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2014 3rd Quarter Federal Tax Developments

Dear Client:

During the third quarter of 2014, there were many important federal tax developments. This letter highlights some of the more significant developments for you. As always, contact our office if you have any questions.

Tax legislation

Congress returned to work in September after a five-week recess with a busy agenda of tax legislation. In August, the issue of corporate inversions gained prominence with some high-profile transactions. President Obama urged Congress to take steps to make inversions less attractive; and in the interim, he directed the Treasury Department to review if it could take administrative action to curb inversions. Treasury Secretary Jack Lew said in September that his department is moving forward with the President's directive and could announce some measures in coming weeks.

Congress may also take up the so-called tax extenders. Many of these popular tax incentives expired after 2013 and taxpayers will not be able to claim them for 2014 unless they are extended. The extenders include the state and local sales tax deduction, the higher education tuition deduction, the residential energy credit, the research tax credit, and more. Because of the looming November elections, lawmakers are likely to postpone action on the extenders until the lame-duck Congress. Late legislation, in turn, means that the IRS will likely delay the start of the 2015 filing season in order to update its return processing systems. Our office will keep you posted of developments.

Additionally, several tax technical corrections bills are pending in Congress. These bills are intended to make technical corrections to tax laws already enacted, such as the American Taxpayer Relief Act. Congress could vote on these technical corrections bills before year-end.

Affordable Care Act

Creating a split among the Circuits, two appellate courts reached opposite conclusions on the validity of regulations extending the Code Sec. 36B premium assistance tax credit to individuals who obtain insurance in a federally-facilitated Marketplace. A divided panel of the Court of Appeals for the District of Columbia Circuit struck down the regulations, finding that they conflict with the plain language of the Patient Protection and Affordable Care Act (PPACA) (*Halbig v. Burwell*, July 22, 2014). In contrast, a unanimous panel of the Fourth Circuit Court of Appeals upheld the regulations (*King v. Burwell*, July 22, 2014). The taxpayers in *King* have appealed to the U.S. Supreme Court to hear their case.

In September, the full Court of Appeals for the D.C. Circuit agreed to rehear the *Halbig* case. If the full court upholds the Code Sec. 36B regulations, this would eliminate the split among the circuits and reduce the likelihood of review by the Supreme Court.

In related news, the IRS released draft versions of the forms and instructions for 2014 that employers, health insurers, and Health Insurance Marketplaces (Exchanges) will use to report health insurance coverage under the Patient Protection and Affordable Care Act (PPACA). Employers will generally report the type of health insurance coverage offered, if any, to employees and if they self-insure, among other reporting requirements. Small employers – employers that employ fewer than 50 full-time employees (including full-time equivalent employees) – are not subject to the reporting requirements (or the employer mandate).

Straddle positions

The IRS issued final regulations in September that treat an obligor's own debt as a position in personal property that can be part of a straddle under Code Sec. 1092. The final regulations generally track regulations from 2001 and 2013 that also treated an issuer's obligation as a position that was part of a straddle. In the preamble to the 2013 regulations, the IRS explained that a debtor or obligor's own obligation generally is not "property" and thus would not be a position in property. However, the IRS indicated that if a debt instrument provides for payments that are linked to the value of personal property, then the obligor has a position in the personal property referenced by the debt instrument.

IRS enforcement and service

Taxpayers should expect more reductions in IRS services because of budget cuts, Commissioner John Koskinen cautioned in August. Koskinen said that the IRS's funding level for FY 2014 is \$11.29 billion, or about \$850 million below FY 2010 funding. Reduced funding has had a direct impact on enforcement of the nation's tax laws and the agency's customer service, Koskinen said. The IRS will conduct fewer audits and wait times to speak with IRS personnel will be longer, he predicted. The IRS's level of customer service for the 2014 filing season was around 70 percent, meaning that about 70 percent of taxpayers who called got through to the IRS. This could drop significantly during the 2015 filing season, Koskinen said.

Individual income

The Tax Court found in September that the value of an airline ticket obtained through the redemption of "thank you points" was includable in the taxpayer's income (Shankar, 143 TC No. 5). The taxpayer had redeemed 50,000 "thank you points" after opening an account at a bank and used the points to obtain an airline ticket. The court found that the bank gave the taxpayer something of value in exchange for use of the taxpayer's funds.

Tangible property

In August, the IRS issued final regulations on the treatment of dispositions of tangible property under the Modified Accelerated Cost Recovery System (MACRS) and Code Sec. 168. The final regulations clarify the identification of assets, the treatment of dispositions, and the computation of gain and loss, particularly in the context of general asset accounts. The final regulations retain the definition of a disposition that was in the proposed reliance regulations and clarify but make no significant changes to the general asset account (GAA) regulations.

Business deductions

The Tax Court denied substantial depreciation deductions claimed by owners of a recreational vehicle (RV) who used it partially for business. The owners' use of the RV as a dwelling disqualified the deduction under Code Sec. 280A in Jackson, TC Memo. 2014-60. The court found that the owner's use of the RV for business was legitimate and substantial, and would ordinarily support at least a partial deduction. However, the requirements of Code Sec. 280A, which denies business deductions for a dwelling unit also used as a residence, were absolute.

S corporations

Final regulations issued in July aim to clarify when a shareholder of an S corporation can increase basis in the S corporation because of the S corporation's indebtedness to the shareholder. The final regulations provide two different standards: for a shareholder loan to the S corporation: the debt must be bona fide; and for a guarantee of S corporation debt, there must be an actual outlay by the shareholder.

Whistleblowers

In August, the IRS finalized comprehensive regulations whistleblower awards. The final regulations reiterate that whistleblowers must provide specific and credible information to the IRS. The final regulations provide that the Whistleblower Office must determine when the information provided substantially contributed to the underlying action, and this determination will depend on the facts and circumstances of each individual case. IRS Commissioner John Koskinen and his leadership team directed that agency personnel take timely action on whistleblower claims and protect the confidentiality of whistleblower information.

Longevity annuities

In July, the Treasury Department and the IRS issued final regulations that expand retirement income options by making longevity annuities more accessible. The final regulations amend the required minimum distribution (RMD) rules so that participants do not have to begin receiving longevity annuity payments prematurely. Participants can defer the commencement of their qualifying longevity annuity contract (QLAC) until age 85.

Employment taxes

The IRS announced its nonacquiescence in Dixon, CCH Dec. 59,628 (2013), in which the Tax Court allowed a corporation making late employment tax payments to voluntarily designate the payments to specific employees' income tax liabilities. In the IRS's view, the law does not allow a taxpayer, such as the corporation, to allocate the payments to a different taxpayer, such as an employee.

Exempt organizations

The IRS unveiled a new package of guidance in July intended to simplify the tax-exempt application process for small and mid-size organizations seeking Code Sec. 501(c)(3) status. The package follows-up on earlier promises by the IRS to streamline the application process for small and mid-size charitable organizations. The IRS also released Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3).

If you have any questions about these or other federal tax developments, please contact our office.