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Key Developments, Quarter 3 2013

The following is a summary of the most important tax developments that have occurred in the past three months that may affect you, your family, your investments, and your livelihood. Please call us for more information about any of these developments and what steps you should implement to take advantage of favorable developments and to minimize the impact of those that are unfavorable.

Developments concerning the Affordable Care Act (ACA). In the lead-up to the roll out of the health insurance exchanges on Oct. 1, 2013, the IRS issued the following guidance on the ACA:

The IRS released Questions and Answers (Q&As) on the health insurance premium tax credit on its website. This credit is designed to make health insurance affordable to individuals with modest incomes (i.e., between 100% and 400% of the federal poverty level, or FPL) who are not eligible for other qualifying coverage, such as Medicare, or "affordable" employer-sponsored health insurance plans that provide "minimum value." To qualify for the credit, individuals must purchase insurance on a health exchange. The Q&As note that individuals can choose to have the credit paid in advance to their insurance company to lower what they pay for their monthly premiums, and then reconcile the amount paid in advance with the actual credit computed when they file their tax return. Alternately, individuals can claim all of the credit when they file their tax return for the year. The Q&As explain exactly who is eligible for the credit and address other important aspects of it.

The IRS issued proposed regulations on the tax credit available to certain small employers that offer health insurance coverage to their employees. This credit is available to an employer with no more than 25 full-time equivalent employees (FTEs) employed during its tax year, and whose employees have annual full-time equivalent wages that average no more than \$50,000. However, the full credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of not more than \$25,000. The proposed regulations would become effective when they are formally adopted as final regulations. However, employers may rely on the proposed regulations for tax years beginning after Dec. 31, 2013, and before Dec. 31, 2014.

The IRS issued final regulations on the shared responsibility payment under the ACA, which is the enforcement mechanism for the ACA's mandate that most individuals maintain minimum health

insurance coverage. Starting in 2014, the individual shared responsibility provision calls for each individual to have basic health insurance coverage (known as minimum essential coverage), qualify for an exemption or pay the shared responsibility payment when filing a federal income tax return. Exempt individuals include individuals who cannot afford coverage, have low income, are without coverage for less than three consecutive months, suffer from hardships or are exempt because of their religious beliefs.

Tax treatment of same-sex spouses. The IRS and other Federal agencies issued guidance on the treatment of same-sex spouses and couples for tax and other purposes in light of the Supreme Court's landmark *Windsor* decision striking down section 3 of the Defense of Marriage Act (DOMA), which had required same-sex spouses to be treated as unmarried for purposes of federal law. The key developments are as follows:

Effective as of Sept. 16, 2013, the IRS adopted a "state of celebration" rule in recognizing same-sex marriages. This means that same-sex couples who were legally married in jurisdictions that recognize their marriages (i.e., "state of celebration") will be treated as married for federal tax purposes, regardless of whether their state of residence recognizes same-sex marriage. Spouse may retroactively apply this rule to open years.

Same-sex spouses who were legally married in a state that recognizes same-sex marriages must file their 2013 federal income tax return using either "married filing jointly" or "married filing separately" status, even if they now reside in a state that does not recognize same-sex marriage. Same-sex spouses who file an original 2012 tax return on or after Sept. 16, 2013 also generally must file using a married filing separately or joint filing status. Same-sex spouses may file original or amended returns choosing to be treated as married for federal tax purposes for one or more prior tax years still open under the statute of limitations on refunds.

The IRS provided optional special administrative procedures for employers to use to correct overpayments of employment taxes for 2013 and prior years for certain benefits provided and remuneration paid to same-sex spouses.

The Department of Labor's (DOL)'s Employee Benefits Security Administration (EBSA) announced that it is following the IRS in recognizing "spouses" and "marriages" based on the validity of the marriage in the state of celebration, rather than based on the married couple's state of domicile, for purposes of interpreting the meaning of "spouse" and "marriage" as these terms appear in the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and in Internal

Revenue Code provisions that EBSA interprets.

In Frequently Asked Questions (FAQs) posted on the IRS's website, the IRS made clear that same-sex and opposite-sex individuals who are in registered domestic partnerships, civil unions, or other similar formal relationships that aren't marriages under state law aren't considered as married or spouses for federal tax purposes.

New rules for deducting or capitalizing tangible property costs. The IRS issued new regulations for determining whether amounts paid to acquire, produce, or improve tangible property may be currently deducted as business expenses or must be capitalized. Among other things, they provide detailed definitions of "materials and supplies" and "rotable and temporary spare parts" and prescribe rules and elective de minimis and optional methods for handling their cost. They also have rules for differentiating between deductible repairs and capitalizable improvements, among many other items. The regulations generally are effective for tax years beginning on or after Jan. 1, 2014, but taxpayers can elect to apply them to certain pre-2014 years.

New rules for dispositions of certain depreciable property. The IRS issued proposed regulations that change several of the rules for dispositions of Modified Accelerated Cost Recovery System (MACRS) property. While the regulations are not final but merely proposed, taxpayers may rely on them. Included among the changes are rules that no longer treat structural components of a building as separate from the building and rules providing that partial dispositions generally are treated as dispositions.

New simplified relief for late elections pertaining to S corporations. IRS has issued guidance providing an exclusive method for taxpayers to make late (i) S corporation elections, (ii) Electing Small Business Trust (ESBT) elections, (iii) Qualified Subchapter S Trust (QSST) elections, (iv) Qualified Subchapter S Subsidiary (QSub) elections, and (v) corporate classification elections. The requesting entity must request relief within three years and 75 days after the date the election was intended to be effective. This simplified method is in lieu of filing for a private letter ruling.

Simplified per-diem increase for post-Sept. 30, 2013 travel. An employer may pay a per-diem amount to an employee on business-travel status instead of reimbursing actual substantiated expenses for away-from-home lodging, meal and incidental expenses (M&IE). If the rate paid doesn't exceed IRS-approved maximums, and the employee provides simplified substantiation, the reimbursement isn't subject to income- or payroll-tax withholding and isn't reported on the employee's Form W-2. In general, the IRS-approved per-diem maximum is the GSA per-diem rate paid by the federal government to its workers on travel status. This rate varies from locality to locality. Instead of using actual per-diems, employers may use a simplified "high-low" per-diem, under which there is one uniform per-diem rate for all "high-cost"

areas within the continental U.S. (CONUS), and another per-diem rate for all other areas within CONUS. The IRS released the "high-low" simplified per-diem rates for post-Sept. 30, 2013 travel. The high-cost area per-diem increases \$9 to \$251, and the low-cost area per-diem increases \$7 to \$170.

Supreme Court to decide FICA tax treatment of severance pay. The Supreme Court agreed to review a decision of the Court of Appeals for the Sixth Circuit which held that severance payments aren't wages for purposes of Federal Insurance Contributions Act (FICA) tax. Thus, the Supreme Court will resolve a circuit split that currently exists between the Sixth and Federal Circuit Courts on the issue.