Important Tax Figures for 2015

Every year, the dollar amounts allowed for various federal tax benefits are subject to change based on inflation adjustments and legislation. Here are some important tax figures for 2015, compared with 2014:

Social Security/Medicare	**2015**	**2014**
Social Security Tax Wage Base	$118,500	$117,000
Medicare Tax Wage Base	No limit	No limit
Employee portion of Social Security	6.2%	6.2%
Individual Retirement Accounts	**2015**	**2014**
Roth IRA Individual, up to 100% of earned income	$5,500	$5,500
Traditional IRA Individual, up to 100% of earned Income	$5,500	$5,500
Roth and traditional IRA additional annual "catch-up" contributions for account owners age 50 and older	$1,000	$1,000
Qualified Plan Limits	**2015**	**2014**
Defined Contribution Plan limit on additions on *Sections 415(c)(1)(A)*	$53,000	$52,000
Defined Benefit Plan limit on benefits (*Section 415(b)(1)(A))*	$210,000	$210,000
Maximum compensation used to determine contributions	$265,000	$260,000
401(k), SARSEP, 403(b) Deferrals (*Section 402(g)), &* 457 deferrals (*Section 457(b)(2))*	$18,000	$17,500
401(k), 403(b), 457 & SARSEP additional "catch-up" contributions for employees age 50 and older	$6,000	$5,500
SIMPLE deferrals (*Section 408(p)(2)(A))*	$12,500	$12,000
SIMPLE additional "catch-up" contributions for employees age 50 and older	$3,000	$2,500
Compensation defining highly compensated employee (*Section 414(q)(1)(B))*	$120,000	$115,000
Compensation defining key employee (officer)	$170,000	$170,000
Compensation triggering Simplified Employee Pension contribution requirement (*Section 408(k)(2)(c))*	$600	$550
Driving Deductions	**2015**	**2014**
Business mileage, per mile	57.5 cents	56 cents
Charitable mileage, per mile	14 cents	14 cents
Medical and moving, per mile	23 cents	23.5 cents

Business Equipment	2015	2014
Maximum Section 179 deduction	$25,000*	$500,000
Phase out for Section 179	$200,000*	$2 million
Transportation Benefit Exclusion	**2015**	**2014**
Monthly commuter highway vehicle and transit pass	$130	$250**
Monthly qualified parking	$250	$250
Standard Deduction	**2015**	**2014**
Married filing jointly	$12,600	$12,400
Single (and married filing separately)	$6,300	$6,200
Heads of Household	$9,250	$9,100
Personal Exemption	**2015**	**2014**
Amount	$4,000	$3,950
Personal Exemption Phaseout	**2015**	**2014**
Married filing jointly and surviving spouses	Begins $309,900	Begins $305,050
Heads of Household	Begins $284,050	Begins $279,650
Unmarried individuals	Begins $258,250	Begins $254,200
Married filing separately	Begins $154,950	Begins $152,525
Domestic Employees	**2015**	**2014**
Threshold when a domestic employer must withhold and pay FICA for babysitters, house cleaners, etc.	$1,900	$1,900
Kiddie Tax	**2015**	**2014**
Net unearned income not subject to the "Kiddie Tax"	$2,100	$2,000
Estate Tax	**2015**	**2014**
Federal estate tax exemption	$5.43 million	$5.34 million
Maximum estate tax rate	40%	40%
Amount you can give each recipient	$14,000	$14,000

* The Section 179 amounts are scheduled to be much lower in 2015 than they were in 2014 unless Congress acts to extend them. The amounts have been increased in recent years by various tax laws, including the *Tax Increase Prevention Act of 2014.*

** The *Tax Increase Prevention Act of 2014* provided a retroactive increase from the $130 limit that had been in place for 2014. If Congress does not act to extend it, the amount goes down to $130 for 2015.

Congress Extends Many Tax Breaks for Individuals

The *Tax Increase Prevention Act of 2014*, which was signed into law on December 19, renewed through 2014 a long list of personal and business federal income tax breaks that had been allowed to expire at the end of 2013. Because Congress habitually allows these breaks to expire before restoring them for a year or two, they are sometimes called "the extenders."

