The Kiplinger Tax Letter

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925

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Dear Client: Washington, Jan. 24, 2020

HIGHLIGHTS

The 2020 tax filing season is upon us. IRS will begin accepting 2019 returns on Jan. 27. The filing due date for individual returns is April 15.

Be alert to IRS phone impersonation scams. They surge at this time of year. The callers claim to be IRS workers and alter the caller ID readout. Victims are told they owe taxes and must pay up through wire transfer, gift card or other payment type. If you get one of these calls, hang up... And be sure not to give out any information.

E-mail phishing scams are also on the rise. These are unsolicited e-mails or websites that resemble a legitimate site and are designed to trick recipients and readers into providing their personal and financial information. Recent examples include scammers spreading a computer virus with e-mails about IRS tax transcripts and random e-mails purporting to come from IRS about errors on tax refunds. Others might pose as a bank, store or an executive at your place of employment. Don't respond and delete the e-mail. If you get a tax-related phishing communication or an IRS impostor e-mail, forward it on to the Revenue Service at *phishing@irs.gov*.

Here are some tips to protect yourself and your data from identity theft. Put antivirus security software on your electronic devices and mobile phones, and set it to update automatically. Use strong passwords for online accounts... note that longer phrases are easier to remember and harder for criminals to hack. Use two-factor authorization where possible, with a security code sent to your phone. And shop at websites where the web address starts with "https," because the letter *s* designates secure communications over the computer network, according to IRS.

Preparers and other tax professionals are also at risk from phishing scams. Cyberthieves are increasingly targeting them in their quest for taxpayer data. And the crooks are becoming much more sophisticated in what they're looking for. For example, scammers pose as professional associations or online education providers, or send fake e-mail communications referencing blocked or closed e-Services accounts. They've stooped to seeking sensitive preparer information...preparer tax ID numbers, e-Services credentials, Centralized Authorization File numbers and the like.

IRS offers steps to help tax professionals safeguard their own information... And that of their clients. Among the measures: Use strong passwords...phrases or a combination of letters, numbers and symbols. Install antivirus security software on all electronic devices. Secure your wireless networks by changing the router name. Back up electronic taxpayer data and store them safely. Create a data security plan. Encrypt e-mails to clients. More tips can be found in IRS Publications 4557 and 5293.

Having a data security plan is mandatory for paid tax return preparers. To get a 2020 preparer tax ID number, new applicants and renewals must check a box to confirm that they are aware of their responsibilities in protecting client data.

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FILING SEASON Filing early is one way to protect yourself from tax-related identity theft... And potential refund delays. Thieves who use stolen taxpayer identities to seek refunds on fraudulent returns typically file the phony returns early in the filing season so that IRS gets them before legitimate taxpayers file their 1040s. But if you file early, your return will likely arrive at IRS before a fake return does.

More e-filers can get identity-protection personal identification numbers. The Service is expanding a program to help thwart identity tax theft and refund fraud. Individual e-filers in Ariz., Calif., Colo., Conn., Del., D.C., Fla., Ga., Ill., Md., Mich., Nev., N.J., N.M., N.Y., N.C., Pa., R.I., Texas and Wash. will be able to opt in to apply for the special identity protection PIN when e-filing their 2019 federal returns. IRS Publication 5367 has the details, including instructions on how to get an IP PIN.

IRS is touting its updated Free File program, after a spate of bad press last year. The Free File program lets taxpayers with adjusted gross income of $69,000 or less use free commercial tax software to prepare and e-file returns. (Note some of the 10 participating tax preparation firms set lower AGI requirements.) However, many taxpayers don't use it or are not even aware that the option exists. Part of the problem was software companies, such as H&R Block and Intuit, the maker of TurboTax, allegedly steering taxpayers away from the free tax software to more costly alternatives. In part, the new Free File agreement bars tax prep firms that participate in the program from hiding those services in online searches.

Here's an option if your AGI is too high to qualify for the Free File program: Free File Fillable Forms. It's for people who are comfortable doing their taxes with little assistance. That's because, unlike typical commercial software programs, this option won't ask a set of questions to determine which forms you need to file and which deductions you are or are not eligible for. But it does do math calculations and allows you to electronically file your return with IRS without having to pay for it.

