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P&M e-News - February 2015

Restrictions Imposed by the Affordable Care Act on Employer Reimbursements of Individual Health Insurance Premiums

Synopsis – For plan years beginning after 2013, the Affordable Care Act (ACA) a/k/a Obamacare, institutes market reform provisions that place a whole host of new restrictions on group health plans. This article explains the new restrictions, the punitive penalties on these arrangements and what employers who still have them should do. It also looks at acceptable alternatives.

Full Article – Many small employers do not qualify for and/or cannot afford the high cost of a group health insurance plan for the employees. But they gladly choose to reimburse their employees for premiums paid on individual health insurance policies. With a limited exception, the new ACA market reform provisions *significantly restrict* an employer's ability to reimburse employees for these premiums. This has dealt a severe blow to employees who purchase individual health insurance.

Employer Payment Arrangements –

Under employer payment arrangements, the employer reimburses employees for premiums paid on their individual health insurance policies (or the employer sometimes pays the premium directly to the insurance provider on behalf of the employee). As long as the employer (1) makes the reimbursement under a qualified medical reimbursement plan, and (2) verifies that the reimbursement was spent only for insurance coverage, the premium reimbursement is excludable from the employee's taxable income. These arrangements have long been popular with small employers who want to offer health insurance but are unwilling or unable to purchase group health coverage.

Unfortunately, according to the IRS and Department of Labor (DOL), group health plans cannot be integrated with individual market policies to meet the new market reform provisions. Furthermore, according to the DOL, an employer that reimburses employees for individual policies (on a pretax or after-tax basis) has established a group health plan because the arrangement's purpose is to provide medical care to its employees. Therefore, reimbursing employees for premiums paid on individual policies violates the market reform provisions. The penalty imposed under IRC § 4980D is $100 / day / employee; or $36,500 per employee per year!

Limited Exception for One-Employee Plans –

The market reform provisions do not apply to group health plans that have only one participating employee. Therefore, it is still allowable to provide an employer payment arrangement that covers only one employee. Note, however, that nondiscrimination rules require that essentially all full-time employees must participate in the plan. Bottom line … while still technically allowed under the tax code, employer payment arrangements, other than arrangements covering only one employee, are no longer a viable alternative.

What should you do if you still have an employer payment plan?

First of all, don't panic. You are not alone. The impact of the market reform provisions to these plans has come as a ***great surprise*** to many small business employers, not to mention the tax practitioner community. We believe there is reasonable cause to keep the penalty from applying for earlier payments. However, it is important to discontinue making payments under the plan and rescind any written documents. Also, any reimbursements made after 2013 should be classified as taxable wages.

Acceptable Alternatives –

Because of the ACA market reform requirements, employers are basically precluded from subsidizing or reimbursing employees for individual health insurance policies if more than one employee is participating in the plan. Employers can, however, continue to do any of the following:

- Provide a tax-free fringe benefit by purchasing an ACA-approved employer-sponsored group health plan. Small employers with 50 or fewer employees can provide a group health plan through the Small Business Health Options Plan (SHOP) Marketplace. A cafeteria plan can be set up for pretax funding of the employee portion of the premium. Assuming this is affordable and the employees are willing to accept any insurance policy restrictions and limitations, this is a good option.

- Increase the employee's taxable wages to provide funds that the employee may use to pay for individual insurance policies. However, the employer can't require that the funds be used to pay for insurance — it must be the employee's decision to do so (or not). The employer can claim a deduction for the wages paid and the additional FICA & Medicare taxes.

  But the wages are taxable to the employee, thus increasing his/her FICA & Medicare taxes and Federal and State income taxes! The employee can claim the premiums as an itemized deduction. This offers little solace because the 10% AGI limit on medical expenses eliminates any deduction for most taxpayers. End result, employee has less cash in pocket.

Final Thoughts –

This tax season is the first time individuals and small employers will likely become aware of these restrictions. It is our opinion that taxpayer discord may be sufficient motivation for Congress to pass reasonable modifications to the Affordable Care Act. Stay tuned.

UPDATE –

After this article was published in early February, IRS has issued Notice 2015-17, IRB 2015-10, on 2/18/2015. It provides transition relief for small employers (less than 50 employees in the prior tax year) that reimburse or pay premiums for individual health care policies for their employees. The notice waives the Section 4980D excise tax penalty for January 2014 - June 2015. Additionally, employers that pay or reimburse employees for Medicare Part B or D premiums or TRICARE-related expenses will not be subject to the penalties with regard to those benefits, provided certain conditions are met.

Action Required –

You have until **June 30, 2015** to determine how to cover employee health insurance. We recommend you discuss the alternatives mentioned above with your employees as soon as possible. Feel free to contact us if you need any assistance.

Retirement Contribution Limitations for 2015

Synopsis - This article describes IRS cost-of-living adjustments affecting the dollar limitations for retirement plan contributions.

Full Article - Several of the limitations are higher for 2015 because the increase in the cost-of-living index met the statutory threshold. However, some limitations did not meet that threshold and remain unchanged from 2015.

