2018 TAX A Supplement

NOTE – This document continues to be updated through mid-January 2019. You might want to just use it online rather than print it. Also, the links are live.

Table of Contents

Errata – Corrections to the Outline or Slides

While we work hard to be complete and accurate, a mistake can happen.

Chapter 1: TCJA: Individual Items without §199A

Chapter 2: TCJA: §199A

Chapter 3: TCJA: Depreciation, §179, NOLs, §461(l)

Chapter 4: 2018 Legislation, 2019 Inflation Adjusted Amounts

Inflation Adjusted Amounts for 2019 – Rev. Proc. 2018-57 (11/15/18

Rev. Proc. 2018-57 (11/15/18) – Numerous items are adjusted for inflation each year. Below are commonly encountered provisions and the 2019 amount.

a. Standard Deduction
   i. MFJ = $24,400
   ii. Single = $12,200
   iii. Head of household = $18,350

b. Gross income for a qualifying relative under §152(d) $4,200

c. Where 37% rate starts:

i.	MFJ	$612,350
ii.	Single and HH	$510,300
iii.	Estate and Trusts	$ 12,750

d. Net capital gain rate structure

Filing Status and Rate Start Amount (taxable income)					Rate
MFJ	HH	Single	MFS	Estates/ Trusts	
$0	$0	$0	$0	$0	0%
$78,750	$52,750	$39,375	$39,375	$2,650	15%
$488,850	$461,700	$434,550	$244,425	$12,950	20%

e. AMT Exemption
   i. MFJ $111,700
   ii. Unmarried $71,700
   iii. Estates and trusts $25,000

f. 199A taxable income thresholds
   i. $160,700 (up from $157,500)
   ii. MFJ $321,400 (up from $315,000)
   iii. MFS $160,725

g. §461(l) excess business loss threshold $255,000 or $510,000 for MFJ.

h. Qualified transportation fringe for transit or parking $265

i. Foreign earned income exclusion (§911) = $105,900.

j. Threshold for small business under §448(c) = $26,000,000.

k. Estate tax exclusion = $11,400,000.

l. Annual gift exclusion = $15,000.

m. §6695(g) preparer due diligence penalty = $530 per failure

Also see summary in IR-2018-222 (11/15/18).

Chapter 5: IRA and Retirement Plan Developments

Notice 2018-90 (11/20/18) - Extension of Transition Relief Under Rev. Rul. 2018-17 on Withholding and Reporting with Respect to Payments From IRAs to State Unclaimed Property Funds

Per the IRS: "Notice 2018-90 provides that transition relief in Rev. Rul. 2018-17 (Withholding and Reporting With Respect to Payments from IRAs to State Unclaimed Property Funds) is extended so that a person will not be treated as failing to comply with the withholding and reporting requirements described in Rev. Rul. 2018-17 with respect to payments made before the earlier of January 1, 2020, or the date it becomes reasonably practicable for the person to comply with those requirements."

REG-107813-18 (11/14/2018) -- Prop. Regs. Make It Easier to Take Hardship Distributions from Section 401(k) Plans.

Excerpt from proposed regulation preamble (in italics):

Deemed Immediate and Heavy Financial Need

The proposed regulations modify the safe harbor list of expenses in current §1.401(k)-1(d)(3)(iii)(B) for which distributions are deemed to be made on account of an immediate and heavy financial need by: (1) adding "primary beneficiary under the plan" as an individual for whom qualifying medical, educational, and funeral expenses may be incurred; (2) modifying the expense listed in §1.401(k)-1(d)(3)(iii)(B)(6) (relating to damage to a principal residence that would qualify for a casualty deduction under section 165) to provide that for this purpose the new limitations in section 165(h)(5) (added by section 11044 of the TCJA) do not apply; and (3) adding a new type of expense to the list, relating to expenses incurred as a result of certain disasters. This new safe harbor expense is similar to relief given by the IRS after certain major federally declared disasters, such as the relief relating to Hurricane Maria and California wildfires provided in Announcement 2017-15, 2017-47 I.R.B. 534, and is intended to eliminate any delay or uncertainty concerning access to plan funds following a disaster that occurs in an area designated by the Federal Emergency Management Agency (FEMA) for individual assistance.

