FRANZEN & FRANZEN, LLP
CERTIFIED PUBLIC ACCOUNTANTS

June 3, 2014 – Important 2014 First Quarter Federal Tax Developments

During the first quarter of 2014, there were many important federal tax developments. Here we highlight some of the more significant developments for you. As always, contact our office if you have any questions.

Tax reform

In February, House Ways and Means Chair Dave Camp, R-Mich., unveiled a massive tax reform bill. Camp proposed to overhaul the Tax Code by reducing the number of individual tax brackets, lowering the corporate tax, and eliminating or modifying many popular tax incentives. Camp has acknowledged that prospects for tax reform moving forward this year are slim but has indicated he will continue to work to move his bill. Camp is expected to hold hearings on some of his proposals before summer.

At the same time, President Obama has proposed many tax changes in his fiscal year (FY) 2015 budget. As he has in past budgets, the President proposed limiting deductions for higher income individuals, repealing many fossil fuel tax preferences and the last-in, first-out (LIFO) method of accounting. In exchange, the President signaled his support for reducing the corporate tax rate. Some of the President's new proposals include expanding the earned income credit and the child and dependent care credit.

In related developments, many lawmakers are also calling for extension of some popular but temporary tax breaks known as "extenders." Many of these tax incentives expired after 2013 and include the state and local sales tax deduction, some education tax breaks, and the research tax credit. For individuals, the impact of the expiration of these tax breaks will not be felt until 2015 when taxpayers file their 2014 returns, so that gives lawmakers additional time to decide whether to renew them or allow them to expire permanently. Our office will keep you posted of developments.

Affordable Care Act

In February, the Obama administration announced transition rules for the Affordable Care Act's employer mandate. The administration limited the employer mandate in 2015 to employers with 100 or more full-time employees. Employers with fewer than 100 full-time employees will be subject to the employer mandate starting in 2016. At all times, employers with fewer than 50 full-time employees are exempt from the employer mandate. The IRS followed up with final regulations describing how employers will report health coverage offered to employees.

Individuals who obtain coverage through an Affordable Care Act Marketplace may be eligible for a tax credit to help offset the cost of health insurance coverage. Generally, married couples must file a joint return to qualify for the credit. In March, the IRS announced special relief from the joint filing requirement for victims of domestic violence.

In February, the IRS finalized regulations on the Affordable Care Act's 90-day waiting period for employer-provided health insurance. The IRS also finalized regulations for the Affordable Care Act's medical loss ratio rule. The medical loss ratio generally requires insurers to spend a certain percentage of premium dollars on medical care or pay rebates to participants.

Repair regulations

Following-up on final "repair" regulations issued in 2013, the IRS issued revised procedures for taxpayers to change their accounting methods. In Rev. Proc. 2014-16, the IRS provided automatic consent for certain changes in accounting methods involving amounts paid to acquire, produce or improve tangible property. Since virtually every business operates with at least some tangible assets, virtually all businesses must comply with rules within these new, far-reaching regulations.

Retirement savings

In January, the Tax Court ruled that a taxpayer can make only one nontaxable rollover distribution/contribution within each one-year period regardless of how many IRAs the taxpayer has (*Bobrow, TC Memo. 2014-21).* The decision surprised many because IRS rules and publications seemed to allow additional rollovers. The IRS announced in March that it would revise its rules and publications to reflect the Tax Court's decision. This change is significant; please contact our office if you have questions about rollovers of retirement savings.

President Obama directed the Treasury Department in January to create a new retirement savings vehicle: myRA. After the accounts are available, sometime later this year, employees will be able to open a myRA with a minimum contribution of $25 and then have a portion of his or her paycheck directly deposited into the account. Account holders will be able to build savings for 30 years or until their myRA reaches $15,000, whichever comes first.

Virtual currency

In some transactions, virtual currency (such as Bitcoin) operates like paper money of the U.S. or of any other country. However, virtual currency does not have legal tender status. In March, the IRS issued much-anticipated guidance on virtual currency. The IRS announced that virtual currency will be treated as property for U.S. federal tax purposes; a virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes. Virtual currency is a relatively new concept; please contact our office for more information.

International

The IRS issued regulations in February to round out the guidance to implement reporting and withholding under the Foreign Account Tax Compliance Act (FATCA). The guidance package, the IRS explained, is intended to provide important clarifications to foreign financial institutions, taxpayers and other affected persons.

The U.S. continues to sign agreements to implement FATCA. The U.S. has entered into FATCA agreements with Canada, Chile, Finland, and other countries.

In a related development, a federal district court upheld IRS regulations requiring U.S. banks to report interest income earned by nonresident aliens from the banks (*Florida Bankers Association, DC-D.C., 2014-1 USTC).* The court found that the IRS had addressed concerns about confidentiality.

Employment taxes

In March, the U.S. Supreme Court ruled that supplemental unemployment benefits (SUB) paid to terminated employees and not linked to the receipt of state unemployment benefits are wages for FICA tax purposes (*In re Quality Stores, March 25, 2014*). The decision effectively closes the door to the potential for millions of dollars in refunds paid in similar cases.

Audits

The IRS reported that audit coverage in fiscal year (FY) 2013 declined in many areas. Overall, the number of audits of all types of individuals declined by 0.07 percent compared to FY 2012. One exception to the trend of declining audit coverage was the number of field examinations of higher income individuals (which the IRS defines as individuals with incomes of $200,000 or more), which increased in FY 2013.

Filing season

The IRS opened the 2014 filing season for individuals on January 31 and for most businesses in mid-January. The start of the filing season was delayed due to the 16-day government shutdown in October 2013. The IRS needed more time to reprogram its return processing systems.

The IRS is also working to improve its customer service response time. IRS National Taxpayer Advocate Nina Olson told Congress that only 61 percent of calls to IRS customer service representatives were answered in FY 2013. IRS Commissioner John Koskinen has promised to improve customer service and in March said that the agency was answering approximately 74 percent of all calls.

Throughout the filing season, the IRS warned taxpayers of phone and online scams. The IRS never contacts taxpayers by phone or email.

Identity theft

The IRS is devoting additional resources to discover and curb tax-return identity theft. The IRS improved its return processing filters to spot bogus returns and has some 3,000 employees working identity theft cases.

IRS operations

In January, President Obama signed the Consolidated Appropriations Act of 2014, which funds the federal government through the end of FY 2014. Funding for the IRS is approximately $526 million below FY 2013 levels, which has promoted senior IRS leaders to warn of service and enforcement cuts.

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