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URGENT! HEALTH INSURANCE REQUIREMENTS BELOW!!

December 19, 2014

Dear Tax Client:

If nothing else, please read the following paragraphs on the individual health insurance requirements that took effect in 2014 as part of the Affordable Care Act, which effectively contains the single largest set of tax increases we've seen in quite a while. Because we anticipate spending extra time in inquiring about and reporting the information necessary to calculate the related penalties or credits for each individual client, our fees will be higher this year as a result. Bringing the necessary information for us to properly report your own individual situation will help us keep the additional preparation fees to a minimum.

Individual Health Insurance Mandate: Starting in 2014, individuals along with their spouses and dependents must be able to show that they had minimum essential health insurance coverage throughout the year or pay a shared responsibility penalty on their tax returns. The penalty could be between $95 and $2,448 for a single individual while a couple with three dependents could see a penalty between $285 and $12,240 for not maintaining insurance in each full month of the year. There are, however, exceptions to the mandate explained at www.healthcare.gov/exemptions.

What We Will Need: We will need to know for each month of the year whether you, your spouse and dependents had minimum essential health coverage. If you purchased insurance from the Exchange, we will need to report the premium assistance credit that you received to determine if you received too much or if you are due an additional amount based on your household income. Please bring with you any Form 1095 that you receive, including 1095-A from the Exchange, 1095-B from your insurance company or 1095-C from your employer. We will also need to know the income of each dependent claimed on your return, preferably from a copy of their tax return if we did not prepare it ourselves, as their income is a factor in the equation for both the penalty and the assistance credit.

Large Employer Health Insurance Mandate: Starting in 2015, employers with 100 or more full-time equivalent employees that do not offer their full-time employees with adequate and affordable health insurance coverage will be subject to a shared responsibility penalty. Starting in 2016, employers with 50 or more full-time equivalent employees will be subject to the same requirement.

Employer Health Insurance Credit: For 2014, a maximum 50% credit (35% for non-profits) can be taken by small employers who acquired group health insurance through their state Exchange’s SHOP Marketplace for their employees and who covered at least 50% of their employees' premiums. The credit starts to phase out, however, as the average full-time number of employees exceeds 10 and completely phases out with an average of 25 or more employees. The credit also starts to phase out once average annual employee compensation exceeds $25,000 and completely phases out with an average employee compensation of $50,000 or more.

Affordable Care Act Provisions: For 2014, deductible medical expenses for those under age 65 first have to exceed 10% of AGI, instead of the old 7.5% of AGI rate, and Flexible Spending Accounts will be limited to $2,500 for employee contributions. Also for 2014, there is the 3.8% Medicare tax on investment income (interest, dividends, rents, royalties, capital gains, passive activity income) once AGI exceeds $200k for Single or $250k for Joint returns as well as an additional 0.9% Medicare tax withheld on wages that exceed $200k.

IRA and Pensions: In 2014, the maximum deduction for IRA contributions is $5,500, or $6,500 for those 50 and older. The salary deferral for pensions is between $12,000 and $23,000, depending on age and plan type. New for 2014 is a limit of one 60-day IRA rollover in any 12-month period, but trustee-to-trustee transfers are not subject to this limit.

Hobby Losses: The IRS is always in search of non-deductible hobby losses on individual and S-Corporation returns. To determine if there is a profit motive for a business, the IRS looks at the manner in which the activity is conducted, the expertise of the taxpayer, the time and effort expended by the taxpayer, the taxpayer's financial history and past successes, and whether an element of personal pleasure or recreation is present. Repetitive losses for part-time business activities are hard to justify when the taxpayer has a full-time job elsewhere.

Auto Mileage Rates: For 2014, the per-mile rate for business use is $0.56. For medical and moving expenses, the per-mile rate is $0.235, and the rate for charity work remains $0.14 per mile. For 2015, the business mileage rate increases to $0.575 and the medical/moving mileage rate drops to $0.23. Log books are critical for proving vehicle deductions to the IRS.

Home Office Expenses: For 2014 and beyond, the home office deduction can be determined using either actual, substantiated expenses and depreciation or a new safe harbor amount of $5 per square foot, up to a maximum office size of 300 square feet. If the safe harbor method is used, all mortgage interest and property taxes can then be deducted on Schedule A. However, unused home office deductions from the safe harbor method cannot be carried over.

Capitalizing vs. Expensing: New regulations establish a $200 de minimis amount under which an item can be expensed rather than capitalized as supplies or equipment. However, a business with a written accounting policy in place at the beginning of the year can make an election to expense items and repairs up to $500 per invoice or per item.

Depreciation: The Section 179 expense election on the federal level was scheduled to drop from $500,000 to $25,000 for 2014 and the 50% bonus depreciation had expired, but Congress passed last-minute legislation and the President is expected to sign the bill to reinstate them. The California maximum expense election remains at $25,000.

Education: For 2014 through 2017, we still have the American Opportunity Credit for the first 4 years of post-secondary education, which is a maximum credit of $2,500 per student, based on 100% of the first $2,000 of tuition, books, supplies and necessary equipment plus 25% of the next $2,000. As an alternative, the Lifetime Learning Credit remains in effect indefinitely and provides up to a 20% credit for up to $10,000 in qualified tuition and fees. All of these credits, however, are subject to income limitations.

Child Tax Credit: The child tax credit for dependent children under age 17 remains $1,000.

