Top Cases (And Rulings) of 2015

Presented by Sandi King Brauer

Using contributed information from

Tony Nitti, contributor to Forbes Magazine

Obamacare Endures Additional Attacks

This case will decide the continued existence of the Affordable Care Act also known as Obamacare.

The Goal of the Affordable Care Act is to achieve near universal health care coverage while lowering health insurance premiums. In order to do so, the ACA relies on the interdependent policies:

- Reforms to the insurance market that prohibits insurers from denying coverage or charging higher premiums based on an individual’s health status.

- Imposing a penalty on a taxpayer who does not carry minimum essential health insurance coverage for any month during the year

- Providing a subsidy, in the form of a tax credit, to those individuals who cannot obtain the required minimum essential coverage through their employer and who instead obtain insurance on an Exchange (the Premium Tax Credit)

Without All three legs, ACA would collapse

- Without insurance market reform, there is no option for many Americans to acquire affordable coverage.
- Without the individual mandate, there is no motivation for an individual to obtain coverage until after they become sick or injured, which would wreak havoc on insurers and increase premiums for all.
- Without the subsidy provided by the Premium Tax Credit, affordable premiums would be out of reach for many taxpayers.

The Problem

The statute clearly states in two separate sections, that the credit only available to those taxpayers who purchase insurance on an **Exchange established by the state under Section 1311.**

After 36 states declined to establish an Exchange, it is only this regulatory language that grants the credit to those taxpayers in those states.

Regulation Section 1.36-2(a)(1) then defines "an Exchange: as "an Exchange serving the individual market for qualified **individuals…regardless of whether the Exchange is established and operated by a state (including a regional Exchange or subsidiary Exchange) or by the HHS (the federal government)**

The problem is the statute clearly states, in two separate sections, that the credit is only available to those taxpayers who purchase insurance on a **Exchange established by the state under Section 1311.**

The regulations expand the reach of the credit, bestowing it upon those qualifying taxpayers who instead purchase insurance on an **Exchange established by the federal government.**

Washington we have a Problem!

- Starting in 2016, employers with more than 50 employees will be required to pay a penalty to the IRS if they don't provide health insurance coverage to their employees. The law, however, states that the employer is only subject to the penalty if "at least one of its employees is eligible for the Premium Tax Credit." Thus, if there is no credit in 36 states, there is no employer penalty
- The individual is required to apply a penalty if he or she does not carry minimum essential coverage for any month during 2014 and beyond. This penalty only applies, however, if the "cost of insurance" does not exceed 8% of your household income. The "cost of the insurance" is treated as the excess of your premiums "reduced by your Premium Tax Credit". No credit is 36 states means likelihood that the cost of insurance would be too high

Governments Argument

- The federal government was forced to establish an Exchange in a state that did not establish one on its own, therefore the Government “stood in the shoes” of the state
- Under Section 1321 authorizing the Federal government to establish the exchange, it was established and operated as if it were set up by the state under Section 1311.

Ruling

The D.C. Court of appeals, concluded that the language is clear: an Exchange must be established by **the state** to meet the standard of the statute.

Next the government argued it is a well established principle that if statutory construction leads to absurd results, the courts are not required to adopt the plain meaning of the statute.

As a result, the D.C. Circuit Court of Appeals could ignore the obvious statutory requirement that in order for taxpayers to be eligible for the credit, insurance must be purchased on an Exchange established by the state, **if adhering to such a requirement would cause the rest of the state to not make much sense**.

The Court, however, once again, **disagreed with the Government.**

King v. Burwell, 759 F.3d 358 (4th Cir. 2014)

Mere hours later, the 4th Circuit court of Appeals heard the same arguments from both sides and reached the opposite conclusion, holding in favor of the government that the Premium Tax Credit applied whether insurance was purchased on a state or federally-established Exchange.

They did not agree with either sides arguments, but ruled by looking at the “three –legged barstool” construction of the ACA as discussed earlier and determined that without the credit, the ACA would crumble.

As a result, allowing the credit in all 50 states was necessary to achieve the ACA's goal of increasing the number of Americans covered by health insurance while decreasing the cost of that care, as evidenced by this testimony by the government:

"discouraging market participation, and the ultimate result would be an adverse-selection "death spiral: in the individual insurance market in states with federally-run Exchanges".

Because "death Spiral" are rarely considered good things, the 4th circuit ultimately sided with the government and upheld the Premium Tax Credit all 50 States.

Decoding the Mortgage Interest Limitation

Section 163(h)(3) allows a deduction for qualified residence on up to \$1.000,000 of acquisition indebtedness and \$100,000 of home equity indebtedness. Should your mortgage balance (or balances, since the mortgage interest deduction is permitted on up to two homes) exceed the limitations, the mortgage interest is limited to amount applicable to only \$1,1000,000 worth of debt

Sophy v. Commissioner

- Two unmarried joint tenants deducted their maximum interest for the same house
- Court ruled each owner’s mortgage interest deduction would be limited under the holding in Sophy because the maximum amount of qualified residence debt on the house is limited to the statute regardless of the number of owners.

Ninth Circuit Reverses

The Ninth Circuit reversed the Tax Court's holding, deciding instead that the $1,100,000 limitation on qualified debt is determined on a per-taxpayer, rather than a per-residence basis.

