The Norton Tax Bulletin

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Tax Developments; Gift Taxes; More Scams

Dear Clients, family and friends,

The following is a summary of important tax developments that occurred in January, February, and March of 2019 that may affect you, your family, your investments, and your livelihood. I have also covered a couple of additional items.

Estimated tax penalty relief. Many taxpayers were surprised when they saw the bottom line for their 2018 returns and discovered that instead of a refund, they had a balance due! The primary reason was the IRS's error in creating the withholding tables in early 2018. The error resulted in most taxpayers receiving a larger take home pay (*thanks to the new tax act*) than they should have received. So while most taxpayers ended the year paying less in Federal income tax than they would have under the old rules, the savings was not effectively distributed. Consequently, the under-withholding for many resulted in a balance due with the return – and that triggered an estimated tax penalty calculation in most software packages.

In response to this situation, the IRS announced that it is waiving the estimated tax penalty for many taxpayers whose 2018 federal income tax withholding and estimated tax payments fell short of their total tax liability for the year. This waiver covers taxpayers whose total withholding and estimated tax payments are equal to or greater than 80% of their taxes owed, rather than the usual statutory percentage threshold of 90%. This relief expanded that initially offered by IRS; the earlier relief pertained to taxpayers who had paid 85% of their taxes owed.

The relief was prompted by changes in the Tax Cuts and Jobs Act (TCJA; P.L. 115-97, 12/22/2017), some of the which might impact withholding (*e.g., the repeal of the personal exemptions and many itemized deductions and the capping the state and local income tax deduction at $10,000*). A Government Accountability Office (GAO) report estimated that nearly 30 million taxpayers could be under-withheld in 2018. IRS also provided procedures for requesting the waiver and procedures under which taxpayers who have already paid underpayment penalties but who now qualify for relief may request a refund.

In my experience with this filing season, the IRS has (*for some of my clients*) made the adjustment on their own after the return was filed and actually refunded a part of the software-calculated estimated tax penalty that was paid with the filing of the return.

Employer identification number (EIN). As part of its ongoing security review, the IRS announced that, starting May 13, only individuals with tax identification numbers may request an Employer Identification Number (EIN for short) as the "*responsible party*" on the application. An EIN is required for businesses (other than sole proprietorships), and for all entities that have a payroll tax filing requirement.

Individuals named as responsible party on the application for an EIN must have either a Social Security number (SSN) or an individual taxpayer identification number (ITIN). Under Code Sec. 6109(a)(1), persons are required to include taxpayer identifying numbers on returns,

statements, or other documents filed with the IRS. One of the principal types of taxpayer identifying numbers is an EIN. IRS generally assigns an EIN for use by employers, sole proprietors (*with employment tax filing requirements),* corporations, partnerships, nonprofit associations, trusts, estates, government agencies, certain individuals, and other business entities for tax filing and reporting purposes. A person required to furnish an EIN must apply for one with the IRS on a Form SS-4 (*Application for Employer Identification Number).*

The new change will prohibit entities from using their own EINs to obtain additional EINs. The requirement will apply to both the paper Form SS-4 and online EIN application.

Electric car credit declines

Internal Revenue Code (IRC) section 30D provides for a credit for certain new qualified plug-in electric drive motor vehicles. The vehicle must be a new vehicle that is purchased for use or lease in the United States. The base amount of the credit is $2,500. The credit is increased by $417 for each kilowatt hour of battery capacity in excess of 5 kilowatt hours, limited to $5,000. Thus, the maximum credit for the purchase or lease of a new electric powered vehicle is $7,500.

The credit begins to phase out in the second calendar quarter after the calendar quarter in which at least 200,000 of a manufacturer's vehicles that qualify for the credit have been sold. Taxpayers purchasing the manufacturer's vehicles during the first two calendar quarters of the phase-out period may claim 50% of the credit, and 25% of the credit during the third and fourth calendar quarter. After the last day of the fourth calendar quarter of the phase-out period, the credit is zero. The IRS issues a Notice when a particular make and model of an electric vehicle reaches 200,000 in total sales and thus begins to be subject to the phase-out period.