401(k), 403(b), most 457 and Fed Gov't Thrift Savings Plan – The elective deferral (contribution) limit for employees who participate in these plans increased from $17,500 in 2014 to $18,000 in 2015. The catch-up contribution limit for those ages 50 and over increased from $5,500 in 2014 to $6,000 in 2015.

Traditional IRA – The contribution limits remain unchanged. You can contribute up to $5,500 ($6,500 if you are age 50 or older by year end) to your IRA in 2015 if certain conditions are met (i.e., sufficient earned income). For married couples, the combined contribution limits are $11,000 ($5,500 each) and $13,000 ($6,500 each if both are age 50 by year end) when a joint return is filed, provided one or both spouses had at least that much earned income. Keep in mind that contributions to traditional IRAs may or may not be tax-deductible. Contributions for 2014 must be made by April 15, 2015.

Roth IRA – The same income and contribution limits of a Traditional IRA apply to the Roth. But there are other significant differences between these IRAs. Contributions to a Roth IRA are not deductible; however, withdrawals are tax-free when specific time requirements are satisfied. You may also continue to make contributions past age 70½ if you meet the earned income requirement. In addition, there are no required minimum distribution (RMD) rules at age 70½ with a Roth IRA. Finally, upon your death a Roth IRA passes to your beneficiary income tax-free (unlike a traditional IRA, which is taxable to the beneficiary).

SIMPLE – The 2015 limitation for SIMPLE retirement accounts increased $500, to $12,500. The SIMPLE catch-up contribution for those age 50 by year end also increased by $500, to $3,000.

Profit-sharing, SEP, and Money Purchase – Finally, the 2015 contribution limit for these plans is the lesser of (1) 25% of the employee's compensation — limited to $265,000, an increase of $5,000 from 2014; or (2) $53,000, an increase of $1,000 from 2014.

Deducting Medically Necessary Home Improvements

Synopsis - Certain home improvements made to accommodate a disabled condition do not usually increase the value of the home, and the cost can be included in full as deductible medical expenses. This article lists a number of such improvements.

Full Article - Individuals can claim medical tax deductions for the cost of special equipment installed in a home, or for home improvements, if the main purpose is to accommodate the individual's, spouse's, or dependents' medical needs.

These improvements include, but are not limited to, the following items:

- Moving or modifying electrical outlets and fixtures.
- Installing porch lifts and other forms of lifts.
  Exception: Elevators generally add value to the house, so only the cost in excess of the increased value in your home is deductible as a medical expense.
- Installing railings, support bars, or other bathroom modifications.
- Constructing entrance or exit ramps.

- Widening doorways at entrances or exits.
- Widening or modifying hallways and interior doorways.
- Lowering or modifying kitchen cabinets and equipment.
- Modifying stairways.
- Adding handrails or grab bars.
- Modifying hardware on doors.
- Modifying fire alarms, smoke detectors, and other warning systems.
- Modifying areas in front of entrance and exit doorways.
- Grading the ground to provide access to the residence.

Medically *required* home improvements that would not ordinarily be for medical care are deductible only to the extent the costs exceed the increase in the home's value. Generally, these improvements are prescribed by a physician and should be supported by a professional real estate appraisal to determine the change in value. An example would be installing an indoor swimming pool to treat severe arthritis.

Helping Your Adult Child Buy a Home

Synopsis – Economic and tax considerations make right now a good time for parents (and grandparents) who are willing and able to help their adult children buy a home. This article looks particularly at the 0% capital gains rate and low federal interest rates as beneficial tax factors that may influence the decision.

Full Article – Some residential real estate markets are "hot" with homes selling for more than asking price. In other markets, the prices are recovering, but are still at lower levels than a few years ago. With mortgage interest rates at historically low levels, now may be a great time to buy a home. In addition, there are some favorable tax factors that will help. How long this good scenario will last is anyone's guess, but we would bet not too much longer.

Zero percent capital gains rate. For 2015, taxpayers in the 10% and 15% tax brackets for regular taxable income will enjoy a 0% tax rate on long-term capital gains (LTCGs). Thus, your child won't pay any federal income tax on any LTCGs they realize this year to the extent his or her taxable income (including LTCGs) does *not exceed* $74,900 if married-filing joint, $50,200 if head of household, or $37,450 if single.

So, if the child's income (after the standard deduction and personal exemptions) will fall below these limits in 2015 and you hold appreciated stocks and mutual fund shares in taxable brokerage firm accounts, you could gift him or her some shares. The child can then sell them and use the proceeds to help finance his or her home purchase. Gains will be long term if your ownership period *plus* his or hers is more than one year.

If the combined value of stock and all other gifts you give your child this year is worth $14,000 or less, your taxable estate is reduced without any adverse federal gift or estate tax consequences — thanks to the annual gift tax exclusion privilege. Married taxpayers can double this amount — they can give up to $28,000 ($56,000 if the child is married) this year without triggering adverse estate and gift tax consequences. You can give away even more than these amounts if you don't mind dipping into your $5.43 million federal gift and estate tax exemption.

