Current Federal Tax Developments

Week of February 18, 2019

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ACCOUNTING
CONTINUING EDUCATION

KAPLAN

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF FEBRUARY 18, 2019
© 2019 Kaplan, Inc.
Published in 2019 by Kaplan Financial Education.

Printed in the United States of America.

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Section: 280F
Safe Harbor for Luxury Autos and Bonus Depreciation Provided by IRS

Citation: Revenue Procedure 2019-13, 2/13/19

The IRS addressed a quirky interaction of bonus depreciation under IRC §168(k) and the luxury auto rules under IRC §280F in Revenue Procedure 2019-13. Absent this safe harbor method, taxpayers who opted not to elect out of §168(k) bonus depreciation for an automobile limited by §280F would find any basis in the automobile in excess of $18,000 would not be deductible until the end of the standard recovery period, which would begin in the seventh year after acquiring the vehicle.

Under the Tax Cuts and Jobs Act, a taxpayer is allowed to deduct 100% of the cost of qualifying assets in the year the asset is placed in service for assets placed in service between September 27, 2017, and January 1, 2023.[1] However, under the provisions most often referred to as the "luxury auto rules" a taxpayer's depreciation and/or §179 deduction for covered vehicles is capped at $10,000 for the first year.[2] This amount is adjusted annually for inflation.

IRC §168(k)(2)(F)(i) provided that the first year amount would be boosted by $8,000 per year for vehicles on which 100% bonus depreciation is allowed. In Revenue Procedure 2018-25 the IRS provided that this first year amount would be $18,000 in total for vehicles subject to bonus depreciation under IRC §168(k).

A problem arises since under IRC §280F(a)(1)(B) any depreciation disallowed under §280F(a)(1) during the regular recovery period (normally six years for an automobile) is treated as an expense in the first year following the recovery period, subject to the limitation amount found at §280F(a)(1)(B)(ii).[3] For automobiles placed in service in 2018 that amount is $5,760.

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[1] IRC §168(k)

[2] IRC §280F(a)(1)(A)

[3] IRC §280F(a)(1)(B)

Thus, if a taxpayer purchased a vehicle for $60,000 in 2018 the allowed depreciation per calendar year would be:

Tax Year	Depreciation
2018	18,000
2019	-
2020	-
2021	-
2022	-
2023	-
2024	5,760
2025	5,760
2026	5,760
2027	5,760
2028	5,760
2029	5,760
2030	5,760
2031	1,680

That result would be "surprising" to most taxpayers. The IRS has issued this revenue procedure to provide a safe harbor method that will allow taxpayers to take advantage of bonus depreciation on luxury automobiles without forgoing all other depreciation on the vehicle for five years following the year it is placed in service.

The safe harbor method applies to a passenger automobile (other than a leased automobile):

- That is acquired and placed in service by the taxpayer after September 27, 2017;
- That is property for which the 100-percent additional first year depreciation deduction is allowable;
- That has an unadjusted depreciable basis exceeding the first year limitation; and
- For which the taxpayer did not elect to treat the cost or a portion of the cost as an expense under § 179.

Under the safe harbor, the remaining basis of the automobile is depreciated for years 2-5 using an amount equal to the lesser of:

- The basis after the first year deducted amount times the appropriate factor from the 5 years MACRS table found in Table A-1 of Appendix A of Publication 946 *or*
- The annual limitation on depreciation for the appropriate year found in the appropriate Revenue Procedure for the year the auto is placed in service. For autos placed in service in 2018 that would be Revenue Procedure 2018-25.

