

# FRANZEN & FRANZEN, LLP

## CERTIFIED PUBLIC ACCOUNTANTS

---

### October 16, 2013 - Important 2013 Third Quarter Federal Tax Developments

During the third quarter of 2013, there were many important federal tax developments. We highlight here some of the more significant developments for you. As always, contact our office if you have any questions.

#### **IRS shutdown**

On October 1, IRS offices across the country emptied as most of the agency's employees were furloughed following a lapse in appropriations. Nearly 90 percent of the IRS's 90,000 employees were furloughed on October 1 after Congress failed to pass legislation to keep the IRS and other federal agencies operating after the end of the government's fiscal year (FY) 2013. The IRS explained that some functions would continue during the government shutdown, including the processing of tax payments, criminal investigations and some litigation. The IRS reminded taxpayers that the underlying tax law remains in effect, as do their tax obligations during the shutdown.

#### **Employer mandate**

In July, the White House announced a one-year delay in the employer shared responsibility payment and employer/insurer reporting under the *Patient Protection and Affordable Care Act* (Affordable Care Act). The Affordable Care Act generally requires applicable large employers to pay an assessable payment if, among other circumstances, the employer fails to offer full-time employees and their dependents the opportunity to enroll in minimum essential coverage. The Affordable Care Act also requires large employers and many insurers to file annual returns reporting minimum essential coverage. After the White House's announcement, the IRS issued transition relief and proposed regulations. The IRS reported that it is exploring simplification of employer/insurer reporting.

#### **Individual mandate**

The IRS issued final regulations on the Affordable Care Act's individual shared responsibility requirements in August. The individual mandate generally requires individuals to carry minimum essential health coverage after 2013 unless they qualify for an exemption. An individual who does not carry minimum essential coverage and does not qualify for an exception must pay a penalty.

#### **Repair regulations**

In September, the IRS issued long-awaited final regulations on the treatment of costs to acquire, produce or improve tangible property. The final regulations impact any industry that uses tangible property, real or personal, the IRS explained. In the final regulations, the IRS added many taxpayer-friendly provisions, including a revised de minimis safe harbor, a routine maintenance safe harbor for buildings and new safe harbors for small taxpayers. Taxpayers will apply the final regulations to

determine whether they can deduct costs as repairs or if they must capitalize the costs and recover them over a period of years.

### **Same-sex marriage/domestic partners**

Following the U.S. Supreme Court's decision to strike down Section 3 of the *Defense of Marriage Act* (DOMA) ( *E.S. Windsor, June 28, 2013*), the IRS issued guidance for taxpayers and tax professionals in August. The IRS announced a general rule recognizing same-sex marriage nationwide. Same-sex married couples are treated as married for all federal tax purposes, including income and estate taxes, the IRS explained.

However, the IRS's treatment of married same-sex couples does not extend to domestic partners. The IRS explained that domestic partners are not considered married for federal tax purposes because they are not married under state law.

### **Net investment income tax**

The Affordable Care Act imposes a 3.8 percent surtax on qualified net investment income under new Code [Sec. 1411](#), generally effective for tax years beginning after December 31, 2012. In August, the IRS released a draft version of Form 8960, Net Investment Income Tax. The IRS is expected to finalize Form 8960 before the start of the 2014 filing season. The IRS is also expected to issue final regulations about the net investment income surtax before year-end to clarify many questions about the scope of the surtax.

### **Tax reform**

The leaders of the House and Senate tax writing committee launched a nationwide tax reform tour during the summer of 2013. Rep. Dave Camp, R-Mich. and Sen. Max Baucus, D-Mont., visited several cities to promote comprehensive tax reform. At the same time, President Obama proposed to eliminate some business tax preferences in exchange for a reduction in the corporate tax rate. President Obama also proposed to tax carried interest as ordinary income.

### **Tax extenders**

After 2013, many popular but temporary tax incentives (known as extenders) are scheduled to expire. They include the state and local sales tax deduction, the teacher's classroom expense deduction, the research tax credit, transit benefits parity, and many more. Some lawmakers in Congress have proposed to include the extenders in year-end comprehensive tax reform legislation, but leaders in the House and Senate have been cool to this idea. More likely, these incentives will be extended for one or two years in a year-end stand-alone bill or linked to other legislation. Our office will keep you posted of developments on the fate of these valuable tax incentives.

### **S corps**

In August, the IRS announced exclusive simplified methods for taxpayers to request late S corporation elections. The IRS consolidated and expanded earlier guidance for taxpayers requesting late S corporation elections, late Electing Small Business Trust elections, late Qualified Subchapter S Trust Elections, Qualified Subchapter S Subsidiary elections, and certain late corporate classification elections.

## **Small employer health insurance tax credit**

Qualified small employers may be eligible for the [Code Sec. 45R](#) tax credit that is designed to help offset the cost of providing health insurance to their employees. In August, the IRS issued proposed reliance regulations on the credit. In tax years beginning after 2013, a qualified small employer must participate in the Small Business Health Options Program (SHOP) to take advantage of the credit. In September, the White House announced a delay in the start of SHOP.

## **Per diem rates**

The IRS announced in September that the simplified per diem rates that taxpayers can use to reimburse employees for expenses incurred during travel after September 30, 2013. The high-cost area per diem increases from \$242 to \$251 and the low-cost area increases from \$163 to \$170. In 2012, the IRS did not increase the per diem rates, reflecting a directive from the White House to federal agencies to curb rising travel costs.

## **Innocent spouse**

The IRS updated its equitable innocent spouse relief procedures in September. The IRS explained that the updated procedures are intended to give greater deference to the presence of abuse in a relationship. Some of the factors that the IRS uses to weigh a request for equitable innocent spouse relief were also made more taxpayer-friendly.

## **Worker classification**

The Tax Court held in August that it lacks jurisdiction to review an IRS determination of worker status. The case arose from a request for the IRS to determine a worker's status. The Tax Court found there was no audit or examination as the IRS was simply responding to the taxpayer's request.

## **Collection due process cases**

Taxpayers subject to IRS levy are generally entitled to a pre-levy hearing (a collection due process (CDP) hearing or an equivalent hearing). The Treasury Inspector General for Tax Administration (TIGTA) reported in September that it had discovered some concerns about the handling of CDP cases by the IRS. TIGTA discovered delays in the initial processing of requests for CDP hearings.

## **LILO/SILO transactions**

In a case of first impression, the Tax Court applied the substance-over-form doctrine and found that an insurance company's lease-in, lease-out (LILO) and sale-in, sale-out (SILO) transactions were not leases (*John Hancock Life Insurance Co. (USA), 141 TC No. 1*). The Tax Court held that the taxpayer could not deduct depreciation, rental expenses, interest expenses, and transactional costs connected with the transactions.

## **Domestic production activities deduction**

[Code Sec. 199](#) provides a deduction for qualified domestic production activities. In August, the IRS determined that a taxpayer could claim the [Code Sec. 199](#) deduction for in-store photo production

activities. However, the taxpayer could not claim the deduction where it only transferred a customer's photos onto DVDs because those activities were a service and not the manufacturing of a product.

### **IRS administration**

President Obama has proposed John Koskinen to serve as the next Commissioner of Internal Revenue. If confirmed by the Senate, Koskinen would replace IRS Principal Deputy Commissioner Daniel Werfel. Koskinen previously served in leadership roles with the Federal Home Loan Mortgage Corporation (Fannie Mae).

If you have any questions about these or other federal tax developments that may impact you or your business, please contact our office.