

# 2011 TAX YEAR-IN-REVIEW

December 15, 2011

Special Report

## HIGHLIGHTS

- Tax Legislation Makes Important Revisions To Code
- IRS Keeps Focus On Enforcement
- New Tools For Foreign Compliance
- Retirement Developments Affect Individuals And Plans
- Health Care Reform Gets Underway
- Return Preparer Oversight Initiative Rolls Out
- Electronic Filing Continues Strong Growth

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## 2011 Lays Groundwork For Tax Reform, Makes Important Changes Impacting 2012

2011 had been predicted to be a quiet year in federal tax news – as it landed between major tax legislation in 2010 and expected tax reform in 2012 – but the year brought many significant tax developments from the Obama Administration, Congress, the Treasury Department, the IRS, and the courts. President Obama signed bills enacting hiring incentives, repealing three percent government withholding, and more. Congress initiated a national conversation on the pros and cons of tax increases, tax reform, and deficit reduction, which will frame tax proposals for 2012 and beyond. The IRS issued a steady stream of much-needed guidance for businesses and individuals, ratcheted up its attention on tax compliance, particularly in the international area, and continued its multi-prong initiative on return preparer oversight. Meanwhile, the Tax Court and other federal courts handed down decisions of their own, impacting rules for many other taxpayers. This Tax Briefing provides a review of the key tax law developments of 2011 and more.

**IMPACT.** *One common theme during 2011 among practitioners and taxpayers was the lack of certainty in tax planning for future years. The uncertainty was magnified by the scheduled expiration of many tax incentives after December 31, 2011 and the end of the Bush-era tax cuts after 2012, due to extension by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief). Despite the issuance of scores of major rules and regulations in 2011, tax practitioners generally felt*

*that the IRS fell short in providing all the guidance needed to deal with an increasingly complex tax code.*

## TAX LEGISLATION

Over the course of 2011, it became clear that blockbuster tax legislation would essentially remain in a holding pattern until the 2012 presidential elections. “Must-do” tax laws, such as the extension of the payroll tax cut and other temporary “tax extenders,” would be considered, as would “single issue” legislation to cure unpopular provisions such as expanded business payment information reporting, three-percent withholding on government payments to contractors, or patents on tax strategies.

### Payroll Tax Cut

At the time this briefing was prepared, Congress was expected to pass – and President Obama was expected to sign – an extension of the 2011 payroll tax cut. The 2010 Tax Relief Act reduced the employee-share of old age, survivors and disability (OASDI) taxes to 4.2 percent (10.4 percent for self-employed individuals) for calendar year 2011. The employer-share of OASDI taxes remained at 6.2 percent for calendar year 2011. Several competing extension bills have been introduced in Congress.

**IMPACT.** *According to the Congressional Research Service (CRS), an individual earning the national average wage of \$44,687 per year received \$894 in tax*

savings in 2011 from the employee-side payroll tax cut. An individual earning at or above \$106,800 (the Social Security wage base) received \$2,136 in tax savings in 2011 from the payroll tax cut.

## Joint Select Committee on Deficit Reduction

The Budget Control Act of 2011 created a Congressional Joint Select Committee on Deficit Reduction, charged with achieving significant reductions in the federal budget deficit. The Budget Control Act directed the Joint Select Committee to present its proposals, in legislative language, to Congress before November 23. On November 21, the co-chairs of the Joint Select Committee announced that committee members could not reach an agreement on deficit reduction proposals.

**IMPACT.** *The failure of the Joint Select Committee to reach an agreement left unanswered the fate of the Bush-era tax cuts, tax extenders, and other expiring provisions, as well as any hope of tax reform being put on a fast track. The Bush-era tax cuts, it appears, will be left for Congress to address after the 2012 elections.*

**COMMENT.** *President Obama has repeatedly said he will veto any legislation that extends the Bush-era tax cuts for higher income taxpayers, whom President Obama broadly defines as individuals with annual incomes over \$200,000 and married couples with annual incomes over \$250,000.*

**COMMENT.** *The Joint Select Committee was made up of six Democrats and six Republicans, practically guaranteeing gridlock. The committee held few public meetings; most of its work was done behind closed doors. What little news about the deliberations of the committee that did leak out came largely from staffers. According to aides, some Republican members of the committee were willing to discuss repealing limited tax breaks (such as certain oil and gas tax preferences) but*

*the majority of deficit reduction proposals from the GOP would have come from cuts to entitlement programs, which Democrats on the committee refused to accept.*

## Business Information Reporting

President Obama signed the Comprehensive 1099 Taxpayer Protection and Replacement of Exchange Subsidy Overpayments Act of 2011, repealing the expansion of Form 1099 business information reporting scheduled under the Patient Protection and Affordable Care Act (PPACA) to start for payments made on or after January 1, 2012. The PPACA required all businesses, charities and state and local governments to file an information return for all payments aggregating \$600 or more in a calendar year to a single provider of goods or services, other than a payee that is a tax-exempt organization. The PPACA also repealed the reporting exception for payments made to corporations. The Comprehensive 1099 Taxpayer Protection Act repealed the PPACA's expanded business information reporting requirement as if it had never been enacted.

