Here are the 2014 issues that will affect 2015 taxes

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Toward the end of 2014, some issues arose which will affect 2015 taxes. We discuss them here beginning with perhaps the most startling item that affects businesses, the Affordable Care Act, also know as Obamacare.

Critical change in the Affordable Care Act

This change, which has received little publicity, contains a clause eliminating a frequently -used section of the tax law pertaining to the reimbursement of health insurance for employees. Let's consider a common example. A married couple both have access to health insurance coverage through each of their separate employers. If one spouse accepts his/her firm's family health insurance plan, the other spouse may be reimbursed by his/her employer for what would have been the premium. This payment has always been tax-free. No more! This will no longer be the case. The reimbursement will be considered taxable income to the spouse declining his/her firm's health insurance. The penalty to the employer for continuing to reimburse at a tax-free rate can be $100 per day!

Congress' objective (and this is surely objectionable) was to force companies into taking on a group insurance policy. There is no exclusion for less than 50 employees. Of course, a sole employee or a spousal couple without other employees can still have their own insurance paid by their company. A medical expense reimbursement plan is also not affected. But a reimbursement in lieu of a group medical plan is no longer acceptable. The employer is required to withhold payroll, federal and state income taxes on that reimbursement or be fined. Apparently, final regulations indicate one exclusion: reimbursements are allowed only to help an employee afford a premium payment required by the company that he/she otherwise would be unable to pay.

Other changes for 2015

Here are some of the other important annual changes for this year.

- The maximum wage for Social Security tax (FICA) is $118,500 (up from $117,000).
- The 401(k) wage deduction is now up to a maximum of $18,000 with an additional $6,000 for those over age 50.
- The maximum IRA contribution is now $5,500 with an additional $1,000 for those over age 50.
- For profit-sharing and SEP purposes, the maximum wage that is eligible for contribution is $265,000, and the maximum contribution for an individual is $53,000.
- The new auto mileage allowance is 57.5 cents per business mile.

Recent court cases

One of the more technically challenging issues in the tax law was presented in a recent court case. A lady took over a house from her brother who had lived in the house for a number of years but could no longer afford it. She didn't buy the house from him but lived in it and paid all the expenses. The IRS disallowed the mortgage interest deduction on her return because she did not own the house. There was no formal arrangement with her brother to pay the mortgage. Payment of the mortgage is not enough for a deduction; there must also be a requirement to pay. This should also apply to real estate taxes, though that issue did not arise in this case.

Finally, there has been some recent activity with regard to "hobby losses." The IRS disallows business losses whenever it appears that there is no intent over a five-year period to earn a profit. This could be true of any business, and it is a long-term problem for the IRS because the decision of whether a business is run for profit is often in the mind of the owner. The IRS therefore relies on outward signs of activity. Is the owner actively trying to create income, control expenses and grow the business, or is he/she just having fun or trying to deduct personal expenses from his/her tax return?

In two recent court cases, the IRS lost. The first one was a race horse farm — one of the IRS favorites for attack. In this case, the owner kept meticulous books, studied books on the business, researched horses before buying them and hired a well-known and regarded trainer. The court believed that he was on-track (terrible pun) to succeed and therefore ruled in the taxpayer's favor. In the second case, the owner's company invested in the auto racing career of the owner's son and spent hundreds of thousands of dollars in support and in promoting the company products on the son's car. The IRS took a dim view and disallowed the expenses. The court determined that: (a) the son was succeeding — he was qualifying for better races and was earning a name for himself; and (b) he was getting other sponsors unrelated to the family.

These cases point out that proper record keeping and earnestly performing acts that indicate the intent to succeed can win the day. One does not always succeed, but a devotion to trying will go a long way to beat the IRS.