



# Tax News and Industry Updates



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## No Need to Amend for Incorrect 1095-A

### Cross References

- [www.treasury.gov/press-center/press-releases/Pages/jl9981.aspx](http://www.treasury.gov/press-center/press-releases/Pages/jl9981.aspx)

The Centers for Medicare & Medicaid Services (CMS) announced that about 20% of the tax filers who purchased health insurance from the federal Marketplace received statements (Form 1095-A) that include an incorrect piece of information. The U.S. Treasury estimates that approximately 50,000 tax filers already have filed their taxes using these incorrect forms. The Treasury Department has concluded that these individuals do not need to file amended returns. The IRS will not pursue the collection of any additional taxes from these individuals based on updated information in the corrected forms. Nonetheless, some individuals may choose to file amended returns. A tax filer is likely to benefit from amending, if the 2015 monthly premium for his or her second lowest cost Silver plan (or “benchmark” plan) is less than the 2014 premium. For example, if a filer’s original form lists

a benchmark premium of \$100 and his or her updated form lists a premium of \$200, it may be in his or her interest to refile. As CMS announced last week, affected individuals who have not yet filed their taxes should wait to file until they receive their corrected forms.



## Penalty Relief for HRAs

### Cross References

- Notice 2015-17

Health reimbursement arrangements (HRAs) are plans solely funded by an employer. Employees are reimbursed tax free under IRC section 105(b) for qualified medical expenses, including the cost of health insurance premiums up to a maximum dollar amount for a coverage period.

Beginning January 1, 2014, health insurance policies and employer group health plans are no longer allowed to place annual or lifetime limits on medical coverage. These rules are better known as the market reform rules. The penalty for failure to meet the market reform rules is \$100 per day per individual with respect to the non-compliance period (IRC §4980D). IRS Notice 2013-54 identified HRAs with two or more participants as being an employer group health plan. The Notice said that a plan under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy, or directly pays a premium for an individual health insurance policy covering the employee is an employer group health plan. As such, Notice 2013-54 stated that unless the HRA is integrated with other coverage that meets

the market reform rules, an employer would be subject to the \$100 per day per employee penalty for reimbursing employees for the cost of their own individual health insurance policies.

**Author's Comment:** *The fact that the individual policy purchased by the employee meets the market reform rules is irrelevant. The market reform rules are broken because the employer places an annual limit on the amount that it reimburses an employee for the cost of the employee's individual health insurance policy.*

**Penalty relief for HRAs.** Notice 2015-17 now provides transitional relief for small employers who offer HRAs. The penalty under IRC section 4980D will not apply for any failure to satisfy the market reforms by employer payment plans that pay, or reimburse employees for individual health policy premiums or Medicare Part B or Part D premiums:

- 1) For employers that are not Applicable Large Employers (ALEs) in 2014, (an ALE is an employer that employed an average of at least 50 full-time employees including full-time equivalent employees), and
- 2) For January 1 through June 30, 2015, for employers that are not ALEs for 2015.

After June 30, 2015, such employers may be liable for the penalty under IRC section 4980D if they continue to offer HRAs to employees that are not integrated with other coverage that meets the market reform rules. This penalty relief does not apply to stand-alone HRAs or other arrangements to reimburse employees for medical expenses other than insurance premiums.

**2% S corporation shareholders.** If an S corporation pays for or reimburses premiums for individual health insurance coverage covering a 2% shareholder-employee, the payment or reimbursement is included in income but the 2% shareholder-employee may deduct the amount of the premiums under the self-employed health insurance rules. The IRS is still deciding on publishing additional guidance on the application of the market reforms to a 2% shareholder-employee healthcare arrangement. Until such guidance is issued, and through the end of 2015, the IRS has ruled that the penalty under IRC section 4980D will not be applied for any failure to satisfy the market reforms by a 2% shareholder-employee healthcare arrangement. Further, unless and until additional guidance provides otherwise, an S corporation with a 2% shareholder-employee healthcare arrangement will not be required to file IRS Form 8928 regarding failures to satisfy requirements for group health plans, including the market reform rules. This guidance does not apply to employees of an S corporation who are not 2% shareholders (other than the relief provided above for HRAs in general).

Also, until further guidance is issued, the federal tax treatment for purposes of the self-employed health insurance deduction and the premium tax credit under IRC section 36B remain the same for purposes of computing the deduction and the credit with respect to the 2% S corporation shareholder-employee.

**Increase compensation to assist with payments of health insurance.** If an employer increases an employee's compensation, but does not condition the payment of the additional compensation on the purchase of health insurance, the arrangement is not an HRA that is subject to the market reform rules.

However, if the benefit is contingent on the employee purchasing health insurance, even if the benefit is provided under an after tax basis (meaning the benefit is added to the employee's W-2 as wages), such arrangement is a group health plan, subject to the market reform rules.

For information on Medicare premium reimbursement arrangements and TRICARE-related HRAs with a group health plan, see Notice 2015-17.



