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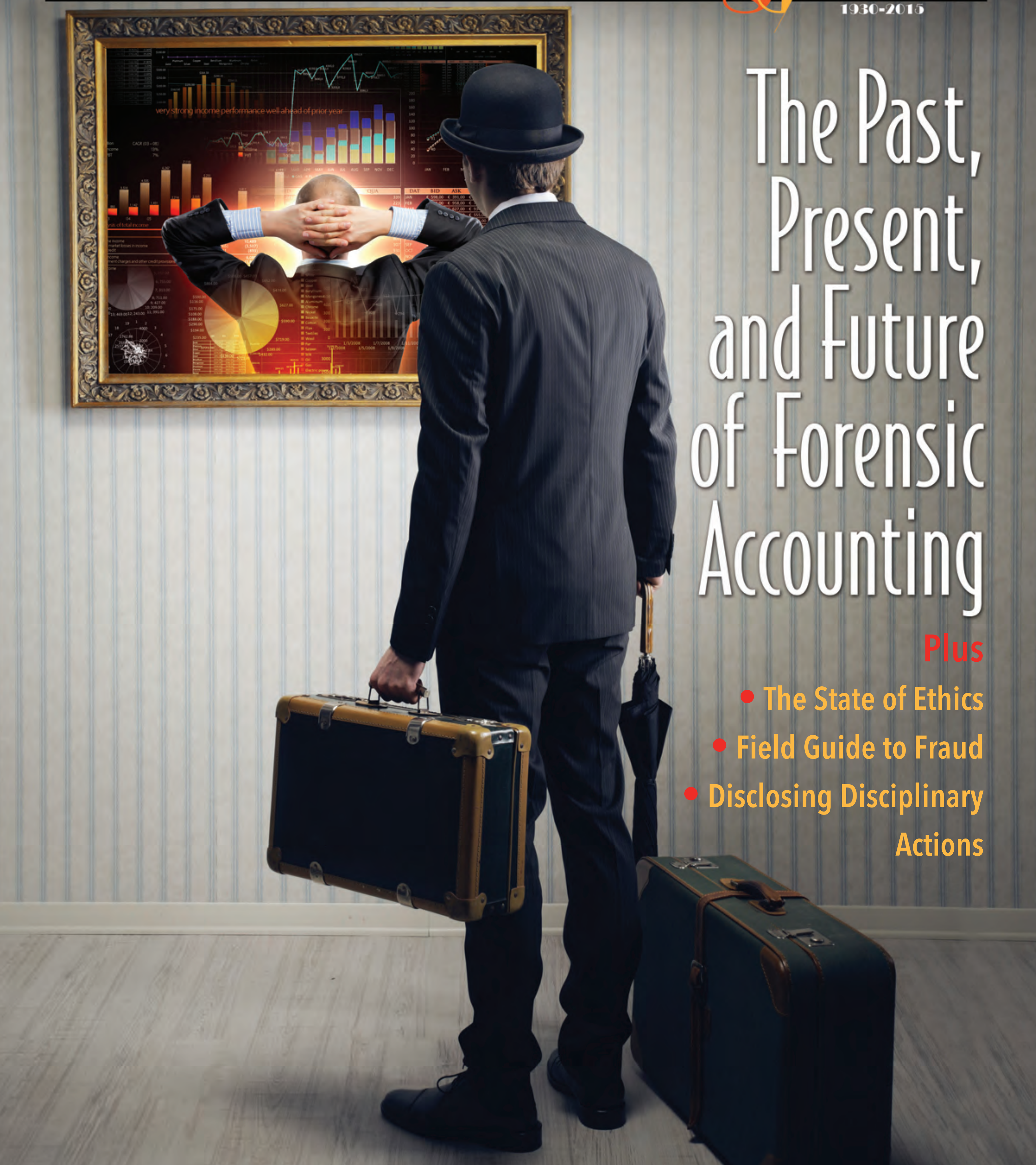
The CPA Journal

The Voice of the Profession

85th Anniversary 1930-2015



The Past, Present, and Future of Forensic Accounting

Plus

- The State of Ethics
- Field Guide to Fraud
- Disclosing Disciplinary Actions

Trends and Issues for the 2015 Busy Season

By Al Colanero and Karen A. Marshall

Every year, some change in the tax law makes tax season difficult for tax professionals. In 2014, it was the implementation of the 3.8% Net Investment Income Tax. In 2015, it will be the IRS's repair regulations, the last-minute passage of the Tax Increase Prevention Act of 2014, the implementation of the Patient Protection and Affordable Care Act (ACA) mandate, and New York changes for estate and gift tax planning. Compliance with each of these changes will require diligence and effort.