Both Free File and Free File Fillable Forms can be accessed on IRS's website at *www.irs.gov/freefile*. Also, keep in mind two free preparation options for seniors and lower-income individuals: Volunteer Income Tax Assistance program (VITA) and Tax Counseling for the Elderly (TCE). You can find more information on both at *www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers*.

D.C. and 22 states also offer a free state return preparation program that is patterned after IRS's Free File. Those states are Ariz., Ark., Ga., Idaho, Ind., Iowa, Ky., Mass., Mich., Minn., Miss., Mo., Mont., N.Y., N.C., N.D., Ore., R.I., S.C., Vt., Va. and W.Va. You'll need to go to the state tax agency's free file page for details.

SOCIAL SECURITY We get lots of questions on the federal taxation of Social Security benefits. For some Social Security recipients, the benefits escape federal income tax. Others aren't so lucky and may have to pay income tax on up to 85% of the benefits.

Let's go over the rules. First, you need to figure your "provisional income." That's your adjusted gross income plus tax-free interest from municipal bonds and 50% of your Social Security benefits. If your provisional income is below $25,000... $32,000 on a joint return...then the benefits are tax-free. If your provisional income is between $25,000 and $34,000 on a single return or between $32,000 and $44,000 for joint filers, then half the benefits are taxable. For provisional income over $34,000 for singles...$44,000 for married couples...up to 85% of your benefits are taxable. A worksheet in the Form 1040 instructions booklet helps you to figure this out.

Don't assume your state follows federal law. Many don't tax Social Security. Take a look at Kiplinger's state-by-state guide for the taxation of retirees. For details, go to *www.kiplinger.com/letterlinks/2019map* to view the online tool.

BUSINESS TAXES Shareholder basis in S corporations is keeping IRS auditors busy. Owners of S corporations can deduct losses only up to their stock basis and loans they make to the firm. IRS knows that compliance in this area is lacking and has ramped up enforcement efforts to curtail losses claimed in excess of basis.

Take this case. Taxpayers who owned stock in two S corporations took losses on their individual returns from one of the S corporations. IRS auditors disallowed the write-offs, arguing that the losses exceeded their basis in the firm. The shareholders claimed that debt owed to one of the S firms by the other company should be treated as if it were debt owed directly to the shareholders. An appeals court ruled the taxpayers must rely on the form of the transaction (Messina, 9th Cir.).

Expenses incurred before starting a business aren't deductible, the Tax Court confirms in this case in which a man purchased land with maple trees and fields and planned to produce syrup and grow blueberries. But in the years under audit, he didn't get past the preparatory stage. He thinned the maple bush and cleared areas for the blueberry plantings, but he didn't yet collect the sap from the trees or plant the blueberry bushes (Primus, TC Summ. Op. 2020-2). Note that once their business begins, firms can make an election to deduct $10,000 of the pre-opening costs and amortize the remaining expenses over 180 months.

TAX TREATIES A Russian scientist who got paid for research in the U.S. gets good news: His payments escape U.S. income tax under the U.S.-Russia tax treaty, the Tax Court says. He worked at a lab operated by a Dept. of Energy contractor. His work was primarily research for the public interest. He was first brought on board for two years as an exchange visitor, and his position was extended three more years. Per the Court, his wages were akin to grants exempt under the U.S.-Russia tax treaty because the funding was earmarked for him, he facilitated scientific research, and his pay was static the whole time, unlike a normal salary (Baturin, 153 TC No. 10).

TAX DISPUTES A couple whose petition lacked a postmark date get their day in Tax Court. The couple's attorney said he mailed the petition to the Court four days before the 90-day period for filing lapsed. But the Court received it 18 days later. The envelope had postage stamps but didn't include a postmark from the post office. IRS claimed the filing was late, but the Court found the lawyer's testimony reliable and ruled the petition was timely mailed and timely filed (Seely, TC Memo. 2020-6).

