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CERTIFIED PUBLIC ACCOUNTANTS

May 10, 2012 – Federal Tax Developments During the First Quarter of 2012

There were many federal tax developments that occurred during the first quarter of 2012. The following highlights some of the more important among them for you. As always, please give our office a call or email if you have any questions, or if you would like to discuss further.

Payroll tax holiday

After weeks of negotiations, Congress approved the Middle Class Tax Relief and Job Creation Act of 2012 on February 17. President Obama signed the Act on February 22. The Act extends the two percent employee-side payroll tax cut through the end of 2012. Individuals who receive wages will pay Old Age, Survivors and Disability Insurance (OASDI) taxes at a rate of 4.2 percent for calendar year 2012 (the same rate they paid in calendar year 2011 but a two percentage point reduction from calendar year 2010). Self-employed individuals also benefit from a rate reduction for 2012. The new law, however, does not reduce the employer-share of OASDI taxes.

IRS Fresh Start initiative

In March, the IRS announced it was expanding its Fresh Start initiative. The IRS raised the threshold for using an installment agreement without having to provide a financial statement from \$25,000 to \$50,000. The agency also indicated that certain unemployed individuals may be eligible for penalty relief.

Corporate tax reform

The Obama administration released a corporate tax reform framework in February. The President proposed to reduce the corporate tax rate to 28 percent in exchange for eliminating many business tax preferences, abolishing the last-in, first-out (LIFO) method of accounting, reforming the treatment of insurance products, and taxing so-called carried interest as ordinary income. The framework also would impose a minimum tax on overseas profits and target some tax relief to small businesses.

Administration's tax proposals

In February, the White House released its FY 2013 budget recommendations, which contained many individual, business and energy tax proposals. Many of the proposals were repeats from past years such as making permanent the research tax credit and the American Opportunity Tax Credit. The President also reiterated his opposition to extending the Bush-era tax cuts for higher income individuals after 2012.

Repair regs

The IRS issued much-anticipated guidance on the capitalization of tangible property (known as the "repair regs"). The temporary and proposed regulations are intended to clarify and expand existing standards for capitalization of specific expenses associated with tangible property and provide some bright-line tests for applying the standards. The IRS subsequently issued guidelines explaining how taxpayers can automatically change their accounting methods to a method permitted under the repair regulations.

In related news, the IRS Large Business and International (LB&I) Division issued a field directive to examiners about capitalization. LB&I instructed its examiners to "stand down" on audits of capitalization issues for pre-2012 tax years.

Foreign accounts

The Foreign Account Tax Compliance Act (FATCA) imposes new reporting requirements on individuals and foreign financial institutions. Treasury and the IRS issued comprehensive proposed FATCA regulations for foreign financial institutions in February. Treasury also announced that it would enter into agreements with five countries (France, Germany, Italy, Spain, and the U.K.) to provide an alternative reporting regime. The IRS also developed Form 8938, Statement of Specified Foreign Financial Assets, for taxpayers to use to satisfy their FATCA reporting requirements.

The IRS announced in January that it would reopen its offshore voluntary disclosure program. The offshore disclosure program provides taxpayers with a reduced penalty framework in exchange for full disclosure of previously unreported foreign accounts. The IRS reserved the right to change the terms or cancel the program at any time going forward.

Foreign tax credit

The IRS issued guidance on the foreign tax credit in February. The "legal liability" final regulations adopt, with changes, proposed regulations issued in 2006. Final, temporary and proposed regulations provide rules under Code Sec. 909 on foreign tax credit splitting events.

Vehicle depreciation limits

The IRS issued limitations on depreciation deductions for owners of passenger automobiles, light trucks and vans first placed in service in calendar year 2012. Generally, depreciation limits for calendar year 2012 are slightly increased from the limits for calendar year 2011. The IRS also provided tables that identify the income exclusion amounts for passenger automobiles, trucks and vans with lease terms beginning in calendar year 2012.

Audits

In January, the IRS announced that it had audited one in eight individuals with incomes over \$1 million in fiscal year (FY) 2011. The audit rate for taxpayers with incomes over \$1 million was 12.48 percent in FY 2011 compared to 8.36 percent in FY 2010. The 2011 IRS Data Book released in March confirmed an uptick in audits of higher-income taxpayers.

Estate tax

In February, the IRS announced an extension of the deadline for certain estates to make a portability election. The portability election is generally available if the first spouse dies in 2011 or 2012. The extension applies to estates of decedents who died in the first six months of 2011.

Tax gap

The tax gap—the difference between what taxpayers owe and what they pay—climbed from \$345 billion in tax year (TY) 2001 to \$450 billion in TY 2006, the most recent year for which statistics are available. Underreporting of income is the largest contributing factor to the tax gap. Despite the increase in the tax gap, the IRS reported that the voluntary compliance rate for TY 2006 was statistically unchanged from TY 2001.

Identity theft

Identity theft is a growing problem, the IRS warned taxpayers in January. In response, the IRS is designing new identity theft screening filters and placing identity theft indicators on taxpayer accounts to track and manage identity theft incidents. The IRS has also issued special Identity Protection Taxpayer Identification Numbers (IP TINs) to taxpayers who have reported being victims of identity theft.

In February, the IRS and the U.S. Department of Justice (DOJ) announced a nationwide crackdown on identity theft. The agencies targeted identity thieves in 23 states and obtained numerous indictments.

Innocent spouse

The IRS proposed to revise the threshold requirements for equitable innocent spouse relief and to streamline determinations of equitable innocent spouse relief. The clarifications would address application of the factors taken into account by the IRS to make a determination.

In January, the Tax Court found that a taxpayer seeking equitable innocent spouse relief was not precluded from obtaining a refund of levied funds because the funds were from a joint account. Under state law, the taxpayer had a 50-percent ownership interest in the joint account.

Damages

The IRS finalized regulations on the Code Sec. 104(a)(2) exclusion from gross income for amounts received on account of personal physical injuries or physical sickness. The final regulations do not require that to qualify for the exclusion, damages received from a legal suit, action or settlement must be based on tort or tort type rights.

S corporations

The Ninth Circuit Court of Appeals held that a Roth IRA is an ineligible S corporation shareholder. Affirming the Tax Court, the Ninth Circuit found that Rev. Rul. 92-73 provides persuasive guidance that IRAs are ineligible S corporation shareholders.

Veterans

The IRS posted frequently asked questions and other materials on its website concerning the Work Opportunity Tax Credit (WOTC) for qualified veterans. The Vow to Hire Heroes Act of 2011 temporarily expanded and enhanced the WOTC for employers that hire unemployed veterans and disabled veterans.

Health care

The IRS and the U.S. Departments of Health and Human Services (HHS) and Labor (DOL) issued guidance on the Patient Protection and Affordable Care Act (PPACA). The agencies posted frequently asked questions about the PPACA's employer-shared responsibility payment and automatic enrollment. The agencies also issued final regulations requiring health care plans to provide summaries of plan benefits and coverage. Additionally, the IRS reminded employers about the small business health insurance tax credit. In the meantime, the Supreme Court heard arguments to assist in its decision on the constitutionality of the insurance coverage mandate and how the rest of the 2010 health care legislation, including many of its tax provisions, should be treated if the mandate is held to be unconstitutional.