The Tangible Property and MACRS Regulations

The Tangible Property and Modified Accelerated Cost Recovery System (MACRS) Regulations, more commonly referred to as the repair regulations, will be on every tax preparer's mind as many business returns filed this busy season will require a Form 3115. The importance of complying with these regulations cannot be understated.

Background. After a long legislative process, the final repair regulations are effective for taxable years beginning on or after January 1, 2014. Prior to the issuance of new regulations, deciding whether an expenditure was considered an ordinary repair or a capital asset was largely determined by case law, such as *Indopco Inc. v. Comm'r* and a number of revenue rulings. The IRS and Treasury Department's collective goal in issuing the regulations was to reduce controversy and give taxpayers clear guidance.

Policies and methods. The provisions of the final repair regulations generally apply to taxable years beginning on or after January 1, 2014:

- Materials and supplies less than $200 are now deductible.
- The election to capitalize materials and supplies is now limited to rotable and temporary spare parts.
- Materials and supplies are now protected by the de minimis safe harbor election ($500 for taxpayers without an applicable financial statement, $5,000 for taxpayers with an applicable financial statement). They require a written accounting policy and the same accounting treatment for book and tax purposes.
- A unit of real or personal property is defined in Treasury Regulations section 1.263(a)-3(e) and is based upon a functional interdependence standard. Special rules are provided for buildings, plant property, network assets, leased property, and improvements to property.
- A taxpayer may elect to capitalize repair and maintenance costs, provided the books and records reflect the same tax treatment.
- Under the safe harbor, the cost of performing certain routine maintenance activities on a unit of property, including a building structure or one of its enumerated components, are deductible as routine maintenance.
- Qualifying small taxpayers with gross receipts less than $10 million for the three preceding years may elect to deduct the cost of repairs, maintenance, improvements and similar items that do not exceed the lesser of 2% of the unadjusted cost basis of the eligible property or $10,000. An eligible building must have an unadjusted basis of $1 million or less.

Improvements. The definition of improvements to property includes betterments, restorations, and adaptations of a unit of property tangible property that require capitalization. In general, a taxpayer must capitalize such improvements.

Betterments include fixing a material condition or defect that existed before the acquisition of the unit of property or arose in the production of the unit of property; a material addition, enlargement, expansion, or extension that increases the capacity of the unit of property; or materially increasing the productivity, efficiency, strength, quality, or output of a unit of property.

Restoration includes replacement of a component of a unit of property; restoration of damage to a unit of property; returning a unit of property to its ordinary efficient operating condition; rebuilding to "like-new" condition; replacement of a part or combination of parts that constitute a major component or substantial structural part.

Adaptation is when a taxpayer adapts a unit of property to a new or different use.

Form 3115, required compliance, and accounting method changes. The IRS's Revenue Procedure 2014-16 provides guidance on the final repair regulations, while Revenue Procedure 2014-54 provides guidance on the MACRS regulations. Special rules exist for small taxpayers with gross receipts of $10 million or less for the preceding three years. (For more information, see http://www.irs.gov/pub/irs-drop/rp-14-16.pdf and http://www.irs.gov/pub/irs-drop/rp-14-54.pdf). In general, unless a method was not previously established, taxpayers will be required to file Form 3115 to be in compliance.

In addition, the repair regulations and related IRC section 481(a) adjustment will generally apply to amounts paid or incurred in taxable years beginning on or after January 1, 2014, or at the taxpayer's option, amounts paid or incurred in taxable years beginning on or after January 1, 2012. The due date of Form 3115 is same as the filing due date of the associated return, including extensions. Related changes in accounting method are considered an automatic change.

Because a significant number of returns will require a Form 3115, tax preparers should consider creating a template and adding it to compliance checklists. CPAs preparing a federal return without a Form 3115 and certain required elections could be in violation of Circular 230 unless not required by Revenue Procedure 2015-20.

Revenue Procedure 2015-20

On February 4, 2015, the IRS issued Revenue Procedure 2015-20, granting significant relief to small business taxpayers (SBT). An SBT is defined as a business with total assets of less than $10 million and average annual gross receipts of $10 million or less for the prior three taxable years. Under Revenue Procedure 2015-20, SBTs are permitted to make certain tangible property changes in methods of accounting with an adjustment under IRS section 481(a) that takes into account only amounts paid or incurred and dispositions in taxable years beginning on or after January 1, 2014, without filing a Form 3115. Effectively, SBTs making these changes in method of accounting may elect to make the change on a cut-off basis.

