# Tax News and Industry Updates

2017
Volume 5, Issue 1

Clear Financial Advisors, LLC
(W) www.clear.financial
(P) 248.677.1762
(E) rob@clearfinancial.net

## Inside This Issue



## Standard Mileage Rate

### Cross References

- Rev. Proc. 2010-51
- Notice 2016-79

The IRS has released the 2017 standard mileage rates for taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. The following chart reflects the new 2017 standard mileage rates compared to the 2016 and 2015 tax year standard mileage rates.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Business rate per mile | 53.5¢ | 54.0¢ | 57.5¢ |
| Medical and moving rate per mile | 17.0¢ | 19.0¢ | 23.0¢ |
| Charitable rate per mile | 14.0¢ | 14.0¢ | 14.0¢ |
| Depreciation rate per mile | 25.0¢ | 24.0¢ | 24.0¢ |

◆ ◆ ◆

## Market Reform and HRAs

### Cross References

- IRC §105(b), *Amounts expended for medical care*
- H.R. 34

**HRA.** A health reimbursement arrangement (HRA) is an employer sponsored plan that reimburses the cost of qualified medical expenses incurred by the employee. Similar to an accountable plan, the employee submits receipts to the employer for proof of medical costs, and the employer reimburses the employee for such costs up to a maximum dollar amount per year. If the expense qualifies under IRC section 213 as a qualified medical expense [expenses that otherwise qualify as medical expenses on Schedule A (Form 1040)], the reimbursement is excluded from the employee's compensation under IRC section 105(b). HRAs can be used to help the employee pay for deductibles and co-pays, as well as the cost of medical insurance premiums.

***Example #1:*** *Ben has two employees and provides each employee with an HRA in which he reimburses up to $4,000 per year of their medical costs. Employees can use the $4,000 to purchase their own health insurance policy, and/or use it to cover out-of-pocket expenses such as deductibles and co-pays that are not covered by health insurance. The reimbursements are deductible by Ben as an employee fringe benefit, and tax free to Ben's employees.*

**Market reforms.** Under the market reform rules of the Affordable Care Act (ACA), a group health plan with two or more participants cannot establish lifetime or annual limits on the dollar amount of benefits for any individual participant in the plan. This rule basically was designed to prevent insurance companies from limiting the amount of medical expenses in which they would cover. However, the rules also apply to employer provided group health plans. The IRS issued regulations that stated any HRA in which an employer reimburses an employee's medical costs, including the employee's cost of health insurance premiums, would violate the market reform rules because the annual benefit under the plan is limited.

***Example #2:*** *Assume the same facts as Example #1. Under the market reform rules, Ben's HRA is an employer group health plan because it covers more than one employee. As an employer group health plan, it is in violation of the prohibition on placing an annual limit on health benefits because the HRA reimburses no more than $4,000 per employee per year.*

The penalty for violating the market reform rules is $100 per day per applicable employee, which is $36,500 per year per employee. (IRC §4980D)

In other guidance, the IRS stated that if the HRA is integrated with other coverage as part of a group health plan and the other coverage alone would comply with the annual dollar limit prohibition, the fact that benefits under the HRA by itself are limited does not fail to comply with the annual dollar limit prohibition because the combined benefit satisfies the requirements. Thus, HRAs could still be offered by employers provided the employer purchases health insurance for the employee in addition to the HRA benefits.

**H.R. 34: The 21st Century Cures Act.** Congress has passed H.R. 34 and the President signed the bill into law. Under section 18001 of H.R. 34, the term "group health plan" does not include any qualified small employer health reimbursement arrangement (Qualified HRA). A Qualified HRA is an arrangement which:

- Is provided on the same terms to all eligible employees of the employer,
- Is funded solely by the employer, meaning no salary reduction contributions are made by the employee to help fund the arrangement,
- Provides the employee with reimbursements for medical expenses incurred by the employee or the employee's family [medical expenses otherwise deductible under IRC section 213(d)] after the employee provides proof of coverage or payment of or reimbursement of such expenses, and
- The amount of payments and reimbursements for any year do not exceed $4,950 for each individual employee or $10,000 per employee if the arrangement includes the employee's family members.

A Qualified HRA does not fail to be treated as provided on the same terms to each eligible employee merely because the employee's permitted benefit varies in accordance with the variation in the price of an insurance policy in the relevant individual health insurance market based on age or number of family members. This permitted variation is determined by reference to the same insurance policy with respect to all eligible employees.

If an employee is not covered by the Qualified HRA for the entire year (such as a new employee), the annual dollar limits are pro-rated on a monthly basis. The $4,950 and $10,000 annual limitations are also adjusted for inflation for years beginning after 2016.

