, Theodore and Tamara (in Example 8.42) may enhance their QBI deduction by filing married filing separately (MFS), but other deductions and credits may be reduced or eliminated by filing MFS. The tax practitioner must consider all applicable factors when choosing a filing status, including the implications on state income tax.

Filing Status Overview

The TCJA retains the five filing statuses available to taxpayers under prior law. A taxpayer can file single, married filing jointly (MFJ), married filing separately (MFS), head of household (HoH), or qualifying widow(er).

Single

An unmarried individual who does not qualify as a qualifying widow(er) or a head of household must file as a single taxpayer.

Married Filing Jointly

A married couple can file a joint return if they are legally married as of the last day of the tax year and they agree to file a joint return. Whether individuals are married depends on the laws of their state of residence. For federal tax purposes, the marriage of a same-sex couple is treated the same as the marriage of a man to a woman. However, individuals who have entered into a registered domestic partnership, civil union, or other similar relationship that is not considered a marriage under state law are not considered married for federal tax purposes.

A surviving spouse can file a joint return if his or her spouse died during the year and the surviving spouse did not remarry before the end of the year. However, the executor of the decedent's estate must agree to the filing of the joint return. On the joint return, the surviving spouse reports the income of both the deceased spouse (earned prior to death) and the surviving spouse. The year of death is the last year for which the taxpayer can file jointly with a deceased spouse.

CROSS-REFERENCE

Determination of Marriage

The determination of whether a taxpayer is legally married may constitute the practice of law. See pages 7–9 in the *2016 National Income Tax Workbook* for a discussion of the unauthorized practice of law. Also, helping taxpayers to choose the correct filing status may create a conflict of interest. See pages 13–15 in that same book for a discussion of conflicts of interest.

Married Filing Separately

In general, married couples may file either joint or separate returns. However, if one spouse chooses to itemize deductions, the other spouse must also itemize deductions, even if the other spouse's itemized deductions are less than the standard deduction. Taxpayers filing MFS generally cannot claim the credit for child and dependent care expenses. They cannot claim the earned income credit, the credit for the elderly or disabled, and the education credits. Other credit amounts may be reduced if taxpayers file MFS.

Head of Household

To claim HoH status, a taxpayer must meet all the following conditions:

- The taxpayer must be unmarried as of the last day of the tax year. Exceptions apply to individuals married to nonresident aliens

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and to certain married individuals living apart from their spouses who are considered unmarried (discussed below).

- An individual cannot claim HoH status in the year his or her spouse died (the surviving spouse must file a joint return or a separate return in the year the spouse died).
- The taxpayer must be a US citizen or resident.
- The taxpayer must pay over half of the costs of maintaining his or her home in which a qualifying person lived for more than half of the tax year. Under a special rule, a taxpayer with a dependent parent qualifies even if the parent does not live with the taxpayer. [I.R.C. § 2(b)]

The costs of maintaining the household include property taxes, mortgage interest, rent, utility payments, expenses relating to upkeep and repairs, property insurance premiums, and expenditures on food consumed on the premises. Not included are the costs of clothing, education, medical treatment, vacations, life insurance, transportation, or the value of services provided by the taxpayer.

A taxpayer is considered unmarried on the last day of a tax year if all the following requirements are met:

1. The taxpayer files a separate return (MFS, single, or HoH filing status).
2. The taxpayer paid more than half the cost of keeping up his or her home for the tax year.
3. The taxpayer's spouse did not live in the taxpayer's home during the last 6 months of the tax year. A spouse is considered to live in the home even if he or she is temporarily absent due to special circumstances.
4. The taxpayer's home was the main home of his or her child, stepchild, or foster child for more than half the year.
5. The taxpayer can claim an exemption for the child (or meets the requirement for the years in which the exemption is suspended). However, the taxpayer meets this test if he or she cannot claim the exemption only because the noncustodial parent can claim the child.

For information about qualifying persons, see IRS Publication 17, *Your Federal Income Tax (For Individuals),* Table 4, "Who Is a Qualifying Person Qualifying You To File as Head of Household"; and Form 886-H-HOH, Supporting Documents To Prove Head of Household Filing Status.

CROSS-REFERENCE

See the "Ethics" chapter in this book for a discussion of the new preparer due diligence requirements that apply to filing as HoH.

Qualifying Widow(er)

For 2 tax years after the year of death, the widow or widower may file as a qualifying widow(er) (also called a surviving spouse) if he or she meets certain conditions [I.R.C. § 2(a)]. The taxpayer

- must have not remarried as of the end of the year in which qualifying widow(er) status is claimed,
- must be a US citizen or resident,
- must have qualified to file a joint return in the year of the spouse's death, and
- must have at least one dependent child living at home during the entire year.

There are exceptions if the taxpayer could have claimed the child as a dependent, but the child had gross income of $4,050 (2017) or more, the child filed a joint return, or the taxpayer could be claimed as a dependent on someone else's return. In addition, the taxpayer must pay over half of the expenses in providing the home for himself or herself and his or her dependent. The surviving spouse reports only his or her income.

Tax Rates

The TJCA temporarily modifies the income rate structure under which individuals are taxed [I.R.C. § 1(j)].

Single vs. MFJ

The MFJ tax brackets in the TCJA are twice the amount of the corresponding tax brackets for single filing status through the 32% bracket. Thus, for taxpayers in these brackets, there is no

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marriage penalty, and the decision to file married or single has no impact on rates. The 35% and 37% brackets for MFJ are not twice the amount of the corresponding tax brackets for single filing status, so the marriage penalty applies to MFJ filers in these brackets. **Figure 8.2** shows the difference between single and MFJ for taxpayers in the 35% and 37% brackets.

FIGURE 8.2 2018 MFJ and Single Tax Rates—35% and 37% Brackets

MFJ	
If Taxable Income Is	**The Tax Is**
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000

Single	
If Taxable Income Is	**The Tax Is**
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000

Example 8.39 Marriage Penalty

Margaret Holmes and Ryan Hunter have been dating for several years and have been contemplating getting married. Margaret runs a successful business, and her 2018 taxable income is $300,000. Ryan is a professional athlete and his 2018 taxable income is $750,000. Their tax liability filing single status is calculated as follows:

- Margaret filing single: $45,689.50 + [35% × ($300,000 − $200,000)] = $80,690
- Ryan filing single: $150,689.50 + [37% × ($750,000 − $500,000)] = $243,190
- Combined filing single: $80,690 + $243,190 = $323,880

If Margaret and Ryan marry and file a joint return, their tax liability is $327,879 [$161,379 + {37% × ($750,000 + $300,000 − $600,000)}]. Filing a joint return results in a $3,999 ($327,879 − $323,880) higher tax liability than filing as single taxpayers.

CROSS-REFERENCE

Tax Rates

See the "Tax Rates and Useful Tables" chapter in this book for a full comparison of the 2017 and the 2018 tax rates.

Single vs. HoH

In 2017, the rate brackets for HoH filers were more favorable than the brackets for single filers. For example, an HoH taxpayer with income that exceeded $130,150 was in the 28% bracket, while a taxpayer who filed single reached the 28% bracket when income was more than $91,150. Under current tax law, HoH taxpayers in the 24% bracket and above are subject to the same brackets as single taxpayers, but their tax calculations are still more advantageous.