## Rental Property Expense Reporting

The Comprehensive 1099 Taxpayer Protection Act repealed rental property expense reporting enacted by the Small Business Jobs Act of 2010. The 2010 Small Business Jobs Act would have required qualified landlords to report certain rental property expense payments of \$600 or more in conjunction with their rental properties for qualified payments made after December 31, 2010. The Comprehensive 1099 Taxpayer Protection Act repealed rental property expense reporting as if it had never been enacted.

## Government Withholding

President Obama signed the 3% Withholding Repeal and Job Creation Act of 2011 to repeal three percent government withholding on payments to contractors. The new law also provides tax credits to employers that hire military veterans, expands the Code Sec. 6331(h)(3) 100-percent continuous levy to federal vendors relating to property,

in addition to goods or services, and directs the Treasury Department to study the tax compliance of government contractors.

**COMMENT.** *The Tax Increase Prevention and Reconciliation Act of 2005 imposed three percent withholding on payments for goods and services to contractors made by federal, state and local governments. The American Recovery and Reinvestment Act of 2009 delayed implementation of government withholding until January 1, 2011. The IRS subsequently delayed withholding until January 1, 2013. The new law repeals three percent government withholding as if it had never been enacted.*

## Veterans Employment Incentives

The 3% Withholding Repeal and Job Creation Act also provides for an expanded Work Opportunity Tax Credit (WOTC) of up to \$5,600 for employers that hire veterans who have been looking for employment for more than six months. Employers that hire veterans who have been unemployed for more than four weeks but less than six months are eligible for a tax credit reaching \$2,400. Additionally, a tax credit of up to \$9,600 is available to employers that hire veterans with service-connected disabilities who have been looking for employment for more than six months. A tax credit of up to \$4,800 is available to employers that hire veterans with service-connected disabilities who have been looking for employment for less than six months. These incentives are available to individuals who begin work for the employer after the date of enactment of the new law (November 21, 2011) and sunset after December 31, 2012.

## Tax Strategy Patents

In 2011, President Obama signed a comprehensive patent reform bill including a ban on tax strategy patents. The America Invents Act denies a patent for any strategy for reducing, avoiding or deferring tax liability.

**IMPACT.** *Critics of tax strategy patents argued that taxpayers (and their tax*

*advisors) should not risk litigation from patent holders. Critics also observed that the U.S. Patent and Trademark Office (PTO) was granting tax strategy patents without input from the IRS.*

### Health Care Tax Credit

The health coverage tax credit (HCTC) pays for a percentage of qualified health insurance purchased by an eligible individual. The Trade Adjustment Assistance Extension Act of 2011 (2011 TAA Act) increased the percentage for coverage months beginning after February 12, 2011. Under the 2011 TAA Act, the HCTC is scheduled to expire after 2013.

**IMPACT.** *The HCTC is generally available to individuals who receive Trade Adjustment Allowances and individuals age 55 to 65 who receive benefits from the Pension Benefit Guaranty Corporation (PBGC).*

### Health Premium Assistance Credit

To pay for the cost of the 1099 Taxpayer Protection Act, estimated at approximately \$25 billion over 10 years, another health care credit was cut back...but not until 2014. Beginning in 2014, taxpayers who purchase qualified health care coverage through an American Health Benefit Exchange are entitled to a refundable income tax credit equal to the health insurance premium assistance credit. The 1099 Taxpayer Protection Act increases the amount of the excess credit that has to be repaid by the taxpayer by providing an increasing cap based on household income.

The 2011 3% Percent Repeal and Job Creation Act went back to the same well for an offset later in the year, revising the definition of modified adjusted gross income for purposes of qualifying for the credit to include a portion of an individual's Social Security benefits excluded from gross income.