An eligible employee means any employee of an eligible employer, except that the employer may exclude employees who:

- Have not completed at least 90 days of service,
- Are under age 25,
- Are part-time or seasonal employees,
- Are certain union employees covered under a union agreement, or
- Are certain nonresident aliens.

An eligible employer is:

- One who is not an applicable large employer defined in IRC section 4980H (employers with at least 50 full-time equivalent employees who are required to offer affordable minimum essential coverage for their full-time employees), and
- One who does not offer a group health plan to any of its employees.

***Note:*** An employer who offers employer group health coverage plus an HRA to employees would not be offering a Qualified HRA. Presumably the HRA would still be an HRA, just not a Qualified HRA. The IRS has already ruled that HRAs integrated with other group health coverage do not violate the market reform rules.

In addition to the above rules, payments or reimbursements from a Qualified HRA of an individual for medical care are not treated as paid or reimbursed under employer-provided coverage for medical expenses under an accident or health plan if for the month in which such medical care is provided the individual does not have minimum essential coverage, within the meanings of IRC section 5000A(f).

***Note:*** In other words, the employee must provide proof of health insurance coverage before any Qualified HRA benefits can be excluded from the employee's income under IRC section 105(b).

The law also has conforming provisions with the Premium Tax Credit (PTC), which basically denies a double benefit if the employee receives an HRA reimbursement and also qualifies for the PTC.

The new law applies to plan years beginning after December 31, 2016. However, transition relief provides that the $100 per day penalty for small employers that have less than 50 full-time equivalent employees will not be subject to the penalty for plan years beginning on or before December 31, 2016.

◆ ◆ ◆

## Vehicle Expenses and Office in Home

### Cross References

- Rev. Rul. 99-7
- *Haag,* T.C. Summary Opinion 2016-29

In general, the cost of commuting from home to a taxpayer's job is a nondeductible personal expense. There are several exceptions to this rule:

- The taxpayer commutes from home to a temporary work location (one expected to last one year or less) and the taxpayer has one or more regular work locations.
- The taxpayer commutes from home to a temporary work location that is outside of the taxpayer's tax home area (out of town travel).
- The taxpayer's home qualifies as a principal place of business and the taxpayer travels between home to another work location in the same trade or business.

The taxpayers (married filing joint) in this court case were both electricians and members of the International Brotherhood of Electrical Workers. Both taxpayers were employees who worked short-term work assignments at various job locations. None of their employers provided permanent office space for administrative work.

The taxpayers maintained a 60 square foot office in their basement of their home which included a desk, a desktop computer, and filing cabinets. The filing cabinets held both personal and work-related documents. The office was used both for personal and work-related purposes, including checking work-related emails, maintaining tax-related documents, and preparing their personal income tax returns.

The taxpayers claimed that their vehicle expenses for mileage between their home and their temporary work sites were deductible because they maintained an office in home. Revenue Ruling 99-7 states in part: "If an office in the taxpayer's residence satisfies the principal place of business requirements of IRC section 280A(c)(1)(A), then the residence is considered a business location and the daily transportation expenses incurred in going between the residence and other work locations in the same trade or business are ordinary and necessary business expenses."

IRC section 280A(c)(1) states that a principal place of business includes a place of business which is used by the taxpayer for the administrative or management activities of the business if there is no other fixed location for the business where the taxpayer conducts substantial administrative or management activities.

The taxpayers admitted in court that they routinely used their basement office space for both business and personal purposes. As such, the taxpayers failed to use the office space exclusively as a principal place of business. The court said that the taxpayers were not entitled to a deduction for their office in home. In addition, because the office failed the exclusive use test, the taxpayers were not eligible for the exception to the general rule barring a deduction for what are otherwise personal commuting expenses. (*Haag,* T.C. Summary Opinion 2016-29)

***Note:*** This court is basically saying an office in the home cannot be the principal place of business if the office in home fails the exclusive use test. The court is implying that this is true even if the taxpayer conducts all of his or her business in the home office. For example, a bookkeeper prepares books for her clients who mail all of their documents to her. She prepares the books for the clients on her computer in her home office and then drives to the post office to mail the books back to her clients. She also drives to the office supply store in town when she needs more paper and toner and other supplies. She has no other place of business. The office in her home is her principal place of business. But if she also uses that home office for hobbies and crafts and other personal purposes, the home office is not a principal place of business within the meaning of IRC section 280A(c)(1)(A) and thus her vehicle miles driving to the post office and office supply store are not deductible.

