January 19, 2015 – Important 2014 Fourth Quarter Federal Tax Developments

During the fourth 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 legislation

In December, Congress passed and President Obama signed the Tax Increase Prevention Act of 2014 and the Consolidated and Further Appropriations Act, 2015. The Tax Increase Prevention Act extended more than 50 popular but temporary tax incentives for individuals and businesses through 2014. This means that these tax breaks, including the state and local sales tax deduction, higher education tuition deduction, Code Section 25C residential energy property credit, research tax credit, and more are available for 2014. Otherwise, taxpayers would not be able to claim them on their 2014 returns. Congress did not, however, make permanent any of the temporary extenders, despite an eleventh-hour push to do so, especially with some of the business tax breaks.

The Consolidated Appropriations Act funds the federal government—including the IRS – for fiscal year (FY) 2015. The Act cuts funding for the IRS by $346 million compared to FY 2014. IRS Commissioner John Koskinen has warned that the budget cut will impair tax enforcement and customer service; and even went so far as to contemplate the possibility of temporary furloughs for agency employees to save money. Some lawmakers, in contrast, have said that the agency's $10.9 billion budget for FY 2015 is adequate for the agency to focus on its core functions.

Filing season

The IRS announced in December that the 2015 filing season will open on January 20, 2015. Previously, there had been some concern that the start of the 2015 filing season would be delayed because of the passage of late tax legislation in 2014. The IRS needed time to reprogram its return processing systems for the late legislation.

Affordable Care Act

The IRS released more guidance on the Code Section 5000A individual shared responsibility requirement under the Patient Protection and Affordable Care Act (PPACA) in November. The IRS clarified certain government coverage, cafeteria plans, health reimbursement arrangements (HRAs), wellness programs, and affordability for purposes of the individual mandate. At the same time, the IRS identified the hardship exemptions from the shared responsibility requirement that may be claimed on an individual tax return without Marketplace certification. The IRS also announced inflation adjustments for Code Section 5000A and the Code Section 36B premium assistance tax credit.

In related news, the Supreme Court announced that it will review *King v. Burwell, 2014-2 USTC ¶50,367,* a much-watched case challenging the IRS's regulations on the Code Section 36B premium assistance tax credit. The plaintiffs argue that the Code Section 36B regulations are inconsistent with the language of the PPACA. In 2014, the Fourth Circuit Court of Appeals upheld the IRS regulations. The Supreme Court will hear oral arguments in March 2015 and is expected to announce its decision in June 2015.

The IRS has developed a number of forms to reflect new requirements under the PPACA. These include information statements from employers, insurers and the PPACA Marketplaces along with new forms to claim the Code Section 36B premium assistance tax credit or an exemption to the individual shared responsibility requirement.

Individual taxation

In October, the IRS issued a long list of cost of living adjustments (COLAs) for various Tax Code provisions in 2015 dependent upon the CPI-U index average from September 2013 through August 2014. The Tax Code requires that federal income tax brackets and certain other figures be adjusted annually for inflation. Despite a low rate of inflation during 2014, many provisions will increase for 2015. Some, however, remain the same due to rounding conventions.

Personal exemptions. Personal and dependency exemptions will increase from $3,950 in 2014 to $4,000 for 2015.

Standard deductions. Standard deductions will increase for 2015 to $12,600 for married joint filers (up from $12,400 for 2014) and $6,300 for single filers and married separate filers (up from $6,200 for 2014). For heads of household, the standard deduction will be $9,250 (up from $9,100 for 2014).

Limitation on itemized deductions. For 2015, the amount of itemized deductions that can be claimed will begin to phase out for certain taxpayers whose income exceeds $309,900 (married joint filers); $284,050 (heads of household); $258,250 (single filers); or $154,950 (married separate filers).

Retirement plans

The IRS issued guidance in October to enable participants in 401(k) plans to invest their accounts in deferred annuities intended to guaranteed income for life to the participants post-retirement. The deferred annuities will be offered through target date funds (TDFs) that are often used by plans as default investments.

Also in October, the IRS provided relief to U.S. citizens and residents who are participants in Canadian retirement plans. Participants can defer income accruing under the plans until it is distributed, without having to file or make a deferral election on Form 8891.

The IRS also announced that many retirement plan contribution and benefit limits will increase slightly in 2015. The cost of living adjustments (COLAs) affect a wide range of retirement savings vehicles, including defined contribution plans, defined benefit plans, employee stock ownership plans (ESOPs), and individual retirement arrangements (IRAs).

Elective deferrals. The limits on elective deferrals for employees who participate in 401(k)s, 403(b)s, certain 457s, and Thrift Savings Plans will increase from $17,500 for 2014 to $18,000 for 2015.

Catch-up contributions. Eligible individuals age 50 and above may make catch-up contributions to IRAs, 401(k)s and other savings arrangements. The catch-up amounts for 401(k)s, 457s, 403(b)s, and SEPs, increase to $6,000 for 2015. IRA catch-up remain at the flat $1,000 level specified under Code Section 219(b)(5)(B).

Defined contribution plans. The limitation for Code Section 415(c)(1)(A) defined contribution plans will increase from $52,000 for 2014 to $53,000 for 2014.

IRAs

In November, the IRS clarified transition relief for the one-rollover-per-year limit on rollovers from individual retirement accounts (IRAs). The IRS previously indicated that it would not apply the limit before January 1, 2015. The latest guidance provided that a distribution occurring in 2014 that was rolled over can be disregarded when applying the one-rollover-per-year limit in 2015. Previously, the IRS

and many taxpayers took the position that the one-rollover limit applied separately to each IRA maintained by a taxpayer. In *Bobrow, TC Memo. 2014-21,* the Tax Court held that a taxpayer could make only one nontaxable rollover contribution within each one-year period, regardless of how many IRAs the taxpayer maintained.

Also in November, the IRS updated the two safe harbor explanations in Notice 2009-68 that provide information to retirement plan participants who receive eligible rollover distributions. The changes reflect guidance on the allocation of pretax and after-tax amounts among multiple distributions and on the use of in-plan Roth rollovers.

Partnerships

Reversing the Tax Court, the Court of Appeals for the Ninth Circuit held in November that a married couple may not opt out of a partnership administrative proceeding under the *Tax Equity and Fiscal Responsibility Act (TEFRA), JT USA, LP, CA-9, November 14, 2014.* The court found that unless a partner elects to have all of his or her partnership items treated as nonpartnership items, the partner cannot elect out of proceedings under TEFRA.

Also in November, the IRS issued proposed regulations, with partial reliance, on the treatment of "hot assets" (unrealized receivables and inventory items) under Code Section 751(b). The proposed regulations prescribe how a partner should measure its interest in a partnership's hot assets, and how to determine the tax consequences of a partnership distribution that reduces the partner's interest in the hot assets.

Offshore accounts

In October, the IRS clarified its Offshore Voluntary Disclosure Program (OVDP) for U.S. taxpayers (whether residing in the U.S. or abroad) who failed to disclose foreign financial assets and pay taxes due, and who apply for relief under the streamlined filing compliance procedures. The streamlined program provides reduced penalties. The streamlined program is only available to taxpayers who can demonstrate that their actions (or failures to act) did not result from willful conduct on their part.

Mediation

The IRS announced in December that it expanded its post-Appeals Mediation program for certain offer-in-compromise (OIC) and Trust Fund Recovery Penalty (TFRP) cases nationwide. Mediators, the IRS explained, serve as facilitators, assist in defining the issues, and promote settlement negotiations between the parties.

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