Distribution Necessary to Satisfy Financial Need Pursuant to BBA 2018 sections 41113 and 41114, the proposed regulations modify the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need by eliminating (1) any requirement that an employee be prohibited from making elective contributions and employee contributions after receipt of a hardship distribution, and (2) any requirement to take plan loans prior to obtaining a hardship distribution. In particular, the proposed regulations eliminate the safe harbor in current §1.401(k)-1(d)(3)(iv)(E), under which a distribution is deemed necessary to satisfy the financial need only if elective contributions and employee contributions are suspended for at least 6 months after a hardship distribution is made and, if available, nontaxable plan loans are taken.

In addition, the proposed regulations eliminate the rules in current §1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a distribution is necessary to satisfy a financial need is based on all the relevant facts and circumstances) and provide one general standard for determining whether a distribution is necessary. Under this general standard, a hardship

distribution may not exceed the amount of an employee's need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution), the employee must have obtained other available distributions under the employer's plans, and the employee must represent that he or she has insufficient cash or other liquid assets to satisfy the financial need. A plan administrator may rely on such a representation unless the plan administrator has actual knowledge to the contrary. In light of the timing of the publication of these proposed regulations, the requirement to obtain this representation would only apply for a distribution that is made on or after January 1, 2020.

The proposed regulations clarify that a plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2018) or, for distributions made before January 1, 2020, the representation described in the preceding paragraph, to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need of an employee. To implement Congress' purpose in enacting section 41113 of BBA 2018 (for example, Congress' concern that a suspension impedes an employee's ability to replace distributed funds), the proposed regulations do not permit a plan to provide for a suspension of elective contributions or employee contributions as a condition of obtaining a hardship distribution. However, in light of the timing of the publication of these proposed regulations, this prohibition would only apply for a distribution that is made on or after January 1, 2020. Expanded Sources for Hardship Distributions

Pursuant to section 41114 of BBA 2018, the proposed regulations modify §1.401(k)-1(d)(3) to permit hardship distributions from section 401(k) plans of elective contributions, QNECs, QMACs, and earnings on these amounts, regardless of when contributed or earned. However, plans may limit the type of contributions available for hardship distributions and whether earnings on those contributions are included. Safe harbor contributions made to a plan described in section 401(k)(13) may also be distributed on account of an employee's hardship (because these contributions are subject to the same distribution limitations applicable to QNECs and QMACs). See §1.401(k)-3(k)(3)(i).

Applicability Dates and Reliance

The changes to the hardship distribution rules made by BBA 2018 are effective for plan years beginning after December 31, 2018, and the proposed regulations provide that they generally would apply to distributions made in plan years beginning after December 31, 2018.

Chapter 6: Non-TCJA Cases and Rulings

Time Sensitive Acts – Rev. Proc. 2018-58 (11/20/18)

Per the IRS: "Revenue Procedure 2018-58 updates Revenue Procedure 2007-56, providing clear guidance with regard to time-sensitive acts that may be postponed for taxpayers affected by a federally-declared disaster, a terroristic or military action, or individuals serving in a combat

zone. The list of acts in the revenue procedure supplements the list of postponed acts in section 7508(a)(1) of the Internal Revenue Code and Treas. Reg. § 7508A-1(c)(1)(vii)."

IRS Tips for Businesses Impacted by Disaster

IRS Tax Tip 2018-180 (11/21/18), Businesses can take these steps after a disaster, is reproduced below.

When disaster strikes, many business owners might find themselves needing to reconstruct records. This will help them prove a loss, which may be essential for tax purposes, getting federal assistance, or insurance reimbursement.

