Dear Client:

Readers have lots of questions for us. Not surprisingly, most queries involve the tax changes that were enacted at warp speed late last year.

Can I deduct investment fees I pay this year? No. The Schedule A write-off for these costs, IRA custodial fees paid directly by the account owner, and the rest of the popular miscellaneous deductions subject to the 2%-of-AGI threshold are now gone.

My employer paid for my cross-country move. Is the amount taxable to me? Generally, yes. It used to be that when you relocated for a new job, you could deduct moving costs, or if your employer reimbursed you, the payment was tax-free. Well, not anymore, except for active-duty military personnel who move pursuant to military orders.

Is the new opportunity zone program up and running yet? In part. This program, which is included in the new tax law, lets taxpayers defer capital gains from the sale or exchange of business or personal property, including stocks, by investing the proceeds in opportunity funds to help low-income communities. Those who opt to take advantage of this break have 180 days from the date of the sale to invest all or part of the gain proceeds in a so-called qualified opportunity fund. IRS is set to release proposed regulations on how this tax break will work. An open question is whether gain deferral will automatically end in 2026, when the break is set to expire. Tax and investment advisers hope the guidance will address this concern plus provide clarity on key definitions and other issues. In the meantime, go to www.kiplinger.com/letterlinks/ozp for a set of FAQ from IRS.

Is Schedule E rental income eligible for the 20% pass-through deduction? It depends on whether the activity rises to the level of a trade or business. The new tax break applies to qualified business income from a trade or business. In proposed rules, IRS refers to the standard under federal tax code Section 162, the statute that generally governs the deductibility of trade or business expenses. Unfortunately, this standard is unclear in the context of a rental activity. That’s because it’s based on facts and circumstances that are specific to each taxpayer, and the issue hasn’t been resolved by case law. Some aspects considered important: Type of property that is leased, extent of day-to-day involvement by the lessor or the lessor’s agents, number of properties rented and specific terms of the lease. Tax pros and others are pleading with IRS to address this in final regulations. If the agency does not, then it will be up to the courts to resolve it later.

Will Congress make permanent the individual tax provisions in the new law? Not this year. Most of the changes affecting individuals and small businesses expire after 2025. House Republicans will act on a bill to make the changes permanent. But the effort will die in the Senate. This won’t stop GOPers from touting tax cuts, which some see as a campaign message to entice voters in the midterm elections.
We’re keeping an eye on a House bill that contains retirement plan provisions. They have bipartisan support and decent odds of passage this year or next. For now, House GOP taxwriters have incorporated the bill into their tax cuts package. Though the cuts will stall in the Senate, the retirement proposals could survive. Lawmakers may act in the lame-duck session after the midterm elections or in 2019.

Included in the bill: Making it easier for small firms to band together to pool retirement plans. Allowing owners of traditional IRAs to make contributions past the age of 70½. Eliminating required minimum distributions for individuals with small retirement account balances...$50,000 or less in the aggregate. And more.

Review your retirement plan beneficiaries, if you haven’t done so recently. You can help avoid unintended consequences by updating beneficiary designations of your 401(k) or 403(b) plans, annuities, pensions and IRAs to account for life changes such as marriage, divorce or the death of a spouse or other listed beneficiary. While you’re at it, review the beneficiaries listed in your will and taxable accounts. And if you don’t yet have a will, think about drafting one sooner rather than later.

IRS blesses 401(k) employer matches conditioned on student loan repayments in a private ruling. The agency allowed a firm to contribute to its existing 401(k) plan on behalf of employees who are paying down their student debt. The employer matches take place regardless of whether the employees are also making 401(k) contributions, but do not preclude workers from also contributing to their 401(k) accounts. Participation in the program is voluntary, and employees must elect to enroll in it.

Employers are watching this closely as firms actively look to help workers pay off their college loans. It’s a perk employers can offer in this tight labor market.