The depreciation per year for autos placed in service in 2018 would be based on the following percentages and limits:

Year	Depreciation Percentage	Maximum Depreciation Dollar Amount (Rev. Proc. 2018-25)
2019	32.00%	16,000
2020	19.20%	9,600
2021	11.52%	5,760
2022	11.52%	5,760
2023	5.76%	5,760
2023 & later	Lesser of balance remaining to recover or $5,760	

So in the above example, there would be $42,000 of basis remaining after the first year. Under the safe harbor method the taxpayer would claim the following depreciation on the vehicle in each of the following years:

Year	Percentage Depreciation	280F Limit	Depreciation Deduction
2019	13,440	16,000	13,440
2020	8,064	9,600	8,064
2021	4,838	5,760	4,838
2022	4,838	5,760	4,838
2023	2,419	5,760	2,419
2024		5,760	5,760
2025		5,760	2,640

Section: 401
Subtrust Qualifies as Conduit Trust for IRA RMD Calculations

Citation: PLR 20190223, 2/8/19

Trusts can be used to hold an inherited IRA and still obtain the benefit of the life expectancy of the trust's beneficiary if certain requirements are met. In PLR 201902023 the IRS ruled that such a result was obtained via the use of a subtrust.

The letter ruling provided the following facts regarding the trust and the associated subtrust:

> *Decedent established the Trust, a living revocable trust, on Date 1, subsequently amended and restated in its entirety on Date 2. The Trust document establishes a Subtrust to hold the benefits and distributions from any retirement plan, including a traditional individual retirement account (IRA). The Trust and Subtrust are valid under the laws of State X. Decedent died on Date 3, after his required beginning date under section 401(a)(9) and after distributions under the IRA had begun. The Trust and Subtrust became irrevocable upon Decedent's death.*

> *…The terms of the Trust document governing the Subtrust provide that all property held by the Subtrust will be held, administered, and distributed for the benefit of Beneficiary. The Trust document further states that Beneficiary shall be the sole beneficiary of the Subtrust, and that all retirement benefits distributed to the Trustee, including required minimum distributions, shall be paid directly to the Beneficiary upon receipt by the Trustee, so that the Trustee shall serve as a conduit only. It also states that upon Beneficiary's death, any tax-qualified retirement plans or accounts, including the remaining assets of the Subtrust, shall be divided equally between and distributed to Decedent's children or their descendants.*

The ruling sought clarification of the proper treatment of the following IRA:

> *At the time of death, Decedent held an IRA. The IRA adoption agreement, executed on Date 4, names the Trust as the designated beneficiary. Prior to October 31 of the calendar year immediately following the calendar year of Decedent's death, on Date 5, the Trustee delivered the Trust document for the Trust and Subtrust to the IRA custodian.*

When an owner of an IRA dies after passing his/her required beginning date (triggered by obtaining age 70 ½), the account must be distributed over a maximum term generally determined by reference to the life expectancy of the beneficiary. If that beneficiary is not an individual, the entity is deemed to have a zero life expectancy, which limits the option for the slowest distribution to be the remaining life expectancy of decedent, of course presuming that the decedent had not just in fact died. Most often that is a relatively short period.

However, under Reg. §1.409(a)(9)-4 Q&A 5, an option is provided for a trust to "look through" to use the age of its oldest beneficiary. The regulation provides:

> *Q-5. If a trust is named as a beneficiary of an employee, will the beneficiaries of the trust with respect to the trust's interest in the employee's benefit be treated as having been designated as beneficiaries of the employee under the plan for purposes of determining the distribution period under section 401(a)(9)?*
>
> *A-5. (a) If the requirements of paragraph (b) of this A-5 are met with respect to a trust that is named as the beneficiary of an employee under the plan, the beneficiaries of the trust (and not the trust itself) will be treated as having been designated as beneficiaries of the employee under the plan for purposes of determining the distribution period under section 401(a)(9).*
>
> *(b) The requirements of this paragraph (b) are met if, during any period during which required minimum distributions are being determined by treating the beneficiaries of the trust as designated beneficiaries of the employee, the following requirements are met -*
>
>> *(1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.*
>>
>> *(2) The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.*
>>
>> *(3) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable within the meaning of A-1 of this section from the trust instrument.*
>>
>> *(4) The documentation described in A-6 of this section has been provided to the plan administrator.*