This article provides a quick summary of the personal extenders that were renewed for the 2014 tax year.

Higher Education Tuition Deduction

This write-off, which can be as much as $4,000 or $2,000 for higher-income taxpayers, expired at the end of 2013. The *Tax Increase Prevention Act* extended it through 2014.

Eligible individuals can deduct qualified higher education tuition and related expenses for themselves, their spouses, or dependents as an adjustment to gross income to arrive at adjusted gross income (AGI). The maximum deduction is allowed for an individual whose AGI for 2014 doesn't exceed $65,000 ($130,000 for married couples filing jointly), or $2,000 for individuals who don't meet this AGI limit but whose AGI doesn't exceed $80,000 ($160,000 for joint filers).

Important Note: If your AGI is too high to qualify for the tuition deduction, ask your tax adviser about the American Opportunity Tax Credit. It also has income limitations, but they are higher.

Option to Deduct State and Local Sales and Use Taxes

In recent years, individuals who paid little or no state income taxes were given the option of claiming an itemized deduction for state and local general sales and use taxes instead of an itemized deduction for state and local income taxes. The option expired at the end of 2013. The *Tax Increase Prevention Act* extends it through 2014.

Charitable Donations from IRAs

In recent years, IRA owners who reached age 70 1/2 have been allowed to make tax-free charitable cash donations of up to $100,000 directly out of their IRAs. These donations are called qualified charitable distributions (QCDs). If you are married and your spouse also has one or more IRAs set up in his or her name, your spouse is entitled to a separate $100,000 QCD limit.

While you get no tax deduction for QCDs, they count toward your IRA required minimum distribution (RMD) obligation. Qualified distributions allow charitably inclined seniors with more IRA money than they need for retirement to reduce their income tax bills by arranging for tax-free QCDs to take the place of taxable RMDs. This break expired at the end of 2013, but the *Tax Increase Prevention Act* extended it through 2014.

Parity for Employer-Provided Transit and Parking Benefits

Thanks to the *Tax Increase Prevention Act*, your employer can provide you with up to $250 per month on a tax-free basis this year to cover transit passes. This is the same amount that you can receive on a tax-free basis for parking. For example, you could get up to $250 per month to pay for the park-and-ride, plus up to another $250 to pay for train or subway passes (for a total of $500). Without the new law, the monthly limit on tax-free employer-provided transit passes for 2014 would have been a paltry $130.

Tax-Saving Alternative: If your company doesn't pay for these fringe benefits, it might offer a salary reduction arrangement instead. Under such an arrangement, you could set aside up to $250 per month for transit passes, plus up to another $250 for parking, for a total of $500 per month. If you are in the 25 percent federal income tax bracket and have 7.65 percent of your salary withheld for Social Security and Medicare taxes, you could have saved up to $1,959 in 2014 federal income and employment taxes ($500 times 12 times 32.65 percent).

Tax-Free Treatment for Forgiven Principal Residence Mortgage Debt

For federal income tax purposes, a forgiven debt generally counts as taxable cancellation of debt (COD) income. However, for the last few years, an exception has been available for COD income from canceled mortgage debt that was used to acquire a principal residence.

Under the exception, up to $2 million of COD income from principal residence acquisition debt that was canceled after 2006 has been treated as a tax-free item. The *Tax Increase Prevention Act* extended this break to cover eligible debt cancellations that occur in 2014.

Energy-Efficient Home Improvement Credit

For the last few years, individuals have been allowed to claim a tax credit of up to $500 for certain energy-saving improvements to a principal residence. This break expired at the end of 2013, but the *Tax Increase Prevention Act* extended it through 2014.

Deduction for K-12 Educator Expenses

The new law extended through 2014 the $250 deduction for teachers and other K-12 educators for school-related expenses paid out of their own pockets.

Mortgage Insurance Premium Write-Off

Premiums for qualified mortgage insurance on debt to acquire, construct, or improve a first or second residence can potentially be treated as deductible qualified residence interest. Before the *Tax Increase Prevention Act,* this break was available only for premiums paid through 2013. The new law extended it to cover premiums paid in 2014. However, the deduction is available only for premiums for qualifying policies issued after December 31, 2006, and for premium amounts allocable to periods before 2015. The break is phased out for higher-income taxpayers.