SETTLE-MENTS Settlement proceeds received by a woman from a fertility clinic are nontaxable, IRS privately rules. The woman contracted with the clinic to provide her with a donor egg and embryo transfer through in vitro fertilization. She got pregnant, but discovered after delivering the baby that her child suffered from a genetic condition with physical and other disabilities. The clinic didn't do genetic testing on the egg prior to implantation in the mom's womb. Testing done post-birth showed that the egg carried the gene responsible for the baby's condition. The mom sued the clinic, and the parties settled. The funds are tax-free because she received them on account of the baby's physical illness and her emotional distress attributable to that illness.

WAIVED DEBTS Some ex-students of closed for-profit or nonprofit schools get a tax break. The government's discharge of their education debt won't draw a tax bill. The relief applies to ex-students whose federal education loans for these schools were waived by the Dept. of Education under two programs...one on closed schools and the other relating to misrepresentations made by educational institutions.

The same goes for a private lender's discharge of their education debt, provided the loans were discharged based on a settlement of a legal cause of action against the school, such as for deceptive or fraudulent practices by the school.

Affected students needn't recognize canceled debt income (Rev. Proc. 2020-11).

Many source documents are available in the online edition of The Kiplinger Tax Letter

DISASTER LOSSES Victims of federally declared disasters in 2018 and 2019 get relief. Individuals can take personal disaster losses even if they don't itemize. They're able to deduct uninsured personal losses in excess of a $500 threshold without regard to the 10%-of-AGI offset that generally applies. This net loss is treated as an additional standard deduction for nonitemizers. See the instructions to Form 1040, line 9 and Schedule A, line 16, on how to report this on your return.

The 10% penalty on pre-age-59½ payouts from retirement accounts is waived as long as the IRA or retirement plan withdrawals are not greater than $100,000. The income tax due on such distributions can be spread over a three-year period.

Victims can borrow more from company retirement plans such as 401(k)s... up to the lesser of $100,000 or 100% of the account. Loan repayments can be deferred.

The 60%-of-AGI limitation on charitable contributions is suspended for any cash donations to qualified charities that aid victims of the federal disasters.

Corporations can fully deduct cash donations for federal disaster relief.

There's a special break for disaster-affected firms that kept paying workers despite suspension of business operations in 2018 or 2019 because of the disaster. They get a 40% tax credit for up to $6,000 of wages paid to each idle employee.

PAYROLL TAXES Employers are required to file W-2s with the federal government by Jan. 31. This matches the due date for sending copies of the form to employees. The Jan. 31 date also applies to 1099 forms reporting nonemployee compensation. Next year, nonemployee compensation over $600 will be reported on the new 1099-NEC.

Missing the deadline can lead to fines, ranging from $50 for late returns filed up to 30 days after Jan. 31 to $110 or $270 per return for later filings.

Hiring your family can lower your payroll tax bill. No Social Security or Medicare tax is due if sole proprietors or husband-wife partnerships hire their kids who are under age 18. Ditto if the child works for a parent's one-person LLC that's disregarded for tax purposes. Also, federal unemployment tax isn't owed on their salaries until they reach 21. If employing your spouse or your parent, then the working spouse's or parent's wages escape federal unemployment tax, but are subject to income tax withholding and Social Security and Medicare taxes.

IRS Mixed news for IRS on its 2020 budget: It got about a 2% funding increase. But this is a drop in the bucket compared with what the agency needs for taxpayer service, modernization, enforcement and operations support, according to tax professionals, the National Taxpayer Advocate's office and others.

The Service's enforcement division especially needs to be beefed up.

In 2019, IRS's individual audit rate fell to 0.45%, down from 0.59% in 2018. One reason for the decline: The government shutdown, which shuttered the Service and other departments for 35 days from late Dec. 2018 through much of Jan. 2019. President Trump's budget plan would have given the agency an extra $14.5 billion over 10 years for enforcement. But this proposal didn't make it into the final budget passed by Congress. Trump also supported giving the Service increased oversight of paid tax return preparers, but this idea was also not included in the budget deal.

Yours very truly,

The Kiplinger Editors

Jan. 24, 2020 THE KIPLINGER WASHINGTON EDITORS

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