Low federal interest rates. If additional funds are needed for your child to purchase a home, you might want to consider loaning the additional funds to him or her. Now is a very good time for taking this step, too. With loans between family members, the Applicable Federal Rate (AFR) is a big deal. Why? Because that's the rate the lending parent (grandparent or any family member) can charge without causing any unwanted tax complications. Currently, AFRs are very low by historical standards, so making a loan that charges the AFR is a great way for a parental lender to give an adult child borrower a favorable loan without having to deal with the complicated below-market loan rules.

Standard Mileage Rates for 2015

Synopsis – This article notes that, rather than keeping track of the *actual cost* of operating a vehicle, employees and self-employed taxpayers can use a standard mileage rate to compute their deduction related to using a vehicle for business. Likewise, standard mileage rates are available for computing the deduction when a vehicle is used for charitable, medical or moving purposes.

Full Article – The 2015 standard mileage rates for use of a vehicle are –

- 57.5 ¢ per mile for business miles (up from 56 cents per mile in 2014),
- 23 ¢ per mile for moving purposes,
- 23 ¢ per mile for medical purposes, and
- 14 ¢ per mile for rendering gratuitous services to a charitable organization.

The business standard mileage rate is considerably higher than the charitable and medical/moving rates because it contains a depreciation component. No depreciation is allowed for the charitable or medical & moving use of a vehicle.

In addition to deductions based on the business standard mileage rate, taxpayers may also deduct the following expenses:

- Parking fees and tolls attributable to the business use of an automobile,
- Interest expense relating to the purchase of the automobile,
- State sales tax paid on the purchase of the vehicle, and
- Local personal property taxes paid (some states assess this through annual license fees).

However, employees using a vehicle to perform services as an employee cannot deduct interest expense related to that vehicle. Also, if the vehicle is operated less than 100% for business purposes, the taxpayer must allocate the business and nonbusiness portion of the allowable taxes and interest deduction.

Finally, if the business standard mileage rate is used in the first year the vehicle is placed in service, you have the option in subsequent years to use either the standard mileage rate or actual operating expenses.

The Importance of an Accountable Expense Reimbursement Plan

Synopsis – Most companies cover their employees' business expenses by reimbursing them for their actual expenses or by paying a travel or mileage allowance. Such arrangements are subject to strict tax rules concerning what qualifies as a legitimate reimbursement arrangement and what is treated (at least for tax purposes) as additional compensation to the employee. It depends on whether the employer's payments are made in accordance with what the IRS calls an *accountable plan*. This article explains the rules and whether it may or may not be advisable to use such a plan.

Full Article – According to the tax rules, the key distinction between a true expense reimbursement and disguised compensation is whether the employer's payments are made in accordance with what the IRS calls an accountable plan. Such a plan basically requires employees to substantiate all reimbursed expenses and return any advances in excess of expenses incurred.

If an employer has an accountable plan in place, expense reimbursements and allowances to employees, who properly comply with the terms of the plan, are deductible by the company (subject to the 50% limit for most meals and entertainment expenses) and nontaxable to the employees.

If a company maintains a nonaccountable plan or an employee fails to comply with the company's accountable plan, expense reimbursements and allowances are still deductible by the company. However, they are taxable to the employee as compensation. Thus, such amounts are included on the employee's Form W-2 and subject to income tax withholding. In addition, both the employer and employee are subject to employment taxes on such payments. Although the employee is allowed an offsetting deduction for the expenses reported on his or her Form W-2, the deduction is claimed as a miscellaneous itemized deduction and thus normally provides little or no tax benefit.

Because the tax ramifications of a nonaccountable expense reimbursement plan are so unfavorable for employees and are potentially unfavorable for the employer, companies generally should use an accountable plan for employee expense reimbursements.

Please contact us If you would like our help in establishing such a plan for your business or ensuring that your current reimbursement policy complies with the requirements for such a plan. We would be glad to assist you.

What to do if you do not get a Form W-2

Synopsis – An employee who worked during 2014 should receive from his or her employer a Form W-2 *Wage and Tax Statement* by February 2, 2015. This article explains what to do if the employee has not received the Form W-2 by mid-February.

Full Article – Form W-2 *Wage and Tax Statement* shows the amount of wages you received for the year, the taxes withheld from those wages, and it must be filed with your return. If you haven't received yours by mid-February, you should first ask your employer to give you a copy of your Form W-2. If the employer mails the form to you, be sure they have your correct address.

If you exhaust the options with your employer and you still have not received the Form W-2, call the IRS at 800-829-1040. Have the following available when you call:

- Your name, address, Social Security number, and phone number.
- The employer's name, address and phone number.
- The dates you worked for the employer.
- An estimate of the amount of wages paid and federal income tax withheld in 2014. If possible, use your final pay stub to determine these amounts.

As an alternative, if you won't get your Form W-2 in time to file your tax return by April 15, you can use Form 4852 *Substitute for Form W-2 Wage and Tax Statement*. You will need to estimate your wages and withheld taxes and the IRS may delay processing your return while it verifies the information. However, if you receive the missing Form W-2 after you file and the information on the form is different from what you originally reported on your Forms 1040 and 4852, an amended tax return may be required. For this reason, we recommend extending your return for six months to allow time to obtain the correct Form W-2 information and save yourself the additional expense of filing an amended return.

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