Here are tips for businesses that need to reconstruct their records:

- To create a list of lost inventories, business owners can get copies of invoices from suppliers. Whenever possible, the invoices should date back at least one calendar year.

- For information about income, business owners can get copies of last year's federal, state and local tax returns. These include sales tax reports, payroll tax returns, and business licenses from the city or county. These will reflect gross sales for a given period.

- Owners should check their mobile phone or other cameras for pictures and videos of their building, equipment and inventory.

- Business owners who don't have photographs or videos can simply sketch an outline of the inside and outside of their location. For example, for the inside the building, they can draw out where equipment and inventory was located. For the outside of the building, they can map out the locations of items such as shrubs, parking, signs, and awnings.

More Information:

- IRS Disaster Assistance Hotline at 866-562-5227/Monday - Friday from 7 a.m. to 10 p.m. local time
- Publication 2194, Disaster Resource Guide for Individuals and Businesses
- Federal Emergency Management Agency
- Small Business Administration
- DisasterAssistance.gov

California Wildfire Disaster Relief - CA-2018-13 (11/13/18)

Tax Relief for Victims of California Wildfires – CA-2018-13 (11/13/18) – The IRS notes that the President declared parts of California to be disaster areas starting on 11/8/18 due to the wildfires. The affected areas are Butte, Los Angeles and Ventura counties. Generally, affected taxpayers have until April 30, 2019 to file returns otherwise due during the disaster time, OTHER than Information returns (W-2, 1094, 1095, 1097, 1098, or 1099 series + Forms 1042-S, 3921, 3922, 8027, and employment and excise tax deposits). Penalties on deposits cue on or after 11/8/18 and before 11/23/18 will be abated as long as made by 11/23/18. Be sure to see CA-2018-13 for additional tax relief measures.

Also see FTB information at https://www.ftb.ca.gov/individuals/disaster.shtml?WT.mc_id=Warning_wildfire_2018.

FEMA information at https://www.fema.gov/disaster/4407.

Hurricane Michael Donations – Notice 2018-89 (11/19/18)

Treatment of Amounts Paid to Section 170(c) Organizations under Employer Leave Based Donation Programs to Aid Victims of Hurricane Michael - Notice 2018-89 provides that where an employer allows employees to give up leave so the employer may donate it to a charitable organization providing relief to victims of Hurricane Michael, it will not be treated as income to the employee and the employee does not get a charitable contribution deduction. This applies for donations made before 1/1/20.

Revenues Not Enough to Indicate Business – *Ford*, TC Memo 2018-8 (1/25/18), aff'd No. 18-1524 (6th Cir., 11/5/18, not for publication)

Ford, TC Memo 2018-8 (1/25/18), aff'd No. 18-1524 (6th Cir., 11/5/18, not for publication) – F used to be recording artist and spend most of her life promoting and performing country music. For the years under exam - 2012 through 2014, she owned and operated the Bell Cover Club in Tennessee on her own. Earlier, she and her husband operated this club (starting in 1986) and wanted it to be a place where artists could perform for talent scouts and producers. It closed when her husband died in 1999 but Joy reopened it in 2008. Customers only had to pay $5 for admission and a small amount for food. F paid performers. Losses were generated. F had some plans she pursued to convert the club into a restaurant or televise the performances, but these changes did not materialize. The IRS disallowed the losses finding the club not operated for profit. The court agreed finding the club was operated mostly for personal pleasure rather than profit with the losses offsetting investment income of F.

