

# FRANZEN & FRANZEN, LLP

## CERTIFIED PUBLIC ACCOUNTANTS

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### October 29, 2012 – Third Quarter 2012 Federal Tax Developments

During the third quarter of 2012, a handful of important federal tax developments covered a variety of critical areas. Highlighted below are some of the more significant developments for you. As always, please give our office a call or email if you have any questions.

#### **Legislation**

***Bush-era tax cuts.*** The House and Senate passed competing tax bills before their August recess to extend the Bush-era tax cuts, which are scheduled to expire after 2012. The House bill, the Recession Prevention and Job Protection Act (HR 8), would extend the Bush-era tax cuts for all taxpayers through 2013. The Senate bill, the Middle Class Tax Cut Act (Sen. 3412) would extend the Bush-era tax cuts on incomes up to \$200,000 for single individuals and \$250,000 for families. These bills could serve as frameworks for an extension of the Bush-era tax cuts in the lame-duck Congress before year-end.

***Tax extenders.*** The Senate Finance Committee approved legislation, the Family and Business Tax Certainty Act, to extend many popular but temporary tax incentives that expired at the end of 2011. These provisions, known as tax extenders, include the state and local sales tax deduction, the higher education tuition deduction, the research tax credit, and many more. The full Senate did not take up the bill before recessing in September but could during the lame-duck session before year-end.

***Payroll tax holiday.*** The payroll tax holiday, which reduced the employee-share of OASDI taxes from 6.2 percent to 4.2 percent through 2012 and provided a comparable benefit to self-employed individuals, is scheduled to expire after 2012. At this time, it is unclear if the payroll tax holiday will be extended into 2013.

***MAP-21.*** Congress passed and President Obama signed in July the Moving Ahead for Progress in the 21st Century Act (MAP-21). The new law provides pension funding stabilization, enhances the ability of employers to transfer excess pension assets to fund retiree health benefits, authorizes phased retirement for federal employees, and expands the definition of tobacco manufacturer to include businesses operating roll-your-own cigarette machines. The IRS issued MAP-21 guidance about pension stabilization in August and September.

***Small business.*** Legislation to provide a 10 percent tax credit to small businesses that add payroll in 2012 failed to pass in the Senate in July. The Small Business Jobs and Tax Relief Act (Sen. 2237) would also have extended 100 percent bonus depreciation through 2012.

***Identity theft.*** The House passed the Stopping Tax Offenders and Prosecuting (STOP) Identity Theft Act (HR 4362) in August. The STOP Act directs the U.S. Attorney General to bring more perpetrators of tax return identity theft to justice and take into account the need to concentrate efforts in areas of the country where the crime is most frequently reported.

## **Foreign accounts**

The Treasury Department released model intergovernmental agreements to implement the Foreign Account Tax Compliance Act (FATCA). The agreements aim to implement FATCA's reporting and disclosure requirements for foreign financial institutions (FFIs) through a government-to-government approach. The agreements were developed by the U.S., France, Germany, Italy, Spain, and the United Kingdom.

In related news, the IRS began implementing new streamlined filing compliance programs for qualified nonresident U.S. taxpayers who have not filed income tax returns and statements of financial accounts. The program is open to taxpayers who have lived abroad since 2009 and who have not filed U.S. income tax returns; and whom the IRS deems to be "low-risk."

The Fourth Circuit Court of Appeals found in July that a taxpayer's failure to file an FBAR (Form TD F 90-22.1, Report of Foreign Bank and Foreign Accounts) was willful and upheld significant penalties (Williams, CA-4, July 20, 2012). According to the court, the taxpayer's conduct showed he deliberately failed to file the FBAR and the IRS properly imposed two \$100,000 penalties.

## **Worker classification**

The Tax Court held in July that farm workers engaged by an S corporation were employees and not independent contractors (Twin Rivers Farm, TC Memo. 2012-184). The court found that the S corporation exercised sufficient control over the activities of the workers to treat the workers as employees. As a result, the S corporation was liable for employment taxes on remuneration paid to the workers.

In August, the Tax Court found that masonry workers were employees of an S corporation and not independent contractors (Atlantic Coast Masonry, Inc., TC Memo. 212-233). The S corporation instructed the masons how to perform their work, set the hours and rate of pay, and had the right to discharge workers. All of these factors evidenced that the S corporation was their employer.

## **Per diem rates**

The IRS issued the simplified per diem rates that taxpayers can use to reimburse employees for expenses incurred during business travel after September 30, 2012. The simplified "high-low" per diems for 2013 remain unchanged from 2012 at \$242 for high-cost localities and \$163 for all other localities.

## **Health care**

The Patient Protection and Affordable Care Act (PPACA) generally will require large employers to pay a penalty starting in 2014 if they fail to offer minimum essential health coverage to qualified employees or if the coverage is deemed unaffordable. The IRS issued interim guidance about the PPACA's employer shared responsibility payment.

## **Dependency exemption**

The Tax Court upheld in July the IRS's determination that a married couple residing in Israel were not entitled to dependency exemption deductions because their children were not U.S. citizens during most

of the relevant tax years (Carlebach, 139 TC No.1). The court found that the IRS's regulations requiring U.S. citizenship for the dependency exemption were valid.

### **Commuting expenses**

In July, the Tax Court held that a taxpayer's travel expenses to five temporary work sites were not exceptions to the general rule treating commuting expenses as nondeductible personal expenses (Saunders, TC Memo. 2012-200). The temporary work sites could not be considered outside of the metropolitan area where the taxpayer resided.

### **Audits**

The Treasury Inspector General for Tax Administration (TIGTA) urged the IRS to improve its audits of S corporations. According to TIGTA, more than 60 percent of S corporations were closed without any changes to the returns. The IRS told TIGTA that it intends to analyze S corporation files to better identify which returns from S corporation exams to select for audit.

### **Severance payments**

In September, the Court of Appeals for the Sixth Circuit held that supplemental unemployment benefits (SUB) payments are not wages for purposes of FICA taxes (Quality Stores, CA-6). The court declined to give deference to prior IRS rulings, which had reached a contrary result.

### **Fast track settlement**

The IRS announced in September that its temporary fast-track settlement program for taxpayers in the Tax Exempt and Government Entities (TE/GE) Division is now permanent. Fast-track settlement uses alternative dispute resolution techniques to help taxpayers and the IRS come to an agreement.

### **Aircraft**

The IRS issued final regulations on an employer's deduction for entertainment or recreational use of employer-owned aircraft. The final regulations describe fixed and variable costs, two alternative methods for allocating costs and include many examples.

### **ITINs**

The Treasury Inspector General for Tax Administration (TIGTA) warned in August that individual taxpayer identification numbers (ITINs) are vulnerable to identity theft. The IRS created ITINs in 1996 provide for an identification number to individuals without a Social Security number. TIGTA urged the IRS to more closely monitor the documents that taxpayers provide when they apply for an ITIN to identify problems.

### **Medical loss ratio rebates**

The first round of medical loss ratio rebates were issued in mid-2012. If an insurance company spends less than 80 percent of premiums on medical care (or less than 85 percent in the large group market), it must rebate the portion of premium dollars that exceeded this limit. Whether a rebate is taxable depends on a number of variables.

If you have any questions about these or any other federal tax developments, please contact our office.