Example 8.40 Allocating HoH Status

Mark Miller is divorced with a 12-year-old daughter who shares her time between her mother's home and her father's home. She is a qualified child of both Mark and his former spouse, Julie Moore. In 2018, Mark has $550,000 taxable income and Julie has $50,000 taxable income. In deciding the value of the HoH status, Mark and Julie compare their tax liability using single status with their tax liability using HoH status using the 2018 tax rate schedules.

- Mark single: $150,689.50 + [37% × ($550,000 − $500,000)] = $169,190
- Mark HoH: $149,298 + [37% × ($550,000 − $500,000)] = $167,798
- Julie single: $4,453.50 + [22% × ($50,000 − $38,700)] = $6,940

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- Julie HoH: $1,360 + [12% × ($50,000 − $13,600)] = $5,728

The value of HoH status to Mark is $1,392 ($169,190 − $167,798). The value of HoH status to Julie is $1,212 ($6,940 − $5,728). The HoH filing status is only $180 ($1,392 − $1,212) more advantageous to Mark than to Julie.

The TCJA eliminated the dependency deduction, but the parties must consider available credits. Although Mark could benefit more from the HoH status, the child tax credit is now $2,000 per qualifying child. The credit begins to phase out for MFJ taxpayers with AGI greater than $400,000, and it begins to phase out for all other taxpayers (MFJ, single, and HoH) with AGI greater than $200,000. See the earlier discussion (Issue 1) of the changes to the child tax credit, and the new family tax credit for other dependents.

State and Local Tax Deduction

For tax years beginning after December 31, 2017 and before January 1, 2026, the I.R.C. § 164 deduction is limited to $10,000 for all taxpayers ($5,000 for MFS). This limit applies to the following types of taxes:

1. State and local real property taxes
2. State and local personal property taxes
3. State and local, and foreign, income; war profits; and excess profits tax
4. Sales taxes

Single taxpayers and MFJ taxpayers are both subject to the same $10,000 limit. Thus, two taxpayers who file single will collectively have a $20,000 limit. If those same two taxpayers file MFJ, they have only a $10,000 limit for both.

Example 8.41 Single vs. MFJ for the State and Local Tax Deduction

June Pederson and Jan Smith have been dating for several years and have been contemplating getting married. In 2018, June paid $5,000 real property taxes and $5,000 state income tax. In 2018, Jan paid $10,000 state income tax. If June and Jan file as single, they can each deduct the full $10,000 taxes paid (assuming that they itemize deductions). If June and Jan get married and file MFJ, their deduction is limited to $10,000. The other $10,000 in taxes paid is not deductible.

Qualified Business Income Deduction

The I.R.C. § 199A (QBI) deduction for qualified business income has two limitations. The limitations phase in for taxpayers with income above a certain threshold amount, and then completely preclude a deduction for taxpayers whose income exceeds the threshold amount plus $50,000 ($100,000 for MFJ). The threshold amount for the W-2 wage limit and the specified service trade or business limit is $157,500 ($315,000 for MFJ). The threshold is indexed for inflation for tax years beginning after 2018.

Thus, taxpayers at or below the threshold amount are not subject to the limits. The wage limit applies fully for a taxpayer with taxable income that exceeds the threshold amount plus $50,000 ($100,000 for MFJ). For taxpayers with taxable income that is more than the threshold amount but less than the threshold amount plus $50,000 ($100,000 for MFJ), the wage limit is phased in.

CROSS-REFERENCE

QBI Deduction

See the "New Legislation—Business" chapter and the "Business Issues" chapter in this book for a detailed discussion of the QBI deduction, the W-2 wage limit, and the specified service trade or business limit.

If spouses collectively have income that exceeds the threshold but the spouse whose income is eligible for the QBI deduction has income that is less than the threshold, the taxpayers may be entitled to a larger QBI deduction if they file MFS instead of MFJ.

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Example 8.42 MFS vs. MFJ and the QBI Deduction

Tamara and Theodore Wright typically file MFJ. Tamara works for a large company, and in 2018 she has $450,000 taxable income. Theodore is an attorney, and his business is structured as a single-member LLC. Theodore's taxable income from the business is $150,000, and the business paid no wages. If Tamara and Theodore file MFJ, their $600,000 ($450,000 + $150,000) combined taxable income will exceed the $415,000 ($315,000 + $100,000) end of the phasein range for the W-2 wage limit and the specified service trade or business limit, and they will have no QBI deduction. If instead Tamara and Theodore file MFS, then Theodore's qualified business income will be fully eligible for the 20% deduction because his $150,000 taxable income is less than the $157,500 threshold for the W-2 wage limit and the specified service trade or business limit, and those limits do not apply.

PRACTITIONER NOTE

Community Property

Taxpayers in a community property state generally must divide income equally. Therefore, there is limited opportunity to file MFS to take advantage of the QBI deduction. Under I.R.C. § 66, community property law will be ignored if the spouses lived apart the entire tax year, do not file a joint return, one or both have earned income, and no part of such earned income is transferred between the spouses.

ISSUE 6: TIMESHARES

This section discusses tax considerations for a taxpayer who owns, sells, or abandons a timeshare.

A timeshare is a property with a divided form of ownership or use rights. Multiple parties hold rights to use the property, and each owner of the property can use the timeshare during specified periods. Timeshares create unique tax issues because of the fractional form of ownership and because they may be used in part for personal purposes and in part for rental purposes. This issue reviews deductions for timeshare expenses, limitations on timeshare losses, and taxation of the disposition of a timeshare, including a disposition by abandonment.

Types of Timeshares

Timeshares are typically structured in the following three different ways:

1. In a *deeded timeshare*, the owner has a deeded interest in real estate. The owner can rent, sell, exchange, or otherwise transfer his or her interest.
2. A *leasehold or right* to use a timeshare gives the owner the right to use a particular unit or unit size each year, but it does not grant an ownership interest in the real estate. Legal ownership is typically vested in the developer.
3. In timeshares that are *based on points*, the owner purchases points, which are then redeemed for the right to use a timeshare unit.

Most timeshares are structured as a deeded interest, and this issue focuses on the tax issues for timeshares that are held as a deeded fractional interest in real property.

Deductible Expenses

A taxpayer may be able to deduct expenses of a timeshare.

Mortgage Interest

As with a personal residence, mortgage interest on a timeshare used for personal purposes may be deductible, subject to the limits on the deduction for mortgage interest. The deduction for interest on indebtedness to acquire a qualified residence (acquisition indebtedness) is limited to $750,000 acquisition debt ($375,000 for MFS). The limit does not apply to any indebtedness incurred on or before December 15, 2017, which is subject to the $1,000,000 ($500,000 for MFS) debt limit.

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For mortgage interest on a personal use timeshare to be deductible, the debt must be a secured debt (i.e., the timeshare must be pledged as collateral for the loan), and it must be secured by a qualified residence. A *qualified residence* is a main home or a second home. A *second home* is a home that the taxpayer chooses to treat as his or her second home.