## IRS Scraps Requirement to File Form 3115 for Certain Taxpayers

### Cross References

- Form 3115, *Application for Change in Accounting Method*
- Rev. Proc. 2015-20

An accounting method is chosen on the first tax return filed by the taxpayer, and generally does not need IRS approval. If the taxpayer later wants to change accounting methods, IRS approval is required. A taxpayer makes a request to change accounting methods by filing Form 3115, *Application for Change in Accounting Method*.

In general, when a taxpayer changes a method of accounting, the rules under IRC section 481 apply. An IRC section 481 adjustment is required to account for how an item being changed in prior years is treated after the change in accounting method. The IRC section 481 adjustment prevents the duplication of deductions or omission of income as a result of the accounting method change.

A simple example is changing from the cash method of accounting to the accrual method. A cash method taxpayer reports income when received. And accrual method taxpayer reports income when earned. If a taxpayer earned income in 2014 but did not receive payment for the income until 2015, a cash method taxpayer would report the income in 2015 while an accrual method taxpayer would report the income in 2014. In this example, changing from the cash method to the accrual method

as of January 1, 2015, would omit the reporting of this income altogether if it were not for the requirement under IRC section 481 to account for this change.

Effective for taxable years beginning on or after January 1, 2014, final regulations were issued to clarify the difference between capital improvements and repairs. Since these final regulations effectively change the method of accounting for certain expenses incurred in repairing and maintaining tangible property, taxpayers are required to follow the rules under IRC section 446(e) and IRC section 481 to avoid duplication or omission of deductions. Taxpayers affected by these rule changes are also required to file Form 3115, although certain simplified filing procedures under Revenue Procedure 2015-14 are permitted to ease the administrative burden faced by small business taxpayers.

Certain annual elections do not require a taxpayer to change its method of accounting, and as a result, no IRC section 481 adjustment is needed and Form 3115 does not need to be filed. These annual elections include:

- The election to apply the de minimis safe harbor in Regulation section 1.263(a)-1(f) (the \$5,000 expense election rule for taxpayers with applicable financial statements and the \$500 expense election rule for taxpayers without applicable financial statements),
- The election to utilize the safe harbor for small taxpayers in Regulation section 1.263(a)-3(h) (the election to expense a cost that is the lesser of 2% of the unadjusted basis of the building or \$10,000), and
- The election to capitalize repair and maintenance costs in Regulation section 1.263(a)-3(n).

**New simplified method of changing accounting methods.** Eligible small businesses do not have to file Form 3115 to change accounting methods to meet the requirements under the new repair and capitalization regulations. An eligible small business is a small business that has:

- Total assets of less than \$10 million as of the first day of the taxable year, or
- Average annual gross receipts of \$10 million or less for the prior three taxable years.

If the small business meets the above, the small business can change its accounting method to conform to the new rules provided it makes the necessary IRC section 481 adjustment that takes into account only amounts paid or incurred, and dispositions in taxable years beginning on or after January 1, 2014. The taxpayer is assumed to have made an accounting method change by including the required IRC section 481 adjustment on its tax return without including a separate Form 3115 with the tax return. However, if the taxpayer chooses not to file Form 3115, the taxpayer does not receive any audit protection for dispositions in taxable years beginning before January 1, 2014.

## Medical Marijuana and the Cost of Goods Sold Calculation

### Cross References

- Ltr. Rul. 201504011, January 23, 2015

Under federal law, marijuana is classified as a Schedule I controlled substance. In recent years, there have been a number of states that have legalized when used for medical purposes. Though a medical marijuana business is illegal under federal law, such a business remains obligated to pay federal income tax on its taxable income. In a series of cases, the U.S. Supreme Court has held that income in the context of a reseller or producer means gross income, not gross receipts. Regulation section 1.61-3(a) provides that gross income includes net gains derived from dealings in property, which includes controlled substances produced or acquired for resale. Gains derived from dealings in property means gross receipts less the cost of goods sold.

In 1982, Congress enacted IRC section 280E which states that no deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances which is prohibited by federal law or the law of any state in which such trade or business is conducted. Under the explanation of provision, the Senate report said all deductions and credits for amounts paid or incurred in the illegal trafficking in drugs are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill.

In other words, for federal income tax purposes, a business buying (or producing) and selling medical marijuana, which is legal under state law but illegal under federal law, is not allowed to deduct any business expenses connected with the buying and selling of medical marijuana, even if the business deduction is otherwise a legal expense (such as wages, rents, telephone, etc.). The only exception to this rule is the deduction for the cost of goods sold. Since the cost of goods sold is taken into consideration in the calculation of gross income (gross receipts minus COGS = gross income), then the direct costs of producing or purchasing the marijuana is allowed in calculating taxable income, while operational type expenses are not deductible.

A recent IRS letter ruling addresses the issue of the Uniform Capitalization Rules under IRC section 263A. This code section was enacted after IRC section 280E. For a legal business, IRC section 263A is basically a timing issue.