The IRS has announced that General Motors, LLC, (GM) has cumulative sales of qualified electric vehicles that have reached the 200,000 limit during the calendar quarter ending December 31, 2018. Accordingly, GM electric vehicles sold after April 1, 2019 are subject to the credit phase-out. The following chart identifies the amount of credit available for the purchase of a new GM electric vehicle depending upon its purchase date.

Qualifying Vehicle	Full credit: purchased before 4/1/2019	50% of credit: purchased from 4/1/2019 through 9/30/2019	25% of credit: purchased from 10/1/2019 through 3/31/2020	No credit: purchased after 3/31/2020
Chevrolet Volt	$7,500	$3,750	$1,875	$0
Chevrolet Spark EV	$7,500	$3,750	$1,875	$0
Chevrolet Bolt	$7,500	$3,750	$1,875	$0
Cadillac ELR	$7,500	$3,750	$1,875	$0

Deduction for back alimony

The Tax Court held that an ex-husband's payment of alimony arrearages resulted from a contempt order by a Family Court was not a "money judgment", and so qualified as deductible alimony. With respect to divorce instruments executed before Jan. 1, 2019, amounts received as alimony or separate maintenance payments are taxable to the recipient and deductible by the payor in the year paid. An alimony payment is one that meets the certain specific requirements,

such as (a) it must be made under a divorce or separation instrument and (b) the payor's obligation to make the payment must end at the death of the payee spouse.

On the other hand, a money judgment is a document issued by a court stating that the creditor (*or other plaintiff)* has won a lawsuit and is entitled to a certain amount of money. A NY court found a taxpayer to be in contempt due to his failure to make his alimony payments and sentenced him to 150 days in jail unless he paid $225,000 to his former spouse. The taxpayer paid the $225,000 at issue and claimed an alimony deduction. The Tax Court found that the court's order was not a money judgment, but rather a contempt order to achieve the payment of alimony arrearages which retained their character as alimony.

Qualified business income deduction: final regulations.

OK – this next section is a bit technical. If you do not own a trade or business as a sole proprietorship, partnership or sub-S corporation, or have a C-corporation, you may want to skip to the next section.

The IRS issued final Code Sec. 199A regulations for determining the amount of the deduction of up to 20% of income from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate (*the new 20% qualified business income deduction for 2018 returns).* This deduction can be very complex to figure out and because of that, there is much confusion on its computation.

The regulations cover a wide range of topics and discuss the operational rules, including definitions, computational rules, special rules, and reporting requirements; the determination of W-2 wages and unadjusted basis immediately after acquisition of qualified property; the computation of qualified business income, qualified real estate investment trust (REIT) dividends, and qualified publicly traded partnership income; the optional aggregation of trades or businesses; the treatment of specified services trades or businesses and the trade or business of being an employee; and the rules for relevant passthrough entities, publicly traded partnerships, beneficiaries, trusts, and estates.

This is one of the coolest provisions of the Tax Cut and Jobs Act. In my personal situation, this new deduction saved me thousands in income tax liability. It is important to know that the deduction, while reducing taxable income, does not reduce self-employment tax.

Qualified business income deduction: calculating W-2 wages

IRS provided three methods for calculating W-2 wages under Code Sec. 199A (*the qualified business income deduction)* for purposes of the <u>*deduction limitation*</u> based on W-2 wages received and for purposes of the deduction reduction for certain specified agricultural and horticultural cooperative patrons. Under Code Sec. 199A, W-2 wages include:

i. The total amount of wages as defined in Code Sec. 3401(a) (dealing with income tax withholding);
ii. The total amount of elective deferrals (within the meaning of Code Sec. 402(g)(3));
iii. Compensation deferred under Code Sec. 457; and
iv. The amount of designated Roth contributions.