The Tax Increase Prevention Act of 2014

A large number of tax provisions that expired as of the beginning of 2014 have been given a retroactive one-year extension by Congress. Not all of the expired provisions were extended, but the ones that were extended will continue to provide relief to both individual and business taxpayers.

Here are some highlights of key provisions and extensions:

- The amount of qualifying property eligible to be expensed under IRC section 179 remains at $500,000, and the cap on total investment in eligible assets remains at $2 million.
- For certain qualifying assets (MACRS property of 20 years or less or qualified leasehold improvement property), an additional 50% first-year bonus depreciation is permitted.
- 15-year straight-line cost recovery life for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.
- Discharge of indebtedness on principal residence continues to be excluded from the borrower's taxable income. (A complete list can be found at: https://www.congress.gov/bill/113th-congress/house-bill/5771.)

Due to the late passage of the tax extenders, it may be prudent for tax advisors to revisit research and advice given to clients during the year. As these provisions were a one-year extension, they have already expired effective December 31, 2014.

On a positive note, the IRS has announced that the extenders legislation did not delay the start of the filing season. The IRS has started accepting returns electronically and began processing paper returns on January 20, 2015.

The Patient Protection and Affordable Care Act

The ACA was enacted to expand health insurance coverage to more Americans. Two important provisions, the individual mandate and the premium tax credit, took effect in 2014. The employer mandate was scheduled to take effect in 2014, but the IRS delayed it until 2015.

Shared responsibility for individuals. Beginning in 2014, the ACA requires individuals to:

- Be covered by a health plan that provides minimum essential coverage,
- Qualify for an exemption from the coverage requirement, or
- Pay a shared responsibility payment (the individual mandate).

Minimum essential coverage. An individual who is covered by health insurance that provides minimum essential coverage (MEC) will not be required for the shared responsibility payment. MEC includes the following:

- Healthcare coverage provided by the taxpayer's employer or purchased by a self-employed individual.
- Health insurance coverage purchased through the Health Insurance Exchange.
- Most government sponsored health coverage, including Medicare and Medicaid.
- Certain types of coverage purchased directly from an insurance company.

Exemptions. The statute exempts nine categories of individuals from the requirement to carry MEC or make a payment:

- Short coverage gap: individuals who are uninsured for three consecutive months or less during the year.
- Unaffordable coverage: the lowest-priced coverage available would cost more than 8% of the individual's household income.
- No filing requirement for individuals who do not have to file a tax return because their income is too low and below the filing threshold.
- Indian tribes: members of a federally recognized tribe are eligible for services through an Indian Health Services provider.
- Members of a recognized healthcare sharing ministry.
- Members of a recognized religious sect with religious objections to insurance.
- Individuals either detained or jailed, and not being held pending disposition of charges.
- The individual is not a U.S. citizen or a resident alien, the individual is a U.S. citizen who spent at least 330 full days outside of the United States during a 12-month period, or is a bona fide resident of a foreign country (or countries) for a full tax year.
- A health insurance marketplace certifies that the individual suffered a hardship and cannot obtain coverage or would have to pay an excessive amount for coverage.

Calculating and reporting the shared responsibility payment/penalty. The required payment is determined on a monthly basis. It equals the lesser of 1) the monthly penalty amounts for each individual in the family (up to three individuals); or 2) the monthly national average bronze plan premiums for the family, as offered through the exchanges.

The monthly penalty amounts are the greater of the flat dollar amount, or the excess income amount. The flat dollar amounts are $95 in 2014, $325 in 2015, or $695 in 2016, per person, up to three individuals for a family. The amounts after 2016 will be indexed for inflation. These amounts are reduced by half for individuals 18 and under. The excess income amounts are the

EXHIBIT 1
New York Exclusion Amounts

Death for Dates on or after	Exclusion Amount	Phased Out at
April 1, 2014–April 1, 2015	$2,062,500	$2,165,625
April 1, 2015–April 1, 2016	$3,125,000	$3,281,250
April 1, 2016–April 1, 2017	$4,187,500	$4,396,875
April 1, 2017–Jan. 1, 2019	$5,250,000	$5,512,500
After Jan. 1, 2019	Equal to federal exclusion	Federal exemption plus 5%

excess of the taxpayer's household income over the taxpayer's filing threshold, multiplied by 1% in 2014, 2% in 2015, and 2.5% for 2016 and thereafter.

Taxpayers will be expected to report their liability on Line 61 of Form 1040 for 2014. The payment is payable upon notice and demand from the IRS. It should be noted, however, that the IRS cannot seek any criminal penalties or place a lien or levy on the taxpayer's property for nonpayment. Accordingly, the IRS expects to collect these payments primarily through deduction from refunds.