Qualified Conservation Contribution Rules

Liberalized deduction rules for qualified conservation contributions expired at the end of 2013. The *Tax Increase Prevention Act* extended them through 2014. Qualified conservation contributions are charitable donations of real property interests, including remainder interests and easements that restrict the use of real property.

For individuals, the maximum write-off for qualified conservation contributions of long-term capital gains property is increased from the normal 30 percent to 50 percent of AGI. In addition, qualified conservation contributions are not counted when calculating an individual's allowable write-offs for other charitable contributions. Qualified conservation contributions in excess of what can be written off in the year of the donation can be carried forward for 15 years. (Only a five-year carryover period is allowed under the normal rules.)

For an individual who is a qualified farmer or rancher, the qualified conservation contribution write-off for donated farm or ranch real property can be as much as 100 percent of the donor's AGI. However, the donation must include a usage restriction stating that the property must remain available for agricultural or livestock production.

This article only provides the basics of the new tax law for individuals. Consult with your tax adviser about your situation and to learn about the implications of the law on businesses.

New Tax-Favored Savings Accounts for Disabled Individuals

The new *Achieving a Better Life Experience Act of 2014* (ABLE) was also passed by Congress at the end of last year and signed into law by the president. It allows states to establish tax-favored accounts to help individuals with disabilities accumulate money to pay for qualified expenses. The accounts are similar to state-run Section 529 college tuition savings accounts.

Each year, up to $14,000 (adjusted annually for inflation) can be contributed to an ABLE account set up for a specific disabled beneficiary. Anybody can contribute, including relatives and friends.

Contributions are not deductible. The tax advantage comes from the fact that ABLE account earnings are allowed to build up free of any federal income tax liability. Then tax-free withdrawals can be taken to cover the account beneficiary's qualified expenses, which include expenditures for education, housing, transportation, employment training and support, assistive technology, personal support services, health and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, and funeral and burial expenses.

Upon the disabled individual's death, any amount remaining in the ABLE account goes to his or her estate or designated beneficiary, and any accumulated earnings are taxable.

ABLE Accounts vs. Special Needs Trusts

The National Disability Institute, a not-for-profit organization, estimates that 5.8 million individuals and their families might be able to benefit from an ABLE account. The institute described how an ABLE account differs from a special needs trust or pooled trust.

"An ABLE Account will provide more choice and control for the beneficiary and family. Cost of establishing an account will be considerably less than either a Special Needs Trust or Pooled Income Trust. With an ABLE account, account owners will have the ability to control their funds and, if circumstances change, still have other options available to them. Determining which option is the most appropriate will depend upon individual circumstances. For many families, the ABLE account will be a significant and viable option in addition to, rather than instead of, a Trust program."

Employer Penalty Alert for Reimbursing Employee Health Coverage

The *Affordable Care Act* (ACA) established a number of so-called "market reform" restrictions on employer-provided group health plans, starting with plan years beginning in 2014. These restrictions generally apply to all employer-provided group health plans -- including those furnished by small employers with less than 50 workers. Even worse, there's a punitive penalty for running afoul of the market reform restrictions. The penalty, under Internal Revenue Code Section 4980D(b)(1), equals $100 per-day per-employee, which can amount to up to $36,500 per-employee over the course of a full year.

In fact, according to the IRS and the U.S. Department of Labor (DOL), the market reform restrictions can penalize employers for offering plans that simply reimburse employees for premiums paid by them for individual health insurance policies. We will call such plans “employer payment arrangements.” This article explains what you need to know to avoid the punitive market reform penalty on such arrangements.

But first, let's cover some necessary background information.

Employer Payment Arrangement Basics

Employer payment arrangements have long been a popular way for smaller employers to help their employees to obtain health coverage without the hassle and expense of furnishing a full-fledged company health insurance plan. Another advantage is that employees are free to select coverage that meets their specific needs instead of being stuck with a one-size-fits-all company plan.