A portion of certain indirect costs such as administrative wages, utilities, telephone, etc. are added to the cost of goods sold calculation rather than deducted as current operating expenses. This works as a negative for the legal business since otherwise deductible expenses are tied up in the cost of inventory and are not deducted until the items are actually sold. The question then, is a medical marijuana business, illegal under federal law, allowed to add a portion of certain indirect costs to the cost of goods sold calculation?

The answer is no. IRC section 263A is merely a timing issue. If it were used in calculating cost of goods sold for a medical marijuana business, then it would effectively transform a portion of business expenses not deductible under IRC section 280E into allowable deductions in computing cost of goods sold. However, Regulation section 1.263A-1(c)(2)(i) states: "Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph." In other words, indirect costs capitalized under the Uniform Capitalization Rules can only include costs that are otherwise allowable as a business deduction. Since an operational type cost for a medical marijuana business is not deductible, then it cannot be treated as an indirect cost under IRC section 263A.



## Penalty Relief Related to Advance Payment of Premium Tax Credit

### Cross References

- IRC §6651(a)(2)
- IRC §6654(a)
- Notice 2015-9

Beginning in 2014, eligible individuals covered under a qualified health plan through an insurance exchange (the Health Insurance Marketplace) are allowed a Premium Tax Credit (PTC) under IRC section 36B. If the taxpayer qualifies, advance credit payments of the Premium Tax Credit (APTC) are made directly to the insurance company to help subsidize the cost of health insurance. The amount of the APTC is determined when an individual enrolls in a qualified health plan and is based on projected household income and family size for the year of coverage.

A taxpayer claims the PTC on the income tax return for the taxable year of coverage. The amount of the PTC is based on actual household income and family size for the year reflected on the tax return. A taxpayer must reconcile, or compare the amount of the PTC allowed with APTC received. Changes in the circumstances on which the APTC payments are based could result in a

difference between the amount of APTC payments and the PTC to which the taxpayer is entitled. If APTC is more than PTC claimed on the return, the difference is treated as an additional tax and may result in a smaller refund or a larger balance due. If APTC is less than PTC claimed on the return, the difference may result in a larger refund or a smaller balance due.

**Penalty relief for tax year 2014.** Some taxpayers who have a balance due on their 2014 income tax return attributable to the reconciliation of their APTC with their PTC may not be able to pay the balance due by the due date of the return (generally April 15, 2015). Generally, taxpayers that do not pay their entire tax liability by the due date of the return are subject to a late payment penalty under IRC section 6651(a)(2). Additionally, some taxpayers may discover that their estimated tax payments were understated, potentially making these taxpayers liable for the estimated tax penalty under IRC section 6654(a). Notice 2015-9 provides relief from these penalties for taxpayers who satisfy the requirements of the notice.

The IRS will abate the late payment penalty for the 2014 tax year for taxpayers who:

- Are otherwise current with their filing and payment obligations,
- Have a balance due for the 2014 taxable year due to excess APTC payments over their allowed PTC, and
- Report this excess on a timely filed 2014 tax return, including extensions.

The IRS will also abate the underpayment of estimated tax penalty for the 2014 tax year for taxpayers who have an underpayment attributable to excess APTC if the taxpayers:

- Are otherwise current with their filing and payment obligations, and
- Report the amount of the excess APTC on a timely filed 2014 tax return, including extensions.

Notice 2015-9 does not extend the time to file a return. Taxpayers must still file Form 4868 to obtain an extension. Taxpayers will also be required to pay interest on the balance due from the original deadline to pay (generally April 15, 2015) to the date in which the balance due is paid, even if the taxpayer qualifies for penalty relief under Notice 2015-9.

**Procedure to claim relief from the late payment penalty.** The IRS will automatically assess the late payment penalty for taxpayers that do not pay the balance due by April 15 and send a notice to the taxpayer demanding payment. When responding to such a notice, taxpayers should submit a letter to the IRS and say: "I am eligible for the relief granted under Notice 2015-9 because I received excess advance payment of the premium tax credit."

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Taxpayers who file their returns by April 15, 2015 will be entitled to relief under Notice 2015-9 even if they have not fully paid the underlying liability by the time they request relief. Taxpayers who file their returns after April 15, 2015 must fully pay the underlying liability by April 15, 2016 to be eligible for relief under Notice 2015-9. Interest will accrue until the underlying liability is fully paid.

**Procedure to claim relief from the estimated tax penalty.** To request a waiver of the estimated tax penalty, taxpayers should check box A in Part II of Form 2210, complete page 1 of the form, and include the form with their return, along with the following statement: "Received excess advance payment of the premium tax credit." Taxpayers do not need to attach documentation from the Marketplace, explain the circumstances under which they received an excess advance payment, or complete any page other than page 1 of the Form 2210. Taxpayers also do not need to figure the amount of penalty for the penalty to be waived.