Also ruled that with married couples who file separately that the residence interest limit for each is cut in half.

Co habitation still allows for the full deduction.

Cash For Egg Donation Is Taxable Income

Donating eggs is a selective, painful, and yes, lucrative process.

The hormone injections, primarily in the stomach, leave burning and bruising behind.

A series of blood tests, pap smears, breast exams, and pregnancy tests, along with extensive physical exams are just among a few of the exhausting process.

Despite this, egg donation is on the rise. A donor may receive up to $50,000 for her eggs. This can be life changing for a 20 year old women

The IRS has treaded lightly because it concerning the human body.

In a 100 years, there has been very little rulings in this area.

- Breast milk is considered property, the donation of which may result in a charitable contribution
- Donating blood may be either the sale of property or the performance of service, depending on the court.

Perez v. Commissioner

Ruled that the amount received represent taxable income.

There were two donations. For each donation, Perez entered into two contracts – one with Donor Source and one with the anonymous intended parent.

The contract with donor source made clear that Perez Was not selling her eggs, explaining instead” that she was being compensated for her physical suffering.”

The contract with the parent stated she was being compensated for “pain, suffering, time, inconvenience, and efforts.”

She did not report her $20,000 of income

IRS Position

Perez made it clear that she was not selling her eggs because she was to receive the compensation whether she produced eggs or not.

It was instead an exchange for services

Tax Court Decision

Tax court reviewed Section 104 regulations as to what “Damages” meant under the section.

Damages are defines as “an amount received(other than workers’ compensation” through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution”.

Perez conceded she had neither sued nor settled with Donor Source, she attacked the very validity of the regulations, arguing that the IRS did not have the power to limit “damages” to amounts received in a lawsuit or due to the threat of one. Instead “damages” should extend to situation where a taxpayer received compensation in money for a loss regardless of legal suit or action

This did not help Perez because she did not receive this money as for any type of action – legal or otherwise –taken after the injuries occurred.

Perez entered into a contract with Donor Source providing for $20,000 of payment **before the injuries took place**.

Even more damning, the injuries were both anticipated and consensual; in fact, they were of the exact nature that Perez was advised to expect when she entered into her contract. Thus Judge Holmes concluded:

“The injury, although painful, was exactly within the scope of the medical procedures to which she contractually consented to twice.

“Her pain was a byproduct of performing a service contract, and we find that the payments were not made to compensate her for some unwanted invasion against her bodily integrity but to **compensate her for services rendered**.

More Bad News for the Marijuana Industry

Section 280E provides that “no deduction is allowed for any amount incurred in a business that consists of trafficking in controlled substances.”

Although the Senate allowed for business to be able to deduct its COGS

Accrual vs Cash

When a taxpayer has inventory, the taxpayer is generally required to report its income on the accrual method.

Under accrual, the taxpayer will capitalize the costs to acquire or produce its inventory and eventually deduct these amounts when units of merchandise are sold as COGS.

The tax reform of 1986 expanded Section 263A which greatly increased the types of costs that are inventor able compared to before.

Under this provision, both producers and sellers are required to capitalize into inventory all of the costs required under G&A costs, such as costs associated with their payroll, legal, and personnel functions. In addition, a reseller also is required to capitalize purchasing, handling, and storage expenses.

This is unfavorable to taxpayers, but favorable to Marijuana manufacturers and retailers. They now would be able to include more of their expenses into COGS, even if it was not deductible until they sale the product.

Problem

Section 263A was not intended to change the character of any expense from nondeductible to deductible.

In other words, that expense must not run afoul of the flush language at the end of Section 263(a)(2) which reads:

> "Any cost which 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".

As a result, the IRS ruled in its Chief Counsel Memorandum that a taxpayer in the marijuana industry, whether medicinal or recreational, may not use the provisions of Section 263A, because the types of G&A expenses the taxpayer would be capitalizing are not deductible under Section 280E.

Parsonage Allowance Gets a Second Life

Freedom from Religion Foundation sued the IRS

Freedom from Religion Foundation's primary purpose is to engage in educational activities promoting nontheistic beliefs and the separation of church and state.

The foundations co-presidents believed they were acting as ministers in a church by delivering their decidedly atheistic gospel. The presidents are paid a salary and a portion is designated as housing

They Sued the IRS stating that “if I am doing the same thing day in and day out as a minister in a church, why should my rental allowance represent taxable income when theirs does not?”

The IRS ruled against them stating that although Section 107 includes members of non-Christian faiths such as Buddhism, there is a difference as having no faith at all.

Furthermore, since atheists have no need for ministers, Further, *Freedom* never filed with the claim, therefore, they were not denied. The plaintiffs claim amounts to nothing more than a generalized grievance about Section 107(s)'s unconstitutionality, which does not support standing.

Although, *Freedom*, did prove to the court that the provision was unconstitutional and discriminatory for several reasons. The Seventh Court did not uphold the merits of the section but instead approved Section 107(2) simply because they decided that a taxpayer cannot challenge the constitutionality of a provision unless they have suffered an injury as a result of that provision. And in this case, there was no injury to the taxpayers because they never bothered to claim the exemption.