Victims of Florence have until Jan. 31 to file their 2017 federal returns, assuming they previously got filing extensions. This deadline also applies to estimated tax payments originally due Sept. 17, plus payroll and excise tax returns.

Consider amending your 2017 return to claim uninsured hurricane losses. Losses incurred in Florence can be deducted on either your 2017 or 2018 tax return. To elect relief for 2017, deduct the loss on the original or amended 2017 return and list the disaster and address where the damaged property is located. If you have already filed your 2017 return, you can amend it to take the write-off, provided you do so within six months after the filing due date for 2018 returns. For individual filers with Florence losses, this translates to Oct. 15, 2019.

Of course, all of the limitations and rules for taking the deduction will still apply.

More hurricane tax relief from IRS is on tap, if the past is any indication. Look for the Service to issue guidance addressing leave donation programs, in which employers let workers forfeit paid vacation or sick days for cash payments that the employer makes to charitable organizations that assist victims of Florence. IRS will likely say that these workers won’t be subject to payroll or income taxes on the value of the donated leave, but that they also can’t take charitable write-offs. Employers are able to write off the payments to the charities as a business expense.

Also, employer-provided tax-free assistance. Firms can help their employees pay for necessary personal, family, living or funeral costs and home repair expenses, provided the losses aren’t insured. As with past natural disasters, the Service will say that the payments are tax-free to the worker and generally deductible by the employer.

And Congress could eventually weigh in with relief, as it did with Harvey, Irma and Maria last year. For example, the 10% penalty on pre-age-59½ retirement payouts up to a $100,000 cap was waived, with the income tax spread out over multiple years. And the cap on borrowing from 401(k)s was increased for victims of those disasters.
Here’s an issue we keep seeing in cases coming out of the Tax Court: Rental losses taken by taxpayers claiming to be real estate professionals. Real estate pros are required to satisfy two time tests to beat the passive loss rules and fully deduct their rental losses: They must spend over half their working hours and more than 750 hours a year materially participating in real estate activities. 

**Take this example.** A couple who owned two multi-unit apartment buildings deducted large rental losses. The wife, a stay-at-home mom, managed the rentals. She produced spreadsheets showing she put in more than 750 hours for the year. The couple also elected on their tax return to group the rentals as a single activity, making it easier to pass the statutory time tests. The Court found her testimony to be convincing and allowed the losses in full (Birdsong, TC Memo. 2018-148).

Having too little income precludes claiming the health premium tax credit... the break for people who buy health coverage through the marketplace and have household incomes ranging from 100% to 400% of the poverty guidelines. Here, a man reported negative adjusted gross income and a $3,156 premium tax credit. His AGI was obviously below the eligible poverty level guideline for the year at issue, so the Tax Court disallowed the credit in full (Gartlan, TC Summ. Op. 2018-42). Note that people eligible for Medicare or other federal insurance can’t take the credit. Nor can folks who are able to get affordable health coverage through their employers.

An individual doesn’t escape a fraud penalty after all. In our July 27 Letter, we reported on a Tax Court case in which IRS assessed a civil fraud penalty. The Court originally nixed the fine, saying the Service didn’t meet its burden of proof in the case because the revenue agent failed to get the requisite prior written approval for the penalty from his or her immediate supervisor. After we published the Letter, the Court revised its original opinion to uphold the fine, saying supervisory approval was received before the fraud penalty was imposed (Guess, TC Memo. 2018-97).

Payments made by a man on his ex-wife’s student loan are deductible alimony, the Tax Court says. Pursuant to the divorce agreement, he was responsible for paying her outstanding college debt. IRS argued that language in the agreement on tax-free transfers of property designated the student loan payments as nonalimony, but the Court disagreed and allowed the write-off (Vanderhal, TC Summ. Op. 2018-41). Note that the tax rules on alimony are changing under the new tax law. Alimony paid under post-2018 divorce decrees will no longer be deductible. This is good news to recipients, who will not be taxed on alimony that they receive. Older divorce decrees can be modified to follow the new tax rules... if both parties agree. The law permits the ex-spouses to modify an earlier agreement to specifically adopt the tax changes, provided the parties wait until after 2018 to do so.