F appealed to the 6th Circuit which upheld the Tax Court decision as it did not find any error in that court's analysis. At the start, the 6th Circuit notes:

""Find a job doing something you love." Perhaps that is sound advice. But deducting business losses from your taxes when you are not trying to profit from the business you love is not a

sound strategy. Here, the Tax Court found that the appellant did just that: ran a business doing something she loved, accumulated substantial losses, and deducted those losses from her income. Because the court below did not commit clear error in making this determination, we AFFIRM." The court re-examined the factors under Reg. 1.183-2 and concluded that the club wasn't operated in a for-profit manner. For example, the court noted that Ford did nothing to reduce costs, leaving empty refrigerators and stage lights running even when the club wasn't open for business. Also, she did not adjust the cover charge to help make a profit. In addition, she did not want to serve alcohol, but let patrons bring int heir own. Per the court: "The record paints a picture of a business operated without regard to cost or profit. There is nothing indicating Ford operated in a "business-like manner.""

Observations: The Tax Court generally applied Reg. 1.183-2 without going through a detailed analysis of each of the nine factors. In contrast, the 6th Circuit analyzed each of the nine factors. But both courts concluded that the club was an activity not engaged in for profit (a hobby). Often, we think that an activity with customers and revenues is automatically a business. But, more is needed under 162 and 183 and the regulations and court cases. Today, this issue can arise with some occasional, part-time gig workers. They generate income from, for example, using the Uber platform, but do not set prices, have no business plan, do not regularly engage in the activity, do not have separate financial records, may be doing the activity to generate cash for bills and/or pass the time. These individuals may fall into the same situation as Joy Ford. A tax adviser can help these individuals to convert their hobby or activity at risk of being a hobby into a business by following the Reg. 1.183-2 factors to make the activity a business. After the TCJA, a hobby means report all of the revenue, but you get no deductions.

2018 IRSAC Report

On 11/15/18, Internal Revenue Service Advisory Council (IRSAC), issued its annual report (IR-2018-221). A few highlights of this 134-page report:

- The IRS must have adequate and reliable funding.
- The IRS should have statutory authority to create and enforce minimum standards of competence for all tax practitioners, including tax return preparers.
- The IRS should "launch a secure, online account for tax professionals (Tax Pro Account) as soon as possible."
- Let taxpayers pay in virtual currency.
- "We recommend the creation of an affirmative and disciplinary duty under Circular 230 for practitioners and their firms to meet a standard of competency related to technology."
- "IRSAC recommends that the IRS develop a process to coordinate its various electronic communications to tax professionals, reduce duplicative messaging and send out non-essential, non-emergency communications in a more consolidated fashion." The report notes that the IRS did not timely communicate to taxpayers that about 30 provisions were extended for 2017 on 2/9/18 even though it affected

some individuals who had already filed. It also noted that people learned of the "hardware failure" of 4/15/18 from sources other than the IRS.

Transcript Requests for Filing Season

IRS News Release IR-2018-225 (11/19/18) on getting ready for tax season includes an explanation of how to get a transcript if needed. Per the IRS:

"Plan ahead. Delivery times for online and phone orders typically take five to 10 days from the time the IRS receives the request. Taxpayers who order by mail should allow 30 days to receive transcripts and 75 days for tax returns."

The IRS provides information on the three ways to get a transcript – by phone, my mail or online.

The IRS also notes: "The IRS is now redacting tax transcripts so that sensitive information, such as the taxpayer's name, address and Social Security number, is partially masked. However, all financial entries, such as the adjusted gross income, are visible. The redacted transcript will better protect taxpayers from identity theft."

Transcript Scams - IR-2018-226 (11/19/18)

IR-2018-226 (11/19/18) - IRS warns of "Tax Transcript" email scam; dangers to business networks – Excerpt from the news release:

> "The scam is especially problematic for businesses whose employees might open the malware because this malware can spread throughout the network and potentially take months to successfully remove.
>
> This well-known malware, known as Emotet, generally poses as specific banks and financial institutions in its effort to trick people into opening infected documents. The Summit partnership of the IRS, state tax agencies and the nation's tax industry remind taxpayers to watch out for this scam.
>
> However, in the past few weeks, the scam masqueraded as the IRS, pretending to be from "IRS Online." The scam email carries an attachment labeled "Tax Account Transcript" or something similar, and the subject line uses some variation of the phrase "tax transcript." These clues can change with each version of the malware. Scores of these malicious Emotet emails were forwarded to phishing@irs.gov recently."