> *(c) In the case of payments to a trust having more than one beneficiary, see A-7 of § 1.401(a)(9)-5 for the rules for determining the designated beneficiary whose life expectancy will be used to determine the distribution period and A-3 of this section for the rules that apply if a person other than an individual is designated as a beneficiary of an employee's benefit. However, the separate account rules under A-2 of § 1.401(a)(9)-8 are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit.*
>
> *(d) If the beneficiary of the trust named as beneficiary of the employee's interest is another trust, the beneficiaries of the other trust will be treated as being designated as beneficiaries of the first trust, and thus, having been designated by the employee under the plan for purposes of determining the distribution period under section 401(a)(9)(A)(ii), provided that the requirements of paragraph (b) of this A-5 are satisfied with respect to such other trust in addition to the trust named as beneficiary.*

The taxpayer was asking for the following rulings:

> *1) The requirements of section 1.401(a)(9)-4, Q&A-5 are satisfied with respect to the Trust and the Subtrust and therefore the individual Beneficiary of the Subtrust is treated as the designated beneficiary of the IRA for purposes of determining the applicable distribution period under section 401(a)(9); and*
>
> *2) The applicable distribution period for Decedent's IRA is to be calculated based on the life expectancy of Beneficiary.*

The IRS gave the following responses to the request:

> *With respect to your first ruling request, you have represented that the Trust is valid and irrevocable and that the required documentation has been provided, in accordance with section 1.401(a)(9)-4, Q&A-5(b)(1), (2), and (4). The Trust document identifies Beneficiary as the sole beneficiary of the Subtrust in accordance with section 1.401(a)(9)-4, Q&A-5(b)(3). In addition, the Trust document requires the Trustee to pay Beneficiary any and all funds in the Subtrust withdrawn by the Trustee, including required minimum distributions under section 401(a)(9), and there can be no accumulation on behalf of any other beneficiary. Therefore, we conclude that the requirements of section 1.401(a)(9)-4, Q&A-5, are met with respect to the Trust and the Subtrust and that the individual Beneficiary of the Subtrust is treated as the sole designated beneficiary of Decedent's IRA.*
>
> *With respect to your second ruling request, under section 1.401(a)(9)-5, Q&A-5(a), the applicable distribution period for distribution calendar years after the distribution calendar year containing Decedent's death is the longer of (i) the remaining life expectancy of Beneficiary determined in accordance with section 1.401(a)(9)-5, Q&A-5(c)(2), and (ii) the remaining life expectancy of Decedent determined in accordance with section 1.401(a)(9)-5, Q&A-5(c)(3). Because Beneficiary's life expectancy is longer than Decedent's, the applicable distribution period for Decedent's IRA is based on the life expectancy of Beneficiary.*

Section: 1256
AICPA Asks IRS to Provide Relief to Small Businesses from Syndicate Rule

Citation: AICPA Letter to Internal Revenue Service on Syndicate Guidance, 2/13/19

The AICPA has written a letter to the IRS requesting that the agency protect certain small businesses that are deemed to be syndicates from the loss of various small business benefits provided in the Tax Cuts and Jobs Act.

Various benefits are available under the Tax Shelter and Jobs Act to businesses with average revenues of less than $25 million over three years, including:

- Use of the cash basis of accounting;
- No longer required to use the uniform capitalization rules of §263A;
- Allowed to use alternatives to the general inventory rules found at IRC §471(a); and
- Exemption from the limitation on business interest expense under §163(j).

However, these benefits are not available if the entity is a tax shelter as defined by IRC §448(d)(3).

This issue was covered in our January 11, 2019 article (Syndicate Rules May Create Problems for Small Businesses and §163(j) Interest Limits) which noted the particular issues raised by the possibility such businesses might meet the definition of a syndicate under IRC §1256(e)(3)(B), one of the three categories of tax shelters.

