The Kiplinger Tax Letter

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925

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Dear Client: Washington, July 2, 2015

HIGHLIGHTS

- **Same-Sex Couples** State taxes
- **Savings Plans** ABLE accounts
- **New Tax Laws** A few tightenings
- **Real Estate** Taxpayer loss
- **Preparers** Filing season program
- **Enforcement** IRS collections down

The health premium tax credit is valid. The Supreme Court handed President Obama a big win when it ruled that the premium tax credit is allowed to qualifying individuals who purchase insurance on the federal exchange, and is not restricted to those who obtain their coverage from a state-run exchange. The Court said the health reform law as a whole shows that Congress didn't intend to limit credits to state exchanges. The rationale of the high court makes it untenable for a subsequent administration to issue regulations to try to limit the subsidies.

Also left unscathed is the employer mandate, which kicked in this year for firms with 100 or more full-time employees (50 beginning in 2016). Under this rule, employers must offer their full-timers affordable coverage that meets minimum value or pay a tax. An employer's liability for the fine is tied to employees getting a credit for insurance bought on an exchange. If the Court had decided to limit the availability of the premium subsidies, the employer mandate would have been greatly weakened.

Lawmakers will now find it nearly impossible to repeal Obama's health law, although many GOPers will continue their efforts to get the legislation off the books.

But don't rule out some pro-business changes under a Republican president:

Reducing the 40% tax on "Cadillac" plans...those costing more than $10,200 for individual coverage and $27,500 for families...or delaying its 2018 effective date.

Hiking the 30-hour-per-week threshold needed to qualify as a full-timer for purposes of triggering the mandate that employers provide insurance to workers.

And doing away with the medical device tax...the 2.3% levy now imposed on manufacturers of medical devices, with an exception for common retail items, such as glasses, contacts and hearing aids. The House has already repealed this tax without a revenue offset, but many Senate Democrats are hard-pressed to go along unless the GOP can find a way to make up for the estimated $25 billion in lost revenue.

Firms that reimburse workers for health coverage want Congress's help.

They're pleading for a reprieve from the $100-a-day-per-employee excise tax. We have previously noted that businesses with arrangements to reimburse employees for premiums paid for individual health insurance policies or Medicare could be nailed by this stiff tax. IRS says these plans run afoul of the health reform law. The Service temporarily waived the tax for firms with fewer than 50 full-time-equivalent employees, but this relief expired June 30, and the agency has yet to announce any more waivers. S corporations are in the clear for now. They can continue to reimburse premiums for their more-than-2% owners without fear of the excise tax until IRS says otherwise.

Legislators are sympathetic to their plight. Sen. Chuck Grassley (R-IA) and Rep. Charles Boustany (R-LA) have each recently introduced bills in Congress to let small employers continue these types of reimbursement plans on a pretax basis. And the American Institute of Certified Public Accountants has also weighed in.

So if the Service doesn't grant relief, it's a safe bet taxwriters will do so.

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Subscription inquiries and customer service: Call 800-544-0155; e-mail sub.services@kiplinger.com; or visit kiplinger.com/customer-service
Editorial information: Tel., 202-887-6457; e-mail, letters@kiplinger.com

SAME-SEX COUPLES

Filing state tax returns will be easier for many same-sex married couples, now that the Supreme Court has said that they have a constitutional right to marry and that all states must recognize same-sex marriages performed elsewhere. Those who marry and live in one of the states that didn't recognize their marriage prior to the high court's ruling should now be able to use the same filing status as other married couples in that state and needn't file separate state returns.

Ditto for estate and gift tax planning in those states that impose the tax.

Many employers will benefit from the uniformity in state marriage laws. They'll no longer need separate systems to manage benefits and calculate state taxes for same-sex married workers that differ from those set up for opposite-sex marrieds. For instance, in states that didn't recognize same-sex marriage, workers were taxed on the value of health benefits for same-sex spouses but not for opposite-sex spouses.

SAVINGS PLANS

States get the go-ahead from IRS to offer ABLE accounts for the disabled. These accounts are similar to 529 plans and allow families to set aside funds to help the long-term disabled maintain their quality of life. Nondeductible payins of up to $14,000 per year can be made to an ABLE for a person who became blind or disabled before age 26. Distributions of earnings from the account will be tax-free if the funds are used for housing, transportation, education, job training and the like.