Estate & Gift Tax: The estate and gift tax for 2014 is at a marginal rate of 40% for estates and gifts that total more than the $5,340,000 exemption. The annual non-includible gift limitation remains at $14,000 per person for 2014 and 2015.

Adoption Credit: For 2014, the adoption credit is $13,190 but is not refundable. This credit will start phasing out when Adjusted Gross Income (AGI) exceeds $197,880.

Kiddie Tax: For 2014, dependent children under age 19 or under the age of 24 if a full-time student with more than $2,000 in taxable investment income will pay tax on the excess at their parent's rates.

Capital Gains and Dividends: For 2014 and beyond, there is a 0% rate (yes, zero) for capital gains and qualified dividends included in taxable income that would otherwise fall in the 15% tax bracket, and a 15% rate for capital gains and qualified dividends in taxable income that would normally be subject to the 25% to 35% marginal rates. We also have a new 20% rate for capital gains and dividends when taxable income is subject to the new 39.6% marginal rate, which starts at $400k for Single filers and $450k for Joint filers. However, AMT could increase the overall effective rates.

Solar Credit: Through 2016, there is a 30% credit on the purchase of solar hot water heaters, solar electrical equipment, geothermal heat pumps, or wind turbines for first or second homes or newly constructed homes.

Plug-in Electric Drive Vehicle Credit: For 2014, a credit for buying qualified plug-in hybrid electric vehicles will start at $2,500 and cap at $7,500, based on the vehicle's battery capacity and gross weight. Only the first 200,000 of these vehicles sold by each manufacturer will receive the full credit before it starts to phase out. A qualifying vehicle must be newly purchased and derive its propulsion from a rechargeable battery with a 4 kilowatt-hour capacity, or 2.5 kilowatt-hour capacity for 2 or 3-wheeled vehicles. Golf carts do not qualify, however.

Charitable Contributions: For charitable contributions, last year's rules remain in effect: used clothing or household items must be in "good" condition to have charitable value, all items worth $5,000 or more require an appraisal prepared within 60 days of the gift, deductions for cash donations require a written receipt or a canceled check, but all cash donations of $250 or more require a contemporaneous written receipt indicating that no goods or services were provided in exchange for the donation. Form 1098-C is required from a charity for vehicle donations.

Foreign Bank and Financial Accounts: Anyone with a financial interest or signature authority over one or more accounts in a foreign country with an aggregate of more than $10,000 in value at any time during the calendar year must electronically file the new FinCEN Form 114 by the following June 30th, and any person or entity with more than $50,000 in value ($100,000 if married filing joint) must also file Form 8938 with their individual, corporate, partnership or fiduciary tax returns.

Foreign Property Trusts and Corporations: The IRS is stepping up compliance in this area as well, requiring anyone owning an interest in or making a transfer of property to a foreign trust or corporation to file Forms 3520, 3520-A, 5471 and/or 926 each year. However, a recent IRS Private Letter Ruling indicated the requirement does not include trust commonly used to establish ownership of foreign property, such as a Fideicomiso, The penalties for failure to file any of these foreign reporting forms are substantial, starting at $10,000 or 10% of total value, depending on the form. Our firm will not be filing Forms 3520, 3520-A, 5471 or 926, as they are not supported by our tax software and do not fall within our area of expertise.

Expiring Provisions: There are a number of tax provisions that expired at the end of 2013 that are awaiting the President's signature to become effective for 2014. The expired provisions include the $250 teacher deduction, the sales tax deduction, the college tuition deduction, the allowable IRA contributions to charities, the 15-year leasehold improvement depreciation, the expanded Section 179 and Bonus depreciation amounts, the mortgage insurance premium deduction, the R&D credit, the residential energy credit and many others.

Bitcoin: This year, both the IRS and the CA State Board of Equalization weighed in on the use of Bitcoin, which is a form of virtual currency. The IRS will treat the use of Bitcoin as the sale of a capital asset, like stocks, where one would have to know how long they held the Bitcoin for short-term or long-term capital gain or loss treatment as well as the original cost basis. The CA BOE has indicated that the use of Bitcoin to purchase tangible goods is subject to the collection of sales tax by the seller or payment of use tax by the consumer.

CA Head-of-Household Credit: California now has a credit for qualifying taxpayers who are seniors filing as head-of-household or parents filing as single but who have joint custody of one or more children.

California Estimates: Tax estimates paid to CA will be uneven for 2015 and in the foreseeable future, following the 30%, 40%, 0% and 30% pattern we've had for the last few years. However, if any estimate or extension payment is greater than $20,000, or if an individual or corporation reports a total tax on their CA return greater than $80,000, then they are required to remit the funds electronically from that point forward. There is a 1% penalty on the amount paid if it is not electronically transmitted when required.

California Use Tax: In situations where goods are purchased out of state, via mail order or internet, and no CA sales tax is collected but the goods are used or consumed in CA, California requires that the responsible party pay the equivalent sales tax as a use tax. This use tax can be paid on an individual return, and California now offers a “safe harbor” table based on income level if a taxpayer has difficulty finding a year's worth of receipts for out-of-state purchases, as long as no single item is purchased for $1,000 or more.

Keep in mind that we have only presented you with highlights of the changes and not the full text of the tax laws, and as such, your own tax situation can be different from anyone else’s. We would be happy to consult with you on how these changes might affect you specifically.

Best wishes for a Happy New Year!

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