However, if the taxpayer chooses to treat a timeshare as a second home and rents it out part of the year, the owners must use the timeshare more than 14 days or more than 10% of the number of days during the year that the timeshare is rented at a fair rental value, whichever is longer. If the owners do not use the timeshare long enough to meet the 10% or 14-day rule, it is not a second home, and the taxpayer cannot claim the I.R.C. § 163 deduction for residential home mortgage interest for the timeshare.

If the timeshare is used in part for personal use and in part for business use, subject to certain limitations (discussed later), the portion of the interest attributable to business use may be deductible, regardless of the amount, and regardless of whether the timeshare is a qualified residence.

PRACTITIONER NOTE

Personal Use

When computing days of "personal use," the taxpayer must include his or her own use, use by a member of the taxpayer's family, and use by any other person who has an interest in the unit [I.R.C. § 280A(d)(2)(A)]. Due to the lack of knowledge and available data about how all other unit owners occupied or rented their allocated nights, it may be virtually impossible to compute an allowable deduction or an allocation of expenses.

CROSS-REFERENCE

Mortgage Interest and Property Taxes

See the "New Legislation—Individual" chapter in this book for a discussion of recent changes to the deductions for real estate taxes and mortgage interest.

Maintenance and Improvements

Maintenance on a timeshare that is solely for personal use is not deductible. If the timeshare is used in part for personal use and in part for business use, accounting for all owners of the unit, the owners, subject to certain limitations (discussed later), may be able to deduct the portion of maintenance costs allocable to business use. Improvements are typically not deductible and must be capitalized (added to the basis) of the timeshare.

CROSS-REFERENCE

Safe Harbors

Certain safe harbors may allow a timeshare owner to expense the cost of an improvement if the property is rental property that satisfies the 10% or 14-day rule. See pages 278–280 in the *2017 National Income Tax Workbook* for a discussion of the small taxpayer safe harbor, the de minimis safe harbor, and the safe harbor for routine maintenance.

Real Estate Taxes

Timeshare owners can deduct real estate taxes attributable to deemed personal use of a timeshare. However, for tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for state and local taxes is limited to $10,000 ($5,000 MFS). The $10,000 annual limit does not apply to real property taxes if those taxes are paid or accrued in carrying on a trade or business or an activity described in I.R.C. § 212 (relating to expenses for production of income). Thus, a timeshare owner's deduction for real estate taxes attributable to business use of the timeshare are not subject to the $10,000 limitation.

PRACTITIONER NOTE

Reporting Real Estate Taxes

Real estate taxes for a timeshare may be billed to the taxpayer either as a separate item or as part of the annual maintenance fee. If the taxes are included in the maintenance fee, the taxpayer must ask the timeshare management to separately identify the amount of real estate taxes.

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Depreciation

The cost of a timeshare that is residential rental property is depreciated over 27.5 years. No depreciation is allowed if the timeshare is used for solely personal purposes. If the owners of the timeshare use the timeshare for personal and rental purposes, the owners may have to allocate depreciation between the rental use and the personal use.

14-Day Rule

If the owners of the timeshare collectively use a timeshare as a residence and rent it less than 15 days during the year, its primary function is not a rental. The owners do not have to report the rental income and cannot deduct the rental expenses [although mortgage interest, property taxes, and any qualified casualty may be deductible on Schedule A (Form 1040), Itemized Deductions].

PRACTITIONER NOTE

Not Used as a Home

If the taxpayer used as timeshare for personal purposes, but not as a residence, the taxpayer must report all the rental income in his or her income and must divide expenses between the rental use and the personal use. The taxpayer uses a dwelling unit as a residence during the tax year if he or she, along with all other fractional owners, have deemed personal use of more than the greater of 14 days, or 10% of the total days it is rented to others at a fair rental price.

Allocating Expenses

If all the fractional owners of the unit use a timeshare that meets the definition of a residence and rent it 15 days or more during the year, the taxpayer must include all rental income in his or her income. The taxpayer must allocate expenses between personal and rental use. Generally, expenses such as maintenance and utilities are allocated based on the days used. The IRS directs taxpayers to also divide expenses that are always deductible (such as interest and taxes) between the rental use and the deemed personal use based on the number of days used for each [IRS Publication 527, *Residential Rental Property* (2017), page 17].

However, some courts have approved allocation of interest and taxes based on the ratio of the number of days rented to the total days in the year [*Bolton v. Commissioner*, 694 F.2d 556 (9th Cir. 1982), *aff'g* 77 T.C. 104 (1981)]. The Tenth Circuit Court of Appeals followed that approach in *McKinney v. Commissioner*, 732 F.2d 414 (10th Cir. 1983).

Example 8.43 Allocating Expenses

Jill Stuart has a timeshare in Hawaii. Jill is entitled to use the timeshare 6 weeks each year. Jill rented the timeshare at a fair rental price for 20 days. She used the timeshare for personal purposes 15 days, and the timeshare was vacant the remaining days. Under the IRS method, Jill's rental expenses are 57% [20 ÷ (20 + 15)] of the total expenses. Note, however, that Jill must account for occupancy by all owners to make a correct allocation of expenses.

Vacation Loss Limits

If the use by all fractional owners exceeds the greater of 14 days or 10% of the days the timeshare was rented, the expenses allocated to rental use may offset the gross income from the property, but expenses cannot exceed the gross income from the property. Gross income is first reduced by direct expenditures to obtain tenants, such as advertising and realtors' commissions; second by real estate taxes and mortgage interest; third by operating expenses; and finally by depreciation.

CROSS-REFERENCE

Loss Limits

See the "Loss Limitations" chapter in the *2017 National Income Tax Workbook* for a further discussion of the vacation loss limitation rules, and for a discussion of the passive activity loss limitations and at-risk rules that may further limit timeshare losses.

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Disposing of a Timeshare Interest

A taxpayer may be required to report and pay taxes on the disposition of a timeshare interest.

Sale at a Gain

If a timeshare sale results in a gain, the treatment of the gain depends on how the property was used. Gains on timeshares used personally are capital gains and are reported on Schedule D (Form 1040), Capital Gains and Losses. Gains from timeshares used as rental properties are treated as ordinary income to the extent of depreciation taken, and any excess gain is a capital gain.

Example 8.44 Gain on Sale—Personal Use

Frank Fullerton purchased a timeshare for $10,000. Frank used the timeshare for personal vacations and did not rent it out to third parties. He sold the timeshare for $12,000. Frank reports a $2,000 capital gain on his tax return.

Example 8.45 Gain on Sale—Rental Use

Peter Patter purchased a timeshare for $25,000. He rented the timeshare to third parties and partially used it for personal use. Over 3 years, Peter claimed $2,273 in depreciation (which was properly calculated based on use of all the unit owners) and paid $1,500 toward capital improvement reserves. Peter sold the timeshare for $27,500. Peter has a $3,273 gain [$27,500 – ($25,000 – $2,273 + $1,500)]. Peter reports $2,273 of the gain attributable to depreciation on Form 4797, Sale of Business Property, and reports the remaining $1,000 on Schedule D (Form 1040).