Under an employer payment arrangement, the employer reimburses participating employees for premiums paid for their individual health insurance policies. To qualify for tax-free treatment under the federal income tax rules, the employer must:

1. Make the reimbursements under a written Section 105 medical reimbursement plan; and

2. Verify that the reimbursements are spent for health insurance coverage.

Market Reform Restrictions and Recent Government FAQ

In 2013, the IRS guidance (*Notice 2013-54)* that stipulates tax-free employer payment arrangements are considered group health plans subject to the ACA market reform restrictions. With a few limited exceptions, such plans fail to meet ACA requirements because, among other reasons, group health plans that are used to purchase coverage in the individual market cannot be integrated with individual market policies.

However, many business owners hoped that plans that reimburse employees on an after-tax basis (instead of on a tax-free basis) would not be treated as employer plans that are subject to the market reform restrictions and the punitive penalty. Those hopes have now been dashed.

According to frequently asked questions (FAQ) posted on the DOL website in November, an employer arrangement that reimburses employees for individual market policies is considered to constitute a group health plan, subject to the market reform restrictions and the punitive penalty, whether the reimbursements are treated as tax-free or after-tax (meaning taxable).

More specifically, the FAQ states:

If an employer arrangement provides cash reimbursements to employees for the purchase of individual market policies, the arrangement will be considered for ACA purposes to be a plan established or maintained for the purpose of providing medical care to employees. It doesn't matter if the employer treats the premium reimbursements as a tax-free benefit or as additional taxable wages.

As stated earlier, such an employer payment arrangement doesn't comply with the ACA market reform rules because cash payments from an employer cannot be integrated with an individual market policy. Therefore, an employer payment arrangement can trigger the punitive penalty, whether the arrangement is treated by the employer as tax-free or taxable.

Impact on S Corporations

Many S corporations have set up employer payment arrangements to reimburse employees who own more than 2 percent of the company stock (more-than-2 percent shareholder-employees) for their individual health insurance premium costs. Under existing IRS rules, the reimbursements are treated as additional taxable wages that are not subject to Social Security or Medicare taxes. Qualifying more-than-2 percent shareholder employees can then deduct their premiums on their individual federal income tax returns under the special break for self-employed health insurance premiums. The company can deduct the reimbursements as compensation expense.

Unfortunately, such employer payment arrangements run afoul of the ACA market reform restrictions and can, therefore, trigger the punitive penalty. Therefore, unless and until something changes, such arrangements need to be reconsidered.

Limited Exception for One-Employee Employer Arrangements

About the only good news here is that the ACA market reform restrictions and the punitive penalty do not apply to employer payment arrangements, including S corporation arrangements, which

have only one participating employee. Therefore, according to *IRS Notice 2013-54*, such arrangements can still be used to reimburse one employee for his or her individual health insurance premiums without triggering the expensive market reform penalty.

Warning: Employer payment arrangements generally must cover all full-time employees in order to avoid IRS non-discrimination rules, under Internal Revenue Code Section 105(h). That said, the non-discrimination rules under Treasury Regulation 1.105-11(c) allow employers to exclude workers who:

1. Have less than three years of service;

2. Have not attained age 25; or

3. Meet the definition of part-time or seasonal employees.

Conclusions

The ACA market reform restrictions penalize the use of employer payment arrangements to subsidize or reimburse employees for individual market health insurance policies -- if more than one employee participates in the arrangement. Similarly, employers cannot directly pay premiums for individual market policies on behalf of their employees without triggering the penalty.

The bottom line is that the market reform penalty is so punitive that employer payment arrangements are basically off limits unless they only cover one worker. However, employers can still choose one of the following options without triggering the market reform penalty:

- Provide a tax-free fringe benefit by paying for an ACA-approved employer-sponsored group health plan. Small employers with 50 or fewer employees can provide a group health plan through the SHOP Marketplace. Under Internal Revenue Code Section 125, employers can also set up cafeteria benefit plans to allow employees to pay for their shares of the cost of coverage with tax-free salary reductions.
- Increase employees' taxable wages to help them pay for individual health insurance policies. However, the employer cannot require that the funds be used for that purpose. In these cases, the employer can claim compensation deductions for the additional wages, but the wages will be subject to federal income tax at the employee level and federal employment taxes at both the employee and employer levels. Qualifying employees can claim itemized medical expense deductions for the premiums, subject to the tax-law limitations on those write-offs.