New IRS regulations clarify the rules on these accounts. For example:

Tax-free payouts can be made for basic living expenses to help a beneficiary improve the quality of life, such as a smartphone that helps an autistic child navigate and communicate better. The expenses needn't be medically necessary, IRS says.

An individual can have only one qualifying ABLE account at a time.

Contributions must be made in cash. Securities cannot be contributed.

ABLE payins are treated as gifts by the contributor for tax purposes. So if a donor puts in $14,000 this year, any other gifts by the donor to the beneficiary in 2015 will trigger the requirement to file a gift tax return. But no tax will be due unless the donor has already made more than $5.43 million of lifetime taxable gifts.

BENEFIT PLANS

The disabled can tap retirement accounts before age 59½ without penalty. But people who have diabetes don't automatically qualify for this break, as this Tax Court case shows. A 45-year-old diabetic left his job and took a payout from his former employer's plan. Shortly thereafter, he went into a diabetic coma and later had trouble performing basic tasks. The Court said he owes the 10% penalty on the payout because he couldn't prove that on the date he received it, his illness prevented him from engaging in gainful activity (Trainito, TC Summ. Op. 2015-37). This is so even though the coma later in the same year left him sufficiently disabled.

Federal public safety officers will get a break on retirement plan withdrawals. Payouts at age 50 will be exempt from the 10% penalty, down from age 55. The easing is part of a new law expanding the president's trade agreement powers and will take effect for distributions after 2015. Federal law enforcement officers and firefighters are eligible for this break, as are air traffic controllers. Withdrawals can be made from defined benefit and defined contribution plans. A similar easing for state public safety officers will be expanded to defined contribution payouts, too.

DONATIONS

Donations to personal fund-raising websites generally aren't deductible as charitable contributions because they are earmarked for a single person or small group, an IRS attorney confirms. This includes contributions made on sites such as *www.gofundme.com* to assist with a person's medical costs or to help a family who lost their home in a fire or storm. But gifts to charities that solicit donations on a fund-raising site can be deducted, provided the groups are 501(c)(3) organizations.

NEW TAX LAWS

A tightening on claiming tax breaks for education will kick in for 2016. Filers must have a 1098-T form from the college in hand before they file for the American Opportunity credit, the Lifetime Learning credit or the deduction for tuition taken on the front of the 1040. The idea is to help the Service better verify that claims for the credit or deduction are valid. Parents can still claim these breaks if the school sends a 1098-T to their dependent student. This requirement takes effect for 1040s for 2016 that will be filed in 2017. Filings for tax year 2015 aren't affected.

IRS won't penalize colleges for mailing 1098s with invalid tax ID numbers as long as the institutions certify they properly asked the students for the numbers. But other penalties for filing incorrect information returns will soar. The basic fine will increase to $250 per 1099, up from $100 currently. Lesser penalties imposed when the 1099s are corrected by Aug. 1 increase as well. The $500,000 annual ceiling on businesses with gross receipts of $5 million or less that unintentionally file incorrect 1099s will rise to $1 million. The penalty ceiling on larger firms also doubles...to $3 million. The hikes will apply to 1099s filed for 2015.

One other newly enacted tightening affects Americans working abroad: Child tax credits are limited for users of the foreign earned income exclusion... the special write-off for as much as $100,800 of income earned in a foreign country. Child credits for those claiming the break cannot exceed the filers' U.S. tax liabilities. In other words, the credit won't be refundable. This change will impact 2015 returns.

GAINS & LOSSES

A stock's worthlessness resulting from corporate fraud isn't a theft loss, according to the Tax Court. Here, a couple purchased millions of shares in a public corporation on the open market. That stock later became totally worthless when the firm went under because of securities fraud committed by its executives. The couple said they should get a theft loss because the husband had direct contact with one of the corporate officers, who lied and misled him. But that's not enough to convert the couple's capital loss into an ordinary loss (Greenberger, D.C., Ohio). The loss would have been ordinary had the shares been bought from the fraudster.