Sale at a Loss

A loss on the sale of a timeshare used for personal purposes is not deductible. If the timeshare is used as a rental property after considering all occupancy by all owners, the loss may be deductible either as an I.R.C. § 1221 asset (capital loss) or an I.R.C. § 1231 asset (ordinary loss). The timeshare is treated as a section 1231 asset only if the timeshare activity rises to an I.R.C. § 162 trade or business activity.

PRACTITIONER NOTE

Reporting a Loss on the Sale of a Personal Use Timeshare

A deduction for a loss on a timeshare used personally is not allowed. However, a taxpayer may have to report the loss if he or she received Form 1099-S, Proceeds from Real Estate Transactions. The taxpayer reports the loss on Schedule D (Form 1040) and uses code L in column f on Form 8949, Sales and Other Dispositions of Capital Assets, to classify the loss as nondeductible.

If a timeshare was used personally and then converted to a rental property, gain is calculated in the same manner as gain on a timeshare that had always been rental property. If the sale results in a loss, the basis is the lower of cost or FMV on the date the timeshare was converted to rental use.

Abandonment

Timeshare properties are often abandoned when the interest cannot be sold. If the loan on the timeshare is secured by the timeshare, and the lender acquires the property from the taxpayer, such as in a foreclosure, or has reason to know the taxpayer has abandoned the timeshare, the lender will send a Form 1099-A, Acquisition or Abandonment of Secured Property. **Figure 8.3** shows Form 1099-A.

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FIGURE 8.3 Form 1099-A, Acquisition or Abandonment of Secured Property

8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.			OMB No. 1545-0877 2018 Form 1099-A	Acquisition or Abandonment of Secured Property
LENDER'S TIN	BORROWER'S TIN	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $	Copy A For Internal Revenue Service Center
BORROWER'S name		3	4 Fair market value of property $	File with Form 1096.
Street address (including apt. no.)		5 If checked, the borrower was personally liable for repayment of the debt . . . . ▶ ☐		For Privacy Act and Paperwork Reduction Act Notice, see the **2018 General Instructions for Certain Information Returns.**
City or town, state or province, country, and ZIP or foreign postal code		6 Description of property		
Account number (see instructions)				

Form **1099-A** Cat. No. 14412G www.irs.gov/Form1099A Department of the Treasury - Internal Revenue Service

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On the form, the lender reports the amount of the principal owed and the FMV of the secured property as of the date of the acquisition or abandonment of the property. The taxpayer uses the amount realized to determine a gain or loss on the disposition of the property and reports the gain or loss on Schedule D (Form 1040), Capital Gains and Losses, (if the property is a personal asset or does not rise to an I.R.C. § 162 trade or business), or on Form 4797, Sales of Business Property (if the property is used as a rental activity and was used in an I.R.C. § 162 trade or business). The amount realized depends on if the debt is recourse or nonrecourse. If the debt is recourse, the amount realized is the FMV of the property. If the debt is nonrecourse, the amount realized is the entire amount of the nonrecourse debt plus the amount of cash and the FMV of any property received.

Observation

Recourse vs. Nonrecourse Debt

Debt associated with timeshares generally is nonrecourse debt as the taxpayer is not personally liable for the debt. For more information about the amount to be realized, see IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals).

Practitioner Note

Cancellation of Debt

If the lender subsequently cancels the debt on the abandoned property, the taxpayer may receive Form 1099-C, Cancellation of Debt. In general, if a taxpayer's debt is canceled, forgiven, or discharged, the amount of the canceled debt is taxable and must be reported in the year the cancellation occurs. For potential non-recognition of cancelled debt, see Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), and the related instructions.

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ISSUE 7: STANDARD OR ITEMIZED DEDUCTIONS

This section reviews how a taxpayer who claims the increased standard deduction can benefit from deductions that are available only to taxpayers who itemize.

The Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, significantly increased the standard deduction and made some changes that limit a taxpayer's itemized deductions. As a result, many taxpayers who formerly itemized deductions may find it more advantageous to claim the standard deduction, which for 2018 is $24,000 for MFJ and surviving spouses, $18,000 for head of household, and $12,000 for single and MFS taxpayer (indexed for inflation in later years). This section reviews the changes to itemized deductions, and it discusses when a taxpayer who claims the standard deduction may still benefit from certain itemized deductions. **Appendix A** to this issue contains the new Schedule A (Form 1040), Itemized Deductions.

Medical and Dental Expenses

After December 31, 2016, and before January 1, 2019 (tax calendar years 2017 and 2018), individual taxpayers who itemize deductions can deduct medical and dental expenses that exceed 7.5% of the taxpayer's AGI. After December 31, 2018, the limit increases to 10%. The lower limit for 2017 and 2018, also applies to the alternative minimum tax (AMT). Taxpayers who do not itemize deductions may be able to deduct certain amounts paid to a health savings account (HSA), and exclude amounts paid to a flexible spending arrangement (FSA), or a health reimbursement arrangement (HRA).

Health Savings Accounts

An HSA is a tax-advantaged medical savings account that allows taxpayers to use pretax money to pay medical expenses. To be eligible, a taxpayer must have a high deductible health plan (HDHP). The participant cannot be enrolled in Medicare or be claimed as a dependent on another person's tax return.

PLANNING POINTER

Medicare Recipient

Taxpayers enrolled in Medicare cannot contribute to an HSA but they can use HSA contributions made prior to age 65 to pay the premiums for Medicare Part B, Part D, and Medicare Advantage plans.

The taxpayer, the taxpayer's family, an employer, or anyone else can make contributions to HSAs. Contributions up to an annual limit (inflation-adjusted after 2006) are deductible as an above-the-line deduction by the taxpayer who owns the HSA. Employer contributions up to the annual limit are not included in an employee's income and are not deductible by the employee. For 2018 the contribution limit is $3,450 for self-only coverage and $6,850 for family coverage, which includes all other coverage. HSA-eligible individuals over 55 years old may contribute an extra $1,000 annually. Any unused amounts can be used in later years.

Distributions from an HSA used exclusively to pay qualified medical expenses of the account beneficiary, spouse, or dependents are excluded from gross income. A taxpayer can receive distributions from an HSA even if he or she is not currently eligible to make contributions to the HSA. However, any part of a distribution not used to pay qualified medical expenses is included in gross income and is subject to an additional 20% tax, unless an exception applies. Generally, qualified medical expenses for HSA purposes are unreimbursed medical expenses that could otherwise be deducted on Schedule A (Form 1040), before the AGI limitation.

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PLANNING POINTER

Current-Year Deduction

The taxpayer claims a current-year deduction for contributions to the HSA but does not have to currently use the funds in the account. Thus, a taxpayer can obtain the deduction while he or she has higher employment income and use the funds later upon retirement.

Flexible Spending Arrangements

An FSA is an employer-sponsored benefit plan, which can be offered with other benefits as part of a cafeteria plan. It allows employees to pay for medical costs and childcare with before-tax dollars. Employees annually elect how much they want deposited in the account. Employers can also contribute. Contributions are excluded from the employee's gross income. For 2018, the annual medical FSA limit is $2,650 and the child care FSA limit remains at $5,000 ($2,500 for MFS).