For any taxable year, a taxpayer must calculate W-2 wages for purposes of Code Sec. 199A using one of the three methods provided by IRS. The first method (*the unmodified Box method*) allows for a simplified calculation, while the second and third methods (*the modified Box 1*

method and the tracking wages method) provide greater accuracy. The Box numbers referenced under each method refers to those on the Forms W-2 (Wage and Tax Statement).

Qualified business income deduction: rental real estate safe harbor

The IRS provided a safe harbor under which a rental real estate enterprise will be treated as a trade or business for purposes of the qualified business income deduction under Code Sec. 199A. That Code provision provides a deduction to non-corporate taxpayers of up to 20% of the taxpayer's qualified business income from each of the taxpayer's qualified trades or businesses, including those operated through a partnership, S corporation, or sole proprietorship, as well as a deduction of up to 20% of aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income.

Solely for this purpose, a rental real estate enterprise will be treated as a trade or business if:

a. Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;
b. For tax years beginning prior to Jan. 1, 2023, 250 or more hours of rental services were performed per year with respect to the rental enterprise; and
c. The taxpayer maintains contemporaneous records on the hours of all services performed; a description of all services performed; the dates on which such services were performed; and who performed the services. (This contemporaneous records requirement doesn't apply to tax years beginning before Jan. 1, 2019).

Options for those unable to pay the taxman

The April 15th deadline for filing 2018 income tax returns (*for most taxpayers, at least; April 17 for Maine, Massachusetts and the District of Columbia*) has recently passed. The IRS advised taxpayers who don't have cash to pay the balance due on their returns, that taxpayers can avoid a late filing penalty, but not interest (*and the late payment penalty*) if they can get a 6-month automatic extension of time to file from the IRS. The extension ONLY delays the filing date for the return (*to October 15, 2019);* any tax liability that is due must still be paid in full by April 15th, or the taxpayer can be assessed interest and late *payment* penalty (*currently, a total of about 1% a month added to the tax*) until the tax is paid.

The IRS outlined ways in which financially distressed clients may be able to defer paying their income taxes by various means - including by entering into an installment agreement (*either a short-term 120-day payment plan or a longer-term payment plan),*or by pursuing an offer in compromise with the IRS.

If a taxpayer has fallen into a hardship situation (*because of having lost a job, had income reduced, or suffered some other financial disaster*), the IRS *(and FTB*) have the option of put a taxpayer’s account into a “*currently not collectible* (*CNC in IRS lingo*) status for a year or more.

I have done this for a significant number of clients who have found themselves unable to meet basic living expenses, let alone commit to a payment plan for taxes owed. This is not a tax forgiveness program (*such as an Offer in Compromise – OIC for short*) – merely a deferral of making payments for a period of time – typically for one or two years. Pursuing a CNC or OIC status can be tricky – and utilizing the services of a professional provides the greatest chance of success.

As further information, if you found yourself with insufficient withholding to cover your tax liability in 2018, then you will want to increase your withholding by filing a new W-4 with your employer. Remember that four months in 2019 have passed already, so any change you make will only take effect for the remaining 8 months. So, for example, if you were short by $1,200 in 2018, then you will need $150 MORE in withholding for the next 8 months to break even ($150 x 8 = $1,200). Once you file the updated W-4, when the next paycheck arrives, compare the Federal withholding to the prior period. If it went up more or less than the $150, you can further change your W-4. Just remember next January (2020) to file a *new* W-4 to reduce the withholding or you will over-withhold for 2020 (*with 12 months of withholding*).

Gift Taxes

There seems to be some confusion about gift taxes. They were imposed by Congress years ago to discourage wealthy taxpayers from giving away their estates before they pass on to avoid the hefty estate tax. The tax considerations for gift taxes has changed over the years, and so I would like to discuss briefly the current tax ramifications of making gifts.

First of all, for anyone RECEIVING a gift, there is no tax consequence. If Bill Gates gives one of you a million dollars, you have no tax consequence. Of course, if you invest that money, then any income earned will be taxable. However, the original gift remains tax-free.