◆ ◆ ◆

## A Parent Cannot Be a Noncustodial Parent if He Lives With the Custodial Parent

### Cross References

- *Tsehay,* T.C. Memo. 2016-200, November 3, 2016

The taxpayer married his wife in 2001. Their relationship was described as "on-again, off-again." The taxpayer testified that during 2013, he and his wife were married and living together with their children in a public housing apartment. At some point in 2014, the taxpayer and his wife were again separated and undergoing divorce proceedings. On his 2013 tax return, the taxpayer claimed a dependency exemption deduction for his children, the earned income tax credit, the child tax credit, and the head of household filing status. The taxpayer did not attach a Form 8332, *Release/Revocation of*

*Release of Claim to Exemption for Child by Custodial Parent,* to his 2013 tax return.

The IRS disallowed the dependency exemption deduction, the earned income tax credit, and the child tax credit for 2013. The IRS also changed his filing status from head of household to single. The IRS argued that the taxpayer was not the custodial parent of his children and failed to attach a copy of Form 8332 to his return. The IRS based this position on the fact that there was a child support order effective August 1, 2015.

The court said the taxpayer credibly testified that although he and his wife had previously been separated and he had at times been ordered to pay child support, for 2013 he was married and living in public housing with his wife and their children. The court noted that the August 1, 2015, child support order does not contradict the taxpayer's testimony. There was no requirement that he attach Form 8332 to his return because he was not a noncustodial parent in 2013, the year at issue.

The court said the taxpayer was entitled to the dependency exemption deductions, the earned income credit, the child tax credit, and the additional child tax credit for 2013. The taxpayer was not entitled to the head of household filing status because he was married to his wife at the end of 2013 and did not live apart from her for the last six months of the year. Therefore, even though the IRS changed his filing status to single, the correct filing status is married filing separately since he did not file a joint return with his wife.

***Note:*** If, according to this court ruling, the taxpayer's correct filing status is married filing separately, then he should not have been entitled to the earned income credit, which is disallowed for married filing separate returns.

◆ ◆ ◆

## New Due Date for Election to Claim Disaster Loss

### Cross References

• Rev. Proc. 2016-53

A loss from a federally declared disaster is a form of casualty loss under IRC section 165. A federally declared disaster is any disaster determined by the President to warrant assistance by the federal government. A casualty loss is generally allowed as a deduction only for the taxable year in which the loss is sustained. However, IRC section 165(i) provides an exception if the loss is the result of a federally declared disaster. The election allows the taxpayer to deduct the casualty loss in the tax year immediately prior to the disaster year. The election is made by deducting the disaster loss on either an original return or an amended return for the prior year. An election statement must be attached to the return describing the disaster with dates and locations of the disaster, plus information required on Form 4684, *Casualties and Thefts.* If the disaster was originally reported on the return for the year of the disaster and the taxpayer wishes to make the election to claim it on the previous year return, an amended return must be filed for the disaster year return to remove the deduction. A taxpayer may also revoke a previously made election to deduct the loss in the prior year. An amended return for the prior year must be filed to remove the deduction before claiming it in the loss year.

**New due date for making the election.** For any election, revocation, or other related action that can be made or taken on or after October 13, 2016, the taxpayer must file an original federal tax return or amended federal tax return on or before the date that is six months after the original due date for the taxpayer's federal tax return for the disaster year, determined without regard to any extension of time to file. The taxpayer does not need to file an extension of time to file the federal tax return for the disaster year in order to benefit from the extended due date for making the election.

***Example #1:*** *In October 2016, Jim sustained major damage to his home from Hurricane Matthew. Jim's home is located in a federally-declared disaster area, and damages not covered by insurance are deductible as a casualty loss on his 2016 tax return. Jim wishes to make an election to claim the loss on his 2015 tax return, which has already been filed. He can make this election by filing an amended 2015 tax return and deduct the loss on that return. The due date for making the election on an amended 2015 tax return is October 16, 2017, which is six months after the due date for filing the 2016 tax return (the disaster year), not including extensions. Jim does not have to file an extension for his 2016 tax return in order to benefit from the October 16, 2017, due date for making the election.*

**Due date for revoking the election.** If an election was made to deduct the loss in the year prior to the disaster year, the taxpayer has 90 days after the due date for making the election to revoke it.

***Example #2:*** *Assume the same facts as Example #1. After making the election by filing a 2015 amended return to deduct the loss, Jim decides to revoke the election and deduct it on his 2016 tax return. He has until January 15, 2018 (90 days after October 16, 2017) to revoke the election by filing an amended return for 2015 to remove the deduction.*

◆ ◆ ◆