As the costs are incurred, the employer reimburses the employee from the account. Withdrawals are tax-free if they are used for qualified expenses. Qualified expenses are typically expenses that could be deducted on Schedule A (Form 1040), before the AGI limitation. Any amounts that are not spent during the year are retained by the plan and are not available to the employee in subsequent years.

PRACTITIONER NOTE

Self-Employed Persons

Self-employed persons are not eligible for an FSA or HRA. For fringe benefit purposes, an S corporation is treated as a partnership, and a 2% shareholder is treated as a partner of the partnership. A 2% shareholder is one that directly or constructively owns more than 2% of the corporation's outstanding stock on any day during the S corporation's tax year. Therefore, greater than 2% shareholders of S corporations receiving W-2 wages are ineligible to participate in an FSA or HRA.

Health Reimbursement Arrangements

I.R.C. § 105 allows for the reimbursement of medical expenses under an employer-sponsored health plan. Under an HRA, the employer contributes to the plan. The contributions are excluded from the employee's income. There is no limit on the employer's contribution. Distributions must be paid to reimburse the employee for qualified medical expenses of the employee and his or her spouse and dependents. Unused amounts can be carried over to the next year.

PLANNING POINTER

Bunching Expenses

If the taxpayer's standard deduction is higher than his or her itemized deductions, and the taxpayer cannot deduct medical expenses or charitable contributions, the taxpayer may consider bunching those expense. If possible, the taxpayer can bunch medical expenses into one year (including medical expenses of a dependent) and can make all his or her charitable contributions every other year, or every third year.

PLANNING POINTER

Medical Expense Election

Generally, unpaid medical expenses are not allowed as a deduction on the decedent's individual income tax return but are allowed as a deduction on the estate tax return. With the increased estate tax exemption amount ($11,180,000 in 2018), most taxpayers no longer have an estate tax liability. In these cases, the executor of the estate can elect to treat any medical expenses paid from the estate within 1 year of the date of death as an itemized deduction [I.R.C. § 213(c)].

Taxes You Paid

For tax years 2018 through 2025, the TCJA limits the deduction for taxes paid.

State and Local Taxes

Under prior law, the following state, local, and foreign real property taxes were fully deductible for a taxpayer who itemized deductions:

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1. State and local real and personal property taxes
2. State, local, and foreign income taxes

The taxpayer could elect to deduct sales taxes instead of income taxes. Effective for tax years after December 31, 2017, taxpayers can no longer deduct foreign real property taxes and the deduction for the remaining tax is limited to $10,000 ($5,000 for MFS). The $10,000 annual limit does not apply to those taxes that are paid or accrued in carrying on a trade or business or an activity described in I.R.C. § 212 (relating to expenses for production of income). For example, an individual taxpayer can deduct state, local, and foreign property taxes, and sales taxes for activities reported on Schedule C (Form 1040), Schedule E (Form 1040), or Schedule F (Form 1040).

PRACTITIONER NOTE

Alternative Minimum Tax

State and local taxes are disallowed for AMT purposes. The AMT exemption deduction has significantly increased and the phaseout is at much higher income levels starting in 2018. With the new limits on the deduction for taxes paid, the elimination of personal and dependent exemptions, and the large AMT deduction, many taxpayers will not be subject to AMT.

State Charitable Contribution Workaround

In response to this new limitation, some state legislatures have adopted or are considering legislative proposals allowing taxpayers to make payments to specified entities in exchange for a tax credit against state and local taxes owed. With limited exceptions, under the proposed regulations, a taxpayer who makes payments or transfers property to an entity eligible to receive tax deductible contributions must reduce his or her charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive.

State Lawsuits

On July 17, 2018, four states sued the United States to void the limit on the state and local tax deduction. New York, Connecticut, Maryland, and New Jersey filed the lawsuit claiming that the limit unconstitutionally intrudes on state sovereignty and that it violates the Tenth Amendment by compelling states to reduce their public spending. They claim that the cap will cause depressed home values, curtail economic growth, and impede their ability to raise revenue. The complaint alleges that the new cap will be responsible for New York taxpayers paying an additional $14.3 billion in federal taxes in tax year 2018, and an additional $121 billion between 2018 and 2025 [*New York v. Mnuchin*, No. 18-cv-6427 (S.D.N.Y. 7/17/18)].

Real Estate Taxes

The new $10,000 limit also includes real estate taxes. Originally taxpayers believed they could prepay 2018 property taxes. Several local governments tried to be helpful by revising computer systems to accept payment in 2017 for the 2018 tax year. However, the 2017 payments were deductible only if they were assessed in 2017. Any payments that were disallowed are allowed as a deduction in the year the tax is assessed (subject to the $10,000 limit).

OBSERVATION

Trust Workaround

Some practitioners have proposed the use of several nongrantor trusts to avoid the limitation on property taxes. They have suggested that an individual taxpayer transfer his or her house or vacation home, and income-earning assets that will generate sufficient funds to pay the property taxes to an LLC (treated as a disregarded entity). The taxpayer then gifts the LLC interests to multiple nongrantor trusts for the grantor's spouse. Each trust would have $10,000 income and take a $10,000 property tax deduction. Thus, if the taxpayer owed $100,000 per year in property taxes, he or she would gift the LLC interests to 9 trusts, and the taxpayer would retain a 10% LLC interest that paid $10,000 in property taxes. The IRS has not yet issued any guidance on this workaround, but if the entities are not created for legitimate business purposes, the IRS may conclude that substance prevails over form.

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Capitalizing Costs

I.R.C. § 266 allows a taxpayer to elect to capitalize (add to basis) certain property taxes and carrying charges instead of currently deducting them. The taxpayer can elect to capitalize the following:

1. For unimproved and unproductive real property, the taxpayer can elect to capitalize annual taxes, interest on a mortgage, and other carrying charges.
2. For other real property, whether improved or unimproved and whether productive or unproductive, the taxpayer can capitalize interest on a loan, and certain other expenditures paid or incurred for the development of the real property or for the construction of an improvement or additional improvement to such real property, up to the time the development or construction work has been completed.

Theoretically, a taxpayer could elect to capitalize these taxes if the taxpayer's other taxes exceed the $10,000 limit on the deduction for state and local taxes. However, an item not otherwise deductible may not be capitalized under section 266. The AICPA has asked Congress to clarify how the new limitation affects this election. Also, if a taxpayer's standard deduction is higher than his or her itemized deductions, the taxpayer could elect to capitalize the section 266 amounts.

The election is made annually by attaching a statement to the tax return, and it must be made by the due date (including extensions) of the return. **Figure 8.4** is a sample election.

FIGURE 8.4 Election to Capitalize Taxes and Interest

For tax year 2018, taxpayer hereby elects under I.R.C. § 266 and Treas. Reg. § 1.266-1 to capitalize, rather than deduct, property taxes, mortgage interest, and other miscellaneous carrying costs on the vacant lot located at 555 Water Street, Any Town, USA.

PLANNING POINTER

Partial Election

Taxpayers can elect to capitalize some categories of expenses but not others, but they cannot split categories. For example, the taxpayer can elect to capitalize real estate taxes but not mortgage interest, but the taxpayer cannot capitalize part of their mortgage interest and deduct the remainder.