For the donor, however, there can be consequences. Any one taxpayer can give *in total during a calendar year* up $15,000 or less to any one recipient without any tax consequence. A single taxpayer can make a joint gift (*like a father to son and daughter-in-law*) $30,000 or less without consequence. A married couple could give the same son and daughter-in-law a joint gift of $60,000 or less without consequence.

But what happens if the gift or gifts given during the year to any person exceeds $15,000?

First, a gift tax return (Form 709) must be filed. It is due by April 15th of the year following the year of the gift (*just like the income tax return form 1040*). Every taxpayer gets a lifetime exemption of $11.4 million (*under current law – which I believe if the democrats ever get control of Congress and the Presidency, it will likely decrease*) for both estate and gift taxes. This limit adjusts annually based upon inflationary factors. In 2018, it was $11.18 million.

So, if a taxpayer gives, say, $100,000 to a recipient (*like father to son*), the Form 709 (*gift tax return)* will reflect an $85,000 *reduction* of the $11.4 million life time exemption. Unless the donor has a huge estate, this for most taxpayers is of no real consequence. It just means when they pass on, if their estate is larger than the current exemption, *less the reductions due to large gifts*, an estate tax will have to be paid. Current estate tax rates range from 18% to 40%.

If during their lifetime a taxpayer uses up the $11.4 million exemption, then further gifts over the annual $15,000 exclusion will currently be taxed annually at the current gift tax rates. Those range from 18% to 40% - the same rates as the estate tax.

Some gifts are tax-free regardless of the amount:

- Gifts to spouses are generally unlimited, with no gift or estate tax due.
- Gifts to charity are free of gift tax.
- Gifts made for tuition and qualified educational expenses don't have gift tax consequences, but in order to avoid the tax, *you have to make payments directly to the college or other educational institution*. If you give the money to

the student, you don't get the gift tax break, even if the student then turns around and pays that money to the school.

- Gifts to cover medical expenses for someone else are also free of tax, under the same limitations: *You have to pay the hospital or medical professional directly,* rather than giving money to the patient and having the patient pay the bill.

Be careful about adding persons (*like sons or daughters*) on your bank accounts or real property. The moment you due, technically, you have made a gift to that person! Many older taxpayers do add children to their accounts to provide them with the ability to make disbursements on their behalf if they become incapacitated. Technically, a Form 709 has to be prepared the year following the date the individual is made a joint owner of the account.

This can be particularly troublesome when property is involved. For example, if a parent passes away and leaves by Will or trust their home to their son or daughter, the cost-basis for the home (*used to figure the gain or loss when sold*) gets adjusted to the fair market value at time of death. To illustrate, mom and dad buy a home in 1970 for $35,000. In 2000, dad passes away and mom now becomes the sole owner of the property. In a community property state, the house gets a step up in basis to the current fair market value, say, $400,000. Mom lives on in the house and passes away in 2019. The house has a fair market value in 2019 of $1,000,000 – and that becomes the new cost-basis for the son who inherits the house. If the son immediately sells if for $1,000,000, there is no gain to be taxed. If he sold it a year later for $1.2 million, he would have a capital gain of $200,000 that would be taxed.

By contrast, if mom put the son on the title before she passed, then the basis is split between son and mom at that time – meaning, each then would have a $200,000 basis ($400,000 x 50%). When mom passes away years later, she gets a basis adjustment for ½ the fair market value of the property at the time she passes away *($1,000,000 x 50% = $500,000*). The son does NOT get a basis adjustment, and his basis remains at $200,000. When he opts to sell the home, his basis is $700,000 (*mom's $500,000 fair market value basis adjustment when she died plus his separate $200,000 basis).* That means he will have a capital gain of $300,000 if he immediately sells it for $1 million.

As a bit of tax planning, if the son moves into the house after mom passes on and makes it his personal residence for at least two years, then he will get a $250,000 exemption – meaning, only $50,000 would be a taxable gain if it were sold for $1 million *($700,000 basis plus $250,000 exclusion*).