Guidance on the new family leave credit is coming soon. For 2018 and 2019, firms that provide paid family or medical leave to workers get a tax credit generally equal to 12.5% of the amount of wages paid during the time of the leave. It’s larger for employers that pay workers over half their normal wages while on leave. There are lots of other rules and limitations. For example, the credit for 2018 doesn’t apply with respect to employees whose wages exceeded $72,000 in 2017. The Service is hard at work on proposed rules to implement this tax break. There will also be a new form for eligible firms to use to compute the credit.

Errors on paper 990 series of returns are causing IRS to reject many filings. So far this year, it’s sent 10% of paper filings back to exempt organizations because the returns were incomplete, incorrect or included the wrong schedules. Groups who’ve heard from IRS have 10 days to correct the returns and resubmit them. Many source documents are available in the online edition of The Kiplinger Tax Letter.
The Service really wants individuals to check their tax withholding...
So much so that the agency has seemingly resorted to full-on blitz mode.
Since March, it has issued more than 15 news releases and over 10 sets of tax tips
advising people to make sure that income taxes being withheld from their paychecks,
pensions, retirement distributions and the like are accurate for their circumstances.
Retirees, filers with dependent children, self-employeds, two-earner couples, itemizers,
people who earn money in the sharing economy, U.S. citizens living abroad and more
are urged to use IRS's online withholding calculator at www.irs.gov for this purpose.

Meanwhile, a revamped W-4 will not be available for the 2019 tax year.
IRS now says. The agency has received lots of flak since releasing an early draft
of the 2019 form a few months ago, so it has opted to delay the overhaul until 2020.

A donation of a conservation easement on a golf course doesn’t pass muster.
The contribution is not for conservation purposes, the Tax Court decides.
The donor said the easement preserved open space and protected a natural habitat.
But the golf course is in a gated community open only to members and their guests,
and the donor couldn’t show that the area was for the scenic enjoyment of the public.
Also, relying heavily on expert testimony, the Court found that the easement property
didn’t generally provide a natural habitat for rare, threatened or endangered plants
or animal species (Champions Retreat Golf Founders LLC, TC Memo. 2018-146).

IRS deals another blow to syndicated conservation easement donations
by pass-through entities...partnerships, LLCs, trusts and the like. In late 2016,
IRS began requiring disclosure and reporting with respect to syndicated easements
that offer investors charitable deductions equal to at least 250% of their investment.
Now, the agency’s Large Business and International Division has added the subject
to its issue-focused compliance campaigns. Expect audits to increase in this area.

IRS will have a new commissioner on Oct. 1: Charles Rettig, the tax lawyer
whom the president nominated in Feb. and the Senate confirmed this month.
Rettig spent 35 years at a law firm representing clients on tax controversy matters.
His hiring bucks the multiyear trend of having a businessperson head the agency.

Rettig is coming in at a challenging time for IRS. Among the issues he’ll face:
Insufficient resources. Years of funding cuts have led to outdated technology,
inadequate employee training, declining audit rates and diminished taxpayer service.
Brain drain, as experienced examiners and managers retire in droves
or take jobs in the private sector. Over 33% of IRS employees are age 56 or older.
Recruiting young talent is a problem, too. Only about 125 workers are under age 26.
Tax law changes. He’ll have to steer the agency through all of the hiccups
that are sure to come with next year’s tax filing season, the first under the new law.
Add to this the mounds of guidance and revised tax forms that need to be done in time.
Uncertainty as to how IRS will look in the future. GOPers have floated ideas
about restructuring the agency or requiring it to develop its own organizational plans.
Also, cybersecurity worries, as scammers and hackers continue on their hunt
for taxpayer data for the purpose of filing unauthorized returns to seek false refunds.

Yours very truly,

Sept. 21, 2018

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