Health insurance premium assistance tax credit. Individuals or families who purchase insurance through the exchange, and whose income is below certain levels, may apply and qualify for the premium assistance tax credit. This credit is refundable to the taxpayer; alternatively, the credit may be paid in advance directly to the insurer, whereupon the taxpayer would pay the difference between the premium and the credit.

The credit is computed on a sliding scale for individuals and families with household incomes between 100% and 400% of the federal poverty level (FPL) for the family size. The credit amount is based upon the percentage of income the share of premiums represents, rising from 2% of income for taxpayers at 100% of FPL, to 9.5% of income for those at 400% of FPL.

In some cases, taxpayers may owe additional tax if they are not entitled to all or part of the advance payment of the credit. A taxpayer who chooses to have advance credit payments sent to their insurer will need to: 1) file a federal income tax return (even if otherwise not required to do so) and 2) complete Form 8962, Premium Tax Credit (PTC), to reconcile the advance credit payments with the PTC eligible to be claimed on the return. If the amount is less than the actual PTC, the difference will result in a higher refund or lower tax due. On the other hand, if the advance credit payments that were paid to the healthcare provider were more than the actual credit, the difference must be paid with the taxpayer's return.

Penalty relief for excess advance payments of the PTC. Beginning with 2014 returns, similar to reconciling tax withholdings with a taxpayer's actual tax liability to determine refunds or balances due, individuals benefiting from tax credits for marketplace coverage will follow the same process. Normally, taxpayers may owe a penalty for late payments or underpayment of estimated tax.

For 2014, however, the IRS will waive these penalties (see Notice 2015-09) for eligible taxpayers if it is due to repayment of excess advance payments of the PTC. Penalties will not apply to underpayment of this shared responsibility payment, but interest will accrue for late payments.

This relief does not extend the April 15, 2015, due date. If an extension of time is requested, repayment of any excess advance payments is required with the taxpayer's extension.

ACA-related Forms for 2014

- *Form 1040, Line 61*. Complete this line to check the box for full-year coverage, or compute the shared responsibility payment to include with the taxpayer's federal return.
- *Form 8965, Health Coverage Exemptions*. Use this form to report a coverage exemption granted by the marketplace or to claim coverage exemption on a taxpayer's return. In addition, use Form 8965 to report the calculated shared responsibility payment for months during the year that the taxpayer or member of the taxpayer's tax household did not have health insurance or a coverage exemption.
- *Form 1095-A, Health Insurance Marketplace Statement*. Taxpayers will receive this form from the exchange reporting information about the health coverage policy, including dates of coverage and total monthly premiums for the policy in which a recipient or family members enrolled. Form 1095-A provides information the taxpayer needs to complete Form 8962.
- *Form 8962, Premium Tax Credit*. The information required on this form will determine if the taxpayer is entitled to the credit. If a taxpayer received Form 1095-A, Form 8962 must be completed.

New York Estate and Gift Planning Issues

As part of the 2014-2015 budget, New York drastically changed its estate and gift tax laws. New York's estate tax reform increases the estate tax exclusion threshold, over a five-year period, from $1 million to $5.25 million. After January 1, 2019, the basic exclusion will be indexed for inflation and calculated to be equal to (and in the same manner as) the federal exclusion. There is a catch, however: Large estates that exceed the exclusion by 5% will lose the exclusion entirely. As a result, the exemption is forfeited, and the taxes on the full value of the estate are due. The highest New York estate tax rate is 16%, which will be indexed for inflation. (See *Exhibit 1* for the exclusion amounts.)

Effective April 1, 2014, New York conforms with the federal provisions related to alternate valuation, qualified domestic trust, and qualified terminable interest property elections. The New York State generation-skipping transfer tax no longer applies to distributions or terminations made after March 31, 2014. And New York's estate and gift tax law requires all taxable gifts made by a New York resident after March 31, 2014, to be included as part of the gross estate for purposes of calculating estate tax.

The new law also adds a limited three-year look back period for gifts made between April 1, 2014, and January 1, 2019. Specifically, if a New York resident dies within three years of making a taxable gift, the value of the gift will be included in the decedent's estate for purposes of computing the state's estate tax. The following gifts are excluded: 1) gifts made when the decedent wasn't a New York resident; 2) gifts made by a New York resident before April 1, 2014; 3) gifts made by a New York resident on or after January 1, 2019; and 4) gifts that are otherwise includible in the decedent's estate under another provision of the federal estate tax law. ❑

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