If you have any questions about your company's health coverage and the tax implications under the Affordable Care Act, consult with your tax or your benefits adviser.

Was a Money-Losing Horse Racing Activity a Business ... or a Hobby?

If you have a sideline business that throws off a net loss (deductible expenses in excess of revenue), you may think you can write off the loss. Not so fast! The IRS may claim your purported business loss is from a hobby that never had a chance of being profitable. The IRS likes to make that argument because the tax rules for hobby losses are strongly in the government's favor.

Here's what you need to know about the business-versus-hobby loss issue, along with details from one U.S. Tax Court decision in which the taxpayer won a partial victory for his horse racing activity.

Why Hobby Losses Matter

When an individual's for-profit business venture generates a net tax loss for the year (deductible expenses in excess of revenue), the loss can be deducted on Form 1040. Specifically:

- Schedule C is used to report a loss from a sole proprietorship business;
- Schedule E is used for a rental activity or an activity operated through an S corporation or partnership; and
- Schedule F is used for a farm or ranch or other agricultural sole proprietorship business.

The loss is then carried to Form 1040 where it offsets income from other sources and reduces your federal income tax bill (and possibly your state income tax bill, too).

But what happens if an activity is deemed to be a not-for-profit hobby? In that scenario, you must report all the revenue on Form 1040. However, your allowable expense deductions are limited to the amount of revenue. So you can't have a net tax loss from a hobby even if you lose a bundle. Worse yet, you must treat the total hobby expense amount (limited to the revenue from the activity) as a miscellaneous itemized deduction. So you get no write-off unless you itemize.

Even if you itemize, your miscellaneous expense write-off is limited to the excess of those items over 2 percent of adjusted gross income (AGI). If you have a healthy AGI, your allowable deduction for hobby expenses may be little or nothing. Finally, if you owe alternative minimum tax (AMT), hobby expenses are disallowed under the AMT rules. When all is said and done, you can easily have a money-losing hobby that actually adds to your taxable income because you must report all revenue -- yet you may not be able to deduct much, or any, of the expenses.

But don't give up hope! The good news is yet to come.

A Business or a Hobby?

Fortunately, the tax law automatically assumes you have a for-profit business if the activity produces positive taxable income (revenue in excess of deductible expenses) for at least three out of every five years. Net losses from the other years can be deducted because they're considered to be legitimate business losses as opposed to hobby losses. For horse racing, breeding, training, or showing activities, you're assumed to have a for-profit business if you can generate positive taxable income in two out of every seven years. If you plan ahead to pass these tests, you earn the right to deduct their losses from the unprofitable years.

Even if you cannot pass one of the aforementioned profitability tests, you may still be able to treat your activity as a for-profit business and rightfully deduct your net losses. Basically, you must demonstrate that you have made an honest intent to make a profit. Factors that can prove this include:

- Conducting the activity in a business-like manner by keeping good records and searching for profit-making strategies;
- Having expertise in the activity or hiring expert advisers;
- Spending enough time to justify that the activity is an actual business and not just a hobby;
- An expectation of asset appreciation (this is why the IRS will almost never claim that owning rental real estate is a hobby, even when tax losses are incurred for years);
- Success in other ventures, which indicates business acumen;
- Losses caused by unusual events and plain bad luck as opposed to foreseeable ongoing losses that nobody except a hobbyist would be willing to accept;
- Your financial status ... rich folks can absorb ongoing losses (which may indicate hobbies) while ordinary folks are usually trying to make a buck (which indicates businesses); and
- Elements of personal pleasure. For example, running a charter fishing boat is more fun than draining septic tanks, so the IRS is far more likely to claim the former is a hobby if losses start showing up on tax returns.