If son is married and he and his wife move into the home and they jointly use it as their personal residence for at least two years, then they get a $500,000 exclusion. So, if the home is sold for less than $1.2 million *($700,000 basis plus $500,000 exclusion*), there would be no capital gain to report! If it sold for $1.5 million, then they would have a $300,000 capital gain.

Be aware of gift tax consequences when messing around with title to assets. For example, when it comes to a bank account for a parent, rather than becoming a joint owner, consider becoming an authorized signer on the account. You can have access to the funds in an emergency to cover costs if your parent becomes incapacitated, but you will not trigger gift tax consequences.

For taxpayers with significant assets, it is always important to consult an estate tax attorney who can provide the best guidance in this area.

Telephone Scam

There apparently is a new scam (*according to news sources*) that involves some creep who calls your number, lets the phone ring once, and then hangs up. The caller ID will display the caller's ID number (*with an unfamiliar area code*). Expecting that the party called will be curious about who just called and why, the scammer bets that the person called will call the number displayed as the caller ID. By doing so, the unsuspecting individual will be calling a toll number that will result in some big charge on their phone bill. The scammer who answers the phone *(it may be a recorded voice*) will try to keep the line open as long as possible to further increase the billing.

Bottom line – if you get a one-ring call and *you do not recognize the number,* the safest action is to do nothing. If the caller has a legitimate reason to reach you, they will call again or leave a voice mail. You can always go on Google, put in the phone number to search, and thereby find out if others have reported the number as a scam.

If you are getting hit with a lot of telemarketer and robo calls, I found a device that has helped me cut down on such calls. It is called DIGITONE ProSeries Blocker. I researched various devices and this one appears to have good reviews. If a robocaller or telemarketer gets through, pushing a "block" button twice will forever block that number. It is about $70.

Here is a link if you are interested: https://www.amazon.com/Digitone-ProSeries-Call-Blocker-Robocalls/dp/B01N45UW7P

Finally on the telephone scam topic, remember that if you get a call from an unrecognized number asking a question that can be answered with a "YES," don't respond by saying *YES*. Crooks are capturing your voice-print and using it as a means to confirm your ordering of some product you have no interest in buying!!! Best response is something like, "*Who wants to know???"*

Computer Scam

Hopefully, all of you are running a good, updated anti-virus software on your computer. There are viruses out there that can infect and lock up your computer, and the only way to get the computer unlocked is to pay some crook a bunch of money for a code that will unlock your system. Occasionally, you will read in the paper or hear online about some company that dropped their guard and had their system hijacked and held for ransom. If a payment is not made, then the virus deletes *permanently* all of the files on the computer.

Hoping to cash in on the unsuspecting computer user's fear of losing files, there are some websites that will suddenly display a *fake message* on your screen that your computer has been hacked and you need to call a number and pay a fee to get the system restored. I have seen this on a couple of occasions primarily on my iMac (*Apple system*). There is no "X" to click on to close the screen, and apparently there appears to be no way to get out of the page – forcing you to believe that you have to call the number displayed.

There is a way out. Hold the power button down for at least 10 seconds to shut off the computer. Once restarted, if the message was fake (*as most are*), the system returns to normal and the message is gone. However, if you revisit the last website that displayed the message, likely you will see the message pop up again!

So, be careful about panicking about such ominous messages. If it is a true hack on your system, then shutting it down and restarting would bring such a message back again. If that occurs, I strongly recommend taking the computer to a service center rather than paying some significant sum to a creep in a foreign county. You have no assurance that once you make payment that they will even provide a code or otherwise help you. It is important to keep important files on a backup device – just in case your primary devices crashes or gets hacked.

I hope that you find the information in this newsletter of value to you.

Very truly yours,

Dick Norton

This newsletter is not intended or written by me to constitute written advice that you may rely upon to avoid penalties that may be imposed by any taxing authority. An attorney should always be consulted in matters involving legal issues such as those inherent in estate planning or other matters where an attorney is best qualified and authorized to provide such guidance.