That provision defines a syndicate as "any partnership or other entity (other than a corporation which is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners or limited entrepreneurs…" A limited entrepreneur is defined at IRC §461(k)(4) as:

> *(4) Limited entrepreneur*
>
> *For purposes of this subsection, the term "limited entrepreneur" means a person who—*
>
> > *(A) has an interest in an enterprise other than as a limited partner, and*
> >
> > *(B) does not actively participate in the management of such enterprise.*

As was discussed in the earlier article, the IRS in regulations under §448 modified the definition of a syndicate to refer to 35 of the losses are *allocated* rather than being *allocable*, thus eliminating a problem for an entity that doesn't have losses.

However, the expansion of the reach of this definition to potentially impact all types of businesses creates a situation where a business that has any significant percentage of inactive ownership could lose significant tax benefits should it have a loss year.

The AICPA letter calls on the IRS to blunt the impact of this provision by using its authority under IRC §1256(e)(3)(C)(v) to treat certain interests as not being treated as inactive if "the Secretary determines (by regulations or otherwise) that such interest should be treated as held by an individual who actively participates in the management of such entity, and that such entity and such interest are not used (or to be used) for tax–avoidance purposes."

Specifically, the AICPA asks the IRS to issue regulations that exempt organizations from the syndicate rules if the organization meets the following three conditions:

- Qualifies under the gross receipts test of section 448(c); and
- Meets the definition of a syndicate under section 1256(e)(3)(B); and
- Does not qualify "for making an election under section 163(j)(7)(B) to be an electing real property trade or business" or "an election under section 163(j)(7)(C) to be an electing farming business."

It remains to be seen if the IRS will consider issuing such regulations and, if they do consider taking such action, what modifications they might make to the AICPA suggestion. But those advising businesses that appear to be at risk of being syndicates will want to watch for IRS action in this area.

Section: 6031
IRS Adds Requirement for Tax Basis Partner Capital Information Reporting to Form 1065 Instructions

Citation: Instructions to Form 1065, 2/4/19

An article published in *Tax Notes Today* on February 15[4] highlighted a change in the 2018 Form 1065 instructions that will impact partnerships reporting partners' capital accounts on Schedule K-1 using other than tax basis capital account reporting.

The new instructions, found in the instructions for Schedule K-1, Item L in the Form 1065 instructions at page 30 reads as follows:

> *If a partnership reports other than tax basis capital accounts to its partners on Schedule K-1 in Item L (that is, GAAP, 704(b) book, or other), and tax basis capital, if reported on any partner's Schedule K-1 at the beginning or end of the tax year would be negative, the partnership must report on line 20 of Schedule K-1, using code AH, such partner's beginning and ending shares of tax basis capital. This is in addition to the required reporting in Item L of Schedule K-1.*
>
> *For these purposes, the term "tax basis capital" means (i) the amount of cash plus the tax basis of property contributed to a partnership by a partner minus the amount of cash plus the tax basis of property distributed to a partner by the partnership net of any liabilities assumed or taken subject to in connection with such contribution or distribution, plus (ii) the partner's cumulative share of partnership taxable income and tax-exempt income, minus (iii) the partner's cumulative share of taxable loss and nondeductible, noncapital expenditures.*

The article notes that the IRS is interested in such cases to help identify situations where the partner will likely have to recognize future income or gain.

A failure to provide such information opens up the partnership for a penalty under IRC §6698(a)(2) for filing "a return or a report which fails to show the information required" for a partnership return or report of imputed adjustment. That penalty is the same penalty as applies for a failure to file a partnership return--$195 per month per partner.

The article points out that the penalty is not subject to abatement under the first-time abatement provisions of IRM 20.1.1.3.3.2.1, but the IRM does provide that a partnership or S corporation that has such an incomplete filing will be offered the opportunity to provide the information before the penalty is assessed.