Example 8.46 Taxpayer Not Itemizing

Sarah and Daniel Graham hold vacant land as an investment. In 2018, they paid $5,000 in property taxes and $5,000 in mortgage interest for the property. They also paid $10,000 in state income tax. Sarah and Daniels's total itemized deductions are $20,000, and they instead claim the $24,000 standard deduction. Sarah and Daniel can capitalize the property taxes and interest on the investment property, which will increase the basis in the land.

Interest You Paid

Taxpayers who itemize deductions can deduct certain home mortgage interest, mortgage insurance premiums, and investment interest.

Home Mortgage interest

Prior to 2018, taxpayers could deduct interest on up to $1,000,000 of home acquisition indebtedness ($500,000 for MFS). Home acquisition indebtedness is debt used to buy or substantially improve a primary or secondary residence under I.R.C. § 163(h)(3)(B). Also, the taxpayer could deduct interest on home equity indebtedness up to $100,000 ($50,000 MFS) [I.R.C. § 163(h)(3)(C)]. Both acquisition and equity debt had to be secured by a qualified residence. The TCJA lowered the limit for home acquisition indebtedness and eliminated the home equity interest deduction for amounts that were not incurred to buy, build, or substantially improve a qualified residence.

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Lower Limit

From 2018 through 2025, the TCJA limits the deduction to qualified home mortgage interest paid on $750,000 ($375,000 MFS). The $750,000/$375,000 limit does not apply to debt incurred on or before December 15, 2017. Also, if before December 15, 2017, the taxpayer had entered into a binding contract to purchase a personal residence by January 1, 2018, and the taxpayer actually purchases the qualified residence before April 1, 2018, the former $1,000,000/$500,000 limits apply. The limits apply to the combined loan amounts used to buy, build, or substantially improve the taxpayer's primary home and second home.

Qualified residence debts that are refinanced will be treated as though incurred on the date that the original debt was incurred if the amount of indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness. However, this exception does not apply if the refinancing occurs after the expiration of the term of the original debt. It also does not apply if the original debt was not amortized over its term, and the term of the first refinancing of the debt expired or, if earlier, it is 30 years or more after the date of the first refinancing. In applying the $750,000 limit to any indebtedness incurred after December 15, 2017, the $750,000 limit is reduced (but not below zero) by the amount of any indebtedness incurred on or before December 15, 2017, that is treated as qualified acquisition indebtedness for the tax year.

Example 8.47 Deduction for Mortgage Interest

Bill and Betty Donaldson have an $825,000 first mortgage that they took out to buy their principal residence in 2013. In 2018, they took out a $90,000 home equity line of credit (HELOC) to remodel their residence. In 2018, Bill and Betty can still deduct all the interest from the first mortgage (assuming that they itemize deductions). However, they cannot deduct the HELOC interest because when it is added to the amount of indebtedness incurred in 2013 it exceeds the $750,000 limit.

Limit on Deducting Home Equity Debt

From 2018 through 2025, home equity debt is not deductible unless the funds are used to buy, build, or substantially improve the taxpayer's home that secures the loan. Thus, taxpayers with a home equity loan or line of credit that is not deductible should consider paying off the loan.

PRACTITIONER NOTE

Tax Organizer

Tax practitioners should consider adding several new questions to the 2019 tax organizer, including the date of each original mortgage and any refinancing, amount of mortgage, purpose of mortgage and any equity extracted from refinancing, and asset collateralizing the debt. Appendix B shows the new Form 1098, Mortgage Interest Statement. As with the prior-year form, the 2018 form shows the mortgage origination date, current balance of the loan, and property securing the loan, but it does not show the purpose of the loan.

Vacation Homes

The limitations do not apply to taxes and interest that are incurred in a trade or business or an activity for the production of income. Owners of a vacation home who rent the property may be able to take a full deduction for mortgage interest and real property taxes for the portion attributable to the rental occupancy [I.R.C. § 280A]. The personal use portion of real estate taxes and mortgage interest may be deductible on Schedule A (Form 1040), Itemized Deductions.

CROSS-REFERENCE

Loss Limits

I.R.C. § 280A limits certain expense in connection with rental of a vacation home. See the "Loss Limitations" chapter in the *2017 National Income Tax Workbook* for a discussion of the loss limitation rules.

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Interest Tracing Rules

In a difficult lending environment, many self-employed small business owners are unable to finance their businesses through commercial lenders. They might refinance their home or obtain a home equity loan. These taxpayers must use interest tracing rules to properly allocate the mortgage interest to the business use of the proceeds.

The tracing rules become more complicated when funds from several different loans and nonloan amounts are combined in a single account, from which expenditures are made for a variety of purposes. The taxpayer must apply detailed ordering rules to match the debt with expenditures.

Mortgage Insurance Premiums

The Bipartisan Budget Act of 2018 (BBA), Pub. L. No. 115-123, retroactively extended the deduction for private mortgage insurance (PMI) premiums for 2017. Lenders typically charge these premiums when the loan to value ratio of the property is greater than 80%. Premiums are typically between $100 and $200 per month. The taxpayer can deduct PMI premiums as interest. The deduction begins phasing out when the taxpayer's AGI exceeds $100,000, and it is completely phased out when the taxpayer's AGI exceeds $109,000 (one-half those amounts for MFS taxpayers). The taxpayer cannot deduct prepaid PMI premiums and must wait to take the deduction in the year the insurance coverage applies. The deduction for PMI premiums has not yet been extended for 2018.

Investment Interest

The TCJA did not change the itemized deduction for investment interest [I.R.C. § 163(d]. Investment interest is interest paid on a loan used to purchase investment property. *Investment property* includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business. It also includes property that produces gains or losses. The amount of interest that can be deducted is limited to the taxpayer's net investment income. Excess amounts can be carried forward and used in future years. If the taxpayer cannot deduct investment interest, the taxpayer may be able to capitalize the expense under I.R.C. § 266 (see the earlier discussion of capitalizing taxes and interest).

Gifts to Charity

The TCJA increased the limit on cash contributions to certain charities. Effective for tax years beginning after December 31, 2017, and before January 1, 2026, the taxpayer can deduct cash contributions that do not exceed 60% (up from 50%) of the taxpayer's contribution base (AGI without any NOL carryback). Amounts that exceed the 60% limitation can be carried forward up to 5 years.

The TCJA repeals the deduction for payments made in exchange for seating rights at college athletic events and it eliminates the I.R.C. § 170(f)(8)(D) exception to the obligation to provide contemporaneous written acknowledgment. Thus, the taxpayer must obtain a contemporaneous written acknowledgment for any contribution of $250 or more.

Certain taxpayers who will not itemize deductions can still benefit from making a charitable contribution if the contribution is structured as a qualified charitable distribution or a gift of commodities.

Qualified Charitable Distributions

A qualified charitable distribution (QCD) is a required minimum distribution (RMD) that goes directly from an IRA to a qualified charity. It is sometimes referred to as an IRA rollover. A QCD allows an IRA owner who is at least age 70½ to contribute up to $100,000 from the IRA to a charity without having to claim the distribution in taxable income. Although the owner does not receive a charitable contribution deduction, the owner does not have a taxable distribution. The exclusion is available only to the extent the owner would have otherwise had to include the distribution in taxable income.