United States v. Adams, No. 0:17-cr-00064-DWF-KMM (D. Minn. Oct. 27, 2018) – Attorney-Client Privilege Where Accountants Worked with Tax Attorney on Criminal Tax Case with *Kovel* Arrangement

On October 27, the US District Court for the District of Minnesota addressed numerous attorney-client privilege issues relevant to accountants working alongside tax attorneys.

The arguments of the taxpayer and government are summarized by the court:

> "Mr. Adams has invoked the attorney-client privilege over numerous communications between himself and accountants at Murry LLC, who were retained by his tax counsel under a so-called Kovel arrangement. See *United States v. Kovel*, 296 F.2d 918, 921-22 (2nd Cir. 1961) (holding that attorney-client privilege may apply to an individual's communications with an accountant if the communications are 'made in confidence for the purpose of obtaining legal advice from the lawyer'). The government raises three challenges to this assertion of privilege. First, the government argues that the protections provided under *Kovel* are not applicable to the individual communications before the Court for in camera review. Even if the protections of Kovel did apply, the government asserts that any protection was waived by Mr. Adams's subsequent filing of amended tax returns. Finally, the government argues that the crime-fraud exception vitiates any claim of privilege."

The District Court explained its interpretation of *Kovel* as follows:

> "With respect to the government's argument that the protections of Kovel do not apply to the Murry communications, the Court finds that [the tax attorney's] Declaration … sufficiently demonstrate that the attorney-client privilege extends to the documents at issue. In these declarations, [the tax attorney] thoroughly explains how communications with Murry LLC and the information Mr. Adams provided to the accountants assisted in Mr. Brever's provision of legal advice to his client regarding tax-related matters. This is sufficient to invoke the attorney-client privilege. (explaining that where an attorney retains an accountant to assist the lawyer in providing legal advice to a client concerning tax issues, the attorney-client privilege may extend to communications between the client and the accountant); see also United States v. Cote, 456 F.2d 142, 144 (8th Cir. 1972) (concluding that attorney-client privilege may apply where 'the accountant's aid to the lawyer preceded the advice and was an integral part of it'). The Court's in camera review of the communications does not contradict Mr. Brever's explanation." (citations omitted)

The Court concludes that the amended returns did not result in a waiver of the privilege:

> "The Court also concludes that Mr. Adams's subsequent filing of amended tax returns for 2008, 2009, and 2010 do not result in a waiver of the privilege as to the Murry communications submitted for in camera review. In Cote, after

concluding that the privilege could apply to communications between a client and an accountant who is retained to assist an attorney in providing legal advice on tax matters, the Eighth Circuit reasoned as follows:

> 'Notwithstanding our recognition that the attorney-client privilege attached to the information contained in the accountant's workpapers under the circumstances existing here, we find that by filing the amended returns the taxpayers communicated, at least in part, the substance of that information to the government, and they must now disclose the detail underlying the reported data.' 456 F.2d at 144.

However, the court cautioned that "[t]oo broad an application of the rule of waiver requiring unlimited disclosure by reason of filing an income tax return might tend to destroy the salutary purposes of the privilege which invite confidentiality between the attorney and his client." *Id.* at 145 n.4. The *Cote* court distinguished between "workpapers [that] contain detail of *unpublished* expressions which are not part of the data revealed on the tax returns," and other workpapers to which the rule of waiver would apply. *Id.* (emphasis in original).

Chapter 7: California Individual Developments

FTB and California Wildfires

FTB information at https://www.ftb.ca.gov/individuals/disaster.shtml?WT.mc_id=Warning_wildfire_2018.

See federal information in Chapter 6 update above.

Chapter 8: Looking Forward