How the Tax Court Treated Losses from a Horse Racing Activity

In one decision, the Tax Court concluded that a former restaurant and nightclub owner who bred and raced horses was operating what was intended to be a for-profit business for two out of the four tax years in question. Therefore, the net losses from those two years could be deducted, even though the horse racing activity never generated a profit. (*Merrill C. Roberts*, TC Memo 2014-74)

Facts of the Case

Merrill Roberts successfully operated several restaurants and nightclubs before deciding to leave those businesses. In 1998 or 1999, Roberts became interested in owning and training race horses. By 2001, he owned 11 horses, including a breeding stallion, and he employed several trainers. He began working every day at his horse training property in Indiana and became a licensed trainer in 2002. Obtaining the license required passing a rigorous test on a range of subjects from horse bridle construction to equine medication.

By 2005, Roberts felt comfortable enough with his knowledge of the horse racing business to build a new training facility to replace his current unsuitable facility. He purchased a 180-acre parcel in Indiana for $1 million in 2006. He then invested between $500,000 and $600,000 in building improvements. Roberts realized that the land would probably appreciate because of its proximity to a planned highway project, but he bought the land specifically for horse racing.

Roberts then decided to go the extra mile by building a first-class training facility. It was completed and placed in service in 2007. The facility included a large training track, portable horse stalls, rehabilitation equipment, specialized training areas, and apartments for employees. It also offered conditioning programs for non-racing horses. Roberts believed his facility was unmatched in the state of Indiana.

The new facility also allowed Roberts to use acreage on the property to grow hay. He purchased equipment to harvest and process the hay. He also rented out some of the acreage to farmers.

During 2005-2008 (the tax years in question), Roberts was involved in multiple aspects of the horse racing industry including boarding, breeding, training, and racing. He primarily raced his horses in Indiana, but he also entered them in at least 11 races each year in Kentucky. He intermittently raced in other states including Ohio, Louisiana, North Dakota, Minnesota, and West Virginia. He spent evenings choosing the races in which each horse would compete, and spent substantial time studying track condition books and picking specific races for specific horses. To ensure compliance with racing regulations and to develop winning strategies, Roberts often conferred with his assistant trainer. This produced some successful horses, including one that was nominated to run in the Triple Crown.

Finally, Roberts joined several professional horse racing associations and served as a board member for two of the organizations.

Roberts used a CPA for his restaurant and nightclub businesses, as well as his horse racing activities. The CPA successfully represented Roberts in two earlier tax audits, and Roberts continued to seek the adviser's advice on tax matters related to horse racing.

Here are Roberts' losses from his horse racing activity:

Year	Net Loss Reported
2005	$153,420
2006	$30,604
2007	$98,251
2008	$291,888 (Largely because his horses were quarantined during most of that year's racing season)

In all these years, there was significant revenue from the horse racing activity, but the expenses were higher.

After auditing Robert's 2005-2008 tax years, the IRS claimed that his horse racing activity was a not-for-profit hobby and sent him a bill for significant amounts of income tax and penalties. The taxpayer disagreed and took his case to the Tax Court.

The Court's Conclusion

The Tax Court found that the taxpayer's intention to make a profit from his horse racing activity was shown by the following facts:

1. He sold his old unsuitable training facility and moved his operation to a new property where he built a premier training facility placed in service in 2007.

2. He hired an assistant trainer and consulted with bloodstock agents and respected trainers on horse racing issues. So he relied on the advice of experts.

3. His accounting methods allowed him to make informed business decisions. Therefore, he conducted his horse racing activity in a business-like manner.

4. For 2007 and 2008, the taxpayer's reasonable expectation that the land value of his new horse training facility would appreciate was an element of his overall for-profit objective for those years.

5. He spent substantial time in the horse racing activity.

6. He had been successful in previous business (restaurant and nightclub) ventures.

However, the Tax Court noted that Roberts attended to the track racing and training sides of his operation during 2005 and 2006. Therefore, according to the court, he participated equally in the social and business aspects of his horse activity in those years. In 2007, he hired an assistant trainer to take over the track racing functions and focused on the training aspects, which basically involved a lot of hard work. So, according to the court, Roberts didn’t have the requisite for-profit motive in 2005 and 2006, but he did in 2007 and 2008. Therefore, the hobby loss rules applied for

the two earlier years, and his net losses were negated for tax purposes. His net losses for the two later years could be deducted as for-profit business losses.

In summary, this was only a partial victory for the taxpayer.