Some of the benefits of a QCD include the following:

1. The contribution satisfies the requirement to take an RMD for a taxpayer who is age 70½ or over.
2. The contribution reduces AGI (because the taxpayer would otherwise have a taxable

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distribution), which decreases federal income taxes.

3. Decreasing AGI could make the taxpayer eligible for higher deductions and credits.
4. Decreasing AGI could decrease Medicare premiums.
5. Decreasing AGI could decrease the taxable portion of social security.
6. The taxpayer can benefit from a charitable contribution, even if he or she does not itemize deductions or the taxpayer's deductions exceed the contribution base.

Gifting Commodities

Cash basis farmers can contribute agricultural commodities to a charity. The proceeds of the sale of the gifted commodity are excluded from the donor's taxable income and the donor can deduct the cost of growing the crop. Thus, even if the farmer does not itemize deductions, he or she will receive a tax benefit from the donation.

To gift a commodity, the farmer must take the following steps:

1. Send a detailed letter to the charity donee explaining that the farmer is making a gift of a commodity to the charity. Describe the commodity and the quantity of the commodity to be donated.
2. Ask the charity to identify where and when it wants the commodity delivered to market.
3. Give a copy of the letter to the charity. (The taxpayer should also keep a copy of the letter.) Signatures make this letter even stronger if both parties sign and date the letter.
4. Deliver the commodity and transfer ownership and control to the charity.
5. The charity authorizes the sale and collects the sale proceeds.
6. The taxpayer obtains a receipt from the charity for the donation.

Example 8.48 Donation of Commodity

Jack Smith is a farmer who annually makes an $8,000 contribution to his church. In 2018, Jack gave the church $8,000. Jack did not itemize deductions, and he received no tax benefit from the deduction. If instead Jack gave the church 2,000 bushels of corn at a time when the market price was $4/bushel, he could exclude the $8,000 (2,000 × 4) sales proceeds of the corn from his income and deduct the cost of producing the corn.

PLANNING POINTER

Donor Advised Funds

Similar to the bunching contributions strategy (discussed earlier), a taxpayer can make a large deductible contribution to a donor advised fund (DAF). The taxpayer receives the deduction in the year the contribution is made and retains the right to direct future distributions from the DAF to qualified charities.

Casualty and Theft Losses

Effective for losses incurred in tax years beginning after December 31, 2017, and before January 1, 2026, for individual taxpayers, a personal casualty or theft loss is allowed as a deduction only to the extent it is attributable to a federally declared disaster. However, if a taxpayer has personal casualty gains, the taxpayer can deduct a personal casualty loss not attributable to a federally declared disaster to the extent the loss does not exceed the gains. Federal disaster losses are deductible subject to the $100-per-casualty and 10%-of-AGI limitations.

CROSS-REFERENCE

Disaster Losses

Certain losses in federally declared disaster areas may be deductible even if the taxpayer does not itemize deductions. For additional information, see the earlier discussion of disaster losses in Issue 4.

Miscellaneous Itemized Deductions

Under former law, taxpayers could deduct miscellaneous itemized deductions that exceeded 2% of AGI. These deductions included unreimbursed employee expenses and investment expenses such as the following:

1. Dues paid to professional societies

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2. Home office deduction for part of an employee's home used regularly and exclusively for work
3. Subscriptions to professional journals
4. Tools and supplies used for an employee's work
5. Union dues and expenses
6. Work clothes and uniforms if required and not suitable for everyday use
7. Work-related education costs
8. Expenses for unreimbursed travel and mileage
9. IRA custodial fees
10. Advisory management fees
11. Tax preparation fees
12. Safe deposit box fees

These deductions are suspended for tax years 2018 through 2025. However, an employee may be able to exclude employee expenses from income if they are reimbursed under an employer accountable plan. An accountable plan is a reimbursement or other expense allowance arrangement that meets *all* three of the following requirements:

1. The employee must have paid or incurred expenses that are deductible while performing services as an employee.
2. The employee must adequately account to the employer for these expenses within a reasonable time.
3. The employee must return any excess reimbursement or allowance within a reasonable time.

Adequate accounting requires that the employee give the employer adequate documentation to support the expenditure being reimbursed as a valid business expense. This includes details about the time, place, and amount of the expense, as well as its business purpose. Plans that reimburse employees by preset amounts for meals, lodging, or mileage (per-diem payments) are considered accountable plans if the employee is required to establish the business purpose for the payment and the per-diem amount does not exceed that paid by the federal government. If the plan is not an accountable plan, then any expense reimbursements are taxable to the employee. **Figure 8.5** is a sample accountable plan.

FIGURE 8.5 Sample Accountable Plan

XYZ Company Accountable Reimbursement Policy

Treas. Reg. §§ 1.162-17 and 1.274-5(e) provide that employees do not have to report on their tax returns expenses paid or incurred by them solely for the benefit of their employer for which they are required to account and do account to their employer and that are charged directly or indirectly to the employer or paid by advancement or reimbursement.

Treas. Reg. § 1.274-5(3) further provides that an adequate accounting means the submission to the employer of an account book, diary, statement of expense, or similar record maintained by the employee in which the information as to each element of expenditure (amount, time and place, business purpose, and business relationship) is recorded at or near the time of the expenditure, together with supporting documentary evidence.

The Company hereby adopts an accountable expense reimbursement policy upon the following terms and conditions:

1. **Adequate accounting for reimbursed expenses**. Any employee now or hereafter employed by the Company shall be reimbursed for any ordinary and necessary business and professional expense incurred on behalf of the Company, if the following conditions are satisfied:

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a. The expenses are reasonable in amount.

b. The employee documents the amount, date, place, business purpose [and in the case of entertainment expenses, the business relationship of the person(s) entertained] of each such expense with the same kinds of documentary evidence as would be required to support a deduction of the expense on the employee's federal income tax return.

c. The employee documents such expenses by providing the Company accountant with a monthly accounting of such expenses. In no event will an expense be reimbursed if substantiated more than 60 days after the expense is paid or incurred by the employee.

2. **Reimbursable expenses**. Reimbursable business and professional expenses include, but are not limited to, local business mileage, overnight travel (including mileage, lodging, and meals), business meals and entertainment, books and subscriptions, continuing education, professional dues, long distance phone calls, office supplies, repairs/maintenance expenses, and other expenses approved by the Company accountant and owners.
3. **Automobile reimbursement rate**. The employee's business use of his or her automobile will be reimbursed at the standard mileage rate allowed by IRS. (For 2018, the standard mileage rate is 54.5 cents per mile.)
4. **Excess reimbursements**. Any Company advance reimbursement that exceeds the amount of business or professional expenses properly accounted for by an employee pursuant to this policy must be returned to the Company within 120 days after the associated expenses are paid or incurred by the employee and shall not be retained by the employee. Additionally, the Company will not pay out an advance more than 30 days before the employee is expected to incur the qualifying expenses.
5. **Reimbursements not funded out of salary adjustments**. Reimbursements shall be paid out of Company funds; and not by adjusting pay checks by the amount of business expense reimbursements.
6. T**ax reporting**. The Company shall not include in an employee's box 1 of Form W-2 the amount of any business or professional expense properly substantiated and reimbursed (or advanced) according to this policy, and the employee should not report the amount of any such reimbursement as income on the employee's individual income tax return.
7. **Maximum annual reimbursement**. Substantiated business expenses that exceed the maximum annual expense reimbursement will not be reimbursed without approval from the Company accountant and owners. For 2018 the maximum annual reimbursement is $500.
8. **Unused budget**. Any portion of the annual budget for professional expense reimbursement that is not reimbursed based on the submission of documentary evidence as provided under this policy shall not be distributed to the employee.
9. **Retention of records**. The Company shall retain receipts and other documentary evidence used by an employee to substantiate business and professional expenses reimbursed under this policy. Under no circumstances will the Company reimburse an employee for business or professional expenses incurred on behalf of the Company that are not properly substantiated according to this policy.