The practical impact of this requirement is that all partnerships will be required to maintain some form of tax basis capital accounts for the partners, even if the partnership itself is reporting its balance sheet and Schedule L using another method of accounting for the

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[4] Nathan J. Richman, "IRS Now Asking About Negative Partnership Tax Capital Accounts," *Tax Notes Today*, Feburary 15, 2019, 2019 TNT 32-1

accounts. Since partnership also are generally required to maintain §704(b) capital accounts as well, assuming the partnership wishes to avail itself of the substantial economic effect justification for its allocations of income and expense under its partnership agreement, this means virtually all partnerships show now have records for two capital account balances for the partners.

Section: 6037
IRS Expands Cases Where S Shareholder Must Attach Basis Computation and Adds Check Box to Schedule E

Citation: Clarification on line 28, column (e), of Schedule E (Form 1040), IRS Website, 2/6/19

Glen Birnbaum, CPA pointed out on Twitter on February 15, 2019 an item referenced in RIA's *Federal Tax Update* the same day regarding a new check box has appeared on Schedule E of Form 1040 that applies to S corporation shareholders. The IRS posted information about this change on its website in an article titled "Clarification on line 28, column (e), of Schedule E (Form 1040)" on February 6, 2019.

The page provides:

> *As stated in Part II of the Schedule E (Form 1040), a taxpayer who owns an interest in an S corporation and reports a loss, receives a distribution, disposes of stock, or receives a loan repayment from the S corporation must check a corresponding box under line 28, column (e), and attach a computation detailing their S corporation basis. The discussion about basis rules for S corporations in the Instructions for Schedule E (Form 1040) for Parts II and III does not limit or modify this requirement.*

First, this page highlights a new checkbox on Schedule E, but it also provides additional clarification beyond what is given in the Schedule E instructions for the box. The instructions provide a more limited case for when a basis schedule is required:

> *If you are claiming a deduction for your share of an aggregate loss, check the box on the appropriate line in Part II, column (e), and attach to your return a computation of the adjusted basis of your corporate stock and of any debt the corporation owes you. For details, see the Shareholder's Instructions for Schedule K-1 (Form 1120S).*

The IRS is referring to the box (e) shown below on line 28 of Part II from page 2 of 2018 Schedule E (Form 1040).

Schedule E (Form 1040) 2018 — Attachment Sequence No. **13** — Page **2**

Name(s) shown on return. Do not enter name and social security number if shown on other side. | **Your social security number**

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II **Income or Loss From Partnerships and S Corporations** – **Note:** If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column **(e)** on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(f)** on line 28 and attach **Form 6198** (see instructions).

27 Are you reporting any loss not allowed in a prior year due to the at-risk, excess farm loss, or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section . . . . ☐ **Yes** ☐ **No**

28	**(a)** Name	**(b)** Enter **P** for partnership; **S** for S corporation	**(c)** Check if foreign partnership	**(d)** Employer identification number	**(e)** Check if basis computation is required	**(f)** Check if any amount is not at risk
A			☐		☐	☐
B			☐		☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		**Nonpassive Income and Loss**		
	(g) Passive loss allowed (attach **Form 8582** if required)	**(h)** Passive income from **Schedule K-1**	**(i)** Nonpassive loss from **Schedule K-1**	**(j)** Section 179 expense deduction from **Form 4562**	**(k)** Nonpassive income from **Schedule K-1**
A					
B					
C					
D					
29a Totals					
b Totals					

30	Add columns (h) and (k) of line 29a.	**30**	
31	Add columns (g), (i), and (j) of line 29b.	**31**	( )
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	**32**	

The requirement to attach a basis schedule to the Form 1040 for an S shareholder claiming a loss is not new. The 2017 Schedule E Form 1040 instructions provided, as they had for a number of years before 2017:

> *If you are claiming a deduction for your share of an aggregate loss, attach to your return a computation of the adjusted basis of your corporate stock and of any debt the corporation owes you. For details, see the Shareholder's Instructions for Schedule K-1 (Form 1120S).*

Advisers who are preparing individual returns for S corporation shareholders will need to note the expanded list of situations when a basis computation must be attached to the tax return and assure the schedules are attached.