REAL ESTATE

Time spent as an investor doesn't make you a real estate professional, the Tax Court says. Folks who spend over 50% of their total working hours and more than 750 hours each year materially participating in real estate activities can fully deduct rental losses. Here, the taxpayer's time log showed 764 hours spent on five rental homes. But much of that was investor-related time, such as research on refinancing and other business opportunities. Also, he hired a real estate firm to manage the properties. So he doesn't get the break (Padilla, TC Summ. Op. 2015-38).

EXEMPT GROUPS

Bad news for IRS in a case challenging its scrutiny of a pro-Israel nonprofit. The organization claims that the Revenue Service improperly scrutinized its application for 501(c)(3) tax exemption because the group's stance on Israel differed from that of the Obama administration and such special scrutiny is unconstitutional. IRS asked for the case to be dismissed on procedural grounds, but an appeals court agreed with a lower court's ruling that the case can proceed (Z Street, D.C. Cir.). We'll continue to follow this closely and update you when a court rules on the merits.

ESTATE TAXES

IRS will no longer automatically mail estate tax closing letters to executors, starting with estate tax returns filed after May 31, 2015. The Revenue Service issues these letters to verify that either an estate's 706 form has been accepted as filed or changes resulting from an audit have been agreed to. Executors of taxable estates typically wait for a closing letter to make final distributions to heirs because heirs can be held liable for unpaid estate taxes as transferees. Executors now must ask IRS for a closing letter. IRS says to wait at least four months after filing to make a request.

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

PREPARERS Participation in IRS's annual filing season program was less than robust. Only 11% of unenrolled preparers met all the requirements, the Service said. After a court struck down the agency's plans to regulate preparers who aren't CPAs, attorneys or enrolled agents, the IRS decided to offer a voluntary annual program to encourage continuing education and filing season readiness for these preparers.

The qualification rules are tighter this year. To get a record of completion, unenrolled preparers will be required to take 18 hours of continuing education... two hours on ethics, 10 hours on federal tax law topics and a six-hour refresher course on federal tax law with a 100-question quiz. A score of 70% or higher is needed to pass. Preparers in states that have their own testing requirements, such as Calif. and Ore., as well as preparers who previously passed IRS's registered tax return preparer exam, can skip the refresher course and test and take 15 hours of continuing education.

And there's bad news for unenrolled preparers who don't opt into the program: They'll lose the ability to represent their clients in audits or claims for refund on returns that they prepare and sign after 2015. Only folks in the voluntary program will be allowed to do so, but the practice rights of these participants will be limited. They cannot assist clients before IRS's Office of Appeals or with collection matters.

PENALTIES Marijuana firms can get penalty relief for making payroll deposits in cash. Under new IRS guidance, businesses that are unable to open bank accounts or make other arrangements to deposit payroll taxes electronically can seek abatement of the failure to deposit penalty. To request relief from the penalty, a firm is required to submit a signed statement explaining the attempts it made to open a bank account and include corroboration, such as the denied application or a letter from the bank.

IRS has a penalty abatement program for first-time late filers or payers. Under its First Time Abate program, if a filer has paid or arranged to pay the tax due and has been tax compliant for the past three years, IRS will OK a onetime waiver of the late payment and late filing penalties. The penalty for late payroll tax deposits is also covered, and the Service has extended the program to delinquent excise taxes. The abatement isn't provided automatically...taxpayers have to ask for the relief.

ENFORCE-MENT The Service is doing a poor job vetting its own contractors for tax debts, according to Treasury inspectors. Although the agency is barred under law from entering into contracts with corporations that have outstanding tax debts, it doesn't make its contractors self-certify this fact prior to awarding them contracts or renewing their existing contracts. The inspectors identified 17 corporations that owed back taxes but were nevertheless awarded contracts. IRS vows to do better and will include the required self-certification language in all contract solicitations.

GOP taxwriters are irate, claiming IRS is giving federal money to tax cheats.

Continued cuts to IRS's budget are hurting the agency's collection efforts, Treasury inspectors say in a new report. They point out the fact that revenue officers collected 7% less money from delinquent taxpayers in 2014 than they did in 2011. Also, the number of collectors in the field has declined 28% over the past five years. Those that remain are working on old computers and using antiquated technology. But there's one piece of good news for the agency: This smaller group of employees is working more efficiently, as the average revenue per case has spiked upward.

Yours very truly,

The Kiplinger Editors

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