____
Owner Signature Date

____
Employee/Owner Signature Date

8

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Each employee and owner must sign a separate accountable plan document. The owner must provide a copy of the signed accountable plan to each employee and keep a copy in his or her employee file.

Other Itemized Deductions

In Notice 2018-61, 2018-31 I.R.B., the IRS announced that it will issue regulations to clarify the effect of the suspension of miscellaneous itemized deductions on nongrantor trusts and estates. The regulations will also clarify that the suspension of the deduction does not apply to certain expenses of nongrantor trusts and estates, and the other itemized deductions specified in I.R.C. § 67(b).

Deductions for Estates and Trusts

I.R.C. § 67(a) provides a deduction for miscellaneous itemized deductions, to the extent that they exceed 2% of AGI. I.R.C. § 67(g) suspends the deduction for tax years 2018 through 2025. Under I.R.C. § 67(e), the AGI of an estate or trust is calculated in the same manner as for an individual taxpayer, except that the following deductions are allowed:

1. Costs that are paid or incurred in connection with the administration of the estate or trust and that would not have been incurred if the property was not held in the estate or trust [I.R.C. § 67(e)(1)]
2. Deductions allowable under I.R.C. §§ 642(b) (the personal exemption for estates and trusts), 651 (deduction for distributable trust income), and 661 (amounts distributed from an estate or trust)

Section 67(b) Deductions

The regulations will clarify that the following deductions are not subject to the suspension of miscellaneous itemized deductions and are still allowed:

1. I.R.C. § 163 deduction for interest
2. I.R.C. § 164 deduction for taxes
3. I.R.C. § 165(a) deduction for certain casualty or theft losses from income producing property
4. I.R.C. § 165(d) gambling losses (up to the amount of gambling winnings)
5. I.R.C. § 170 deduction for charitable contributions and gifts
6. I.R.C. § 642(c) deduction for amounts paid or permanently set aside for a charitable purpose
7. I.R.C. § 213 deduction for medical and dental expenses
8. Deduction for impairment-related work expenses
9. I.R.C. § 691(c) deduction for estate tax on income in respect of the decedent
10. Deduction allowable in connection with personal property used in a short sale
11. I.R.C. § 1341 deduction where the taxpayer restores a substantial amount held under claim of right
12. I.R.C. § 72(b)(3) deduction where annuity payments cease before the investment is recovered
13. I.R.C. § 171 deduction for amortizable bond premium
14. I.R.C. § 216 deductions in connection with cooperative housing corporations

Total Itemized Deductions

For tax years 2018 through 2025, the phaseout of certain itemized deductions is suspended. The taxpayer can still elect to itemize deductions, even if they are less than the standard deduction.

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APPENDIX A: 2018 FORM 1040, SCHEDULE A

SCHEDULE A (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

► Go to *www.irs.gov/ScheduleA* for instructions and the latest information.
► Attach to Form 1040.
Caution: If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 16.

OMB No. 1545-0074
2018
Attachment Sequence No. **07**

Name(s) shown on Form 1040 | **Your social security number**

DRAFT AS OF JULY 10, 2018 DO NOT FILE

Section	Line	Description		
Medical and Dental Expenses		**Caution:** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see instructions)	1	
	2	Enter amount from Form 1040, line 7 [2]		
	3	Multiply line 2 by 7.5% (0.075)	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4
Taxes You Paid	5	State and local taxes		
	a	State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box ► ☐	5a	
	b	State and local real estate taxes (see instructions)	5b	
	c	State and local personal property taxes	5c	
	d	Add lines 5a through 5c	5d	
	e	Enter the smaller of line 5d and $10,000 ($5,000 if married filing separately)	5e	
	6	Other taxes. List type and amount ►	6	
	7	Add lines 5e and 6		7
Interest You Paid Caution: Your mortgage interest deduction may be limited (see instructions).	8	Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box ► ☐		
	a	Home mortgage interest and points reported to you on Form 1098	8a	
	b	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ►	8b	
	c	Points not reported to you on Form 1098. See instructions for special rules	8c	
	d	Reserved	8d	
	e	Add lines 8a through 8c	8e	
	9	Investment interest. Attach Form 4952 if required. See instructions	9	
	10	Add lines 8e and 9		10
Gifts to Charity If you made a gift and got a benefit for it, see instructions.	11	Gifts by cash or check. If you made any gift of $250 or more, see instructions	11	
	12	Other than by cash or check. If any gift of $250 or more, see instructions. You **must** attach Form 8283 if over $500	12	
	13	Carryover from prior year	13	
	14	Add lines 11 through 13		14
Casualty and Theft Losses	15	Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions		15
Other Itemized Deductions	16	Other—from list in instructions. List type and amount ►		16
Total Itemized Deductions	17	Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040, line 8		17
	18	If you elect to itemize deductions even though they are less than your standard deduction, check here ► ☐		

For Paperwork Reduction Act Notice, see the Instructions for Form 1040. Cat. No. 17145C **Schedule A (Form 1040) 2018**

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APPENDIX B: 2019 FORM 1098

8181 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		OMB No. 1545-1380 2019 Form 1098	**Mortgage Interest Statement**
	1 Mortgage interest received from payer(s)/borrower(s) $		**Copy A For Internal Revenue Service Center**
RECIPIENT'S/LENDER'S TIN / PAYER'S/BORROWER'S TIN	2 Outstanding mortgage principal $	3 Mortgage origination date	**File with Form 1096.**
	4 Refund of overpaid interest $	5 Mortgage insurance premiums $	
PAYER'S/BORROWER'S name	6 Points paid on purchase of principal residence $		For Privacy Act and Paperwork Reduction Act Notice, see the **2019 General Instructions for Certain Information Returns.**
Street address (including apt. no.)	7 ☐ If address of property securing mortgage is the same as PAYER'S/BORROWER'S address, check the box, or enter the address or description in box 8.		
City or town, state or province, country, and ZIP or foreign postal code	8 Address or description of property securing mortgage (see instructions)		
9 Number of properties securing the mortgage / 10 Other			
Account number (see instructions)			11 Mortgage acquisition date

DRAFT AS OF July 24, 2018 DO NOT FILE

Form **1098** Cat. No. 14402K www.irs.gov/Form1098 Department of the Treasury - Internal Revenue Service

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