### Preparer EIC Penalty

Individuals who prepare federal tax returns for compensation must meet due

diligence requirements when preparing returns that include a claim for the earned income credit (EIC). The U.S.-Korea Trade Agreement of 2011 increased the penalty for failing to meet the EIC due diligence requirements to \$500 (per occurrence) for returns filed after December 31, 2011.

“One common theme during 2011 among practitioners and taxpayers was the lack of certainty in tax planning for future years.”

### Tax Extenders

At the time this briefing was prepared, a number of temporary tax incentives (known as “tax extenders”) were scheduled to expire after December 31, 2011, unless extended by Congress. The expiring extenders include:

- State and local sales tax deduction
- Transit benefit parity
- Higher education tuition deduction
- Charitable distributions from IRAs
- Teacher's classroom expense deduction
- Research tax credit
- Code Sec. 25C residential energy credit
- Code Sec. 45L energy efficient home construction credit
- Biodiesel and renewable diesel incentives
- Various tax incentives for the District of Columbia

**AMT Patch.** At the time this briefing was prepared, enhanced AMT exemption amounts (part of the so-called “AMT patch”) were scheduled to expire after December 31, 2011. The AMT exemption amounts for 2011 are \$48,450 for single individuals and \$74,450 for married couples filing a joint return and surviving spouses.

**IMPACT.** *If the AMT patch is not extended, the AMT exemption amounts are scheduled to fall after 2011 to \$33,750 for single individuals and \$45,000 for married couples filing a joint return.*

### IRS Budget

At the time this briefing was prepared, Congress was expected to approve an omnibus budget bill for the federal government's 2012 fiscal year. It was unclear if the omnibus budget bill would reduce the IRS's budget for FY 2012.

**COMMENT.** *Earlier in 2011, the House and Senate Appropriations Committees approved FY 2012 budgets for the IRS that fell below what the agency had requested. The IRS recommended a FY 2012 budget of \$13.342 billion. The House Appropriations Committee approved a FY 2012 IRS budget of \$11.516 billion and the Senate Appropriations Committee approved a FY 2012 IRS budget of \$11.663 billion.*

### FUTA Surtax

The 0.20 percent Federal Unemployment Tax Act (FUTA) surtax expired after June 30, 2011. The surtax, originally enacted in 1976, had been renewed in subsequent years, most recently in 2009.

**IMPACT.** *Unless Congress should extend the FUTA surtax retroactively, FUTA taxes for calendar year 2011 are calculated using two rates: 6.2 percent of taxable wages paid through June 30, 2011; and 6.0 percent of taxable wages paid after June 30, 2011. The taxable wage base is the first \$7,000 paid in wages to each employee during a calendar year. The net FUTA tax rate for wages paid through June 30, 2011 is generally 0.8% (6.2% - 5.4%), for a maximum FUTA tax of \$56.00 per employee, per year (.008 x \$7,000 = \$56.00). The net FUTA tax rate for taxable wages paid after June 30, 2011 is generally 0.6% (6.0% - 5.4%), for a maximum FUTA tax of \$42.00 per employee, per year (.006 x \$7,000 = \$42.00).*

**COMMENT.** Employers that pay their state UI taxes on time receive a credit of up to 5.4 percent towards the Federal Unemployment Tax. However, the credit may be reduced in states that have borrowed from the federal government to pay unemployment benefits.

**COMMENT.** Employers pay FUTA by filing Form 940, Employer's Annual Federal Unemployment Tax Return. The IRS posted 2011 Form 940 on its website, reflecting the mid-year expiration of the FUTA surtax.

## DOMESTIC COMPLIANCE MEASURES

Many in Congress view taking steps to increase taxpayer compliance as a relatively straightforward and noncontroversial way to increase tax revenues without raising taxes. Compounded by the economic downturn and the rising national debt, the closure of the tax gap – the difference between what taxpayers owe and what is collected – continued to be a focal point as Congress turns to the IRS for results.

**COMMENT.** The IRS continued the recent trend in 2011 of issuing “guidance” outside of the traditional Revenue Rulings, Notices and other official documents. Details about the 2011 IRS Offshore Voluntary Disclosure Initiative (OVDI), for example, were almost exclusively provided in frequently asked questions (FAQs) posted on the IRS website. IRS officials have explained that FAQs

and other online materials enable the agency to quickly provide information to taxpayers. However, FAQs and other online materials do not provide for a public comment period, or other public input, such as hearings.

### IRS Audits

The IRS audit rate for individual returns filed in fiscal year (FY) 2010 was 1.1 percent, according to statistics released by the agency in 2011 (IR-2011-27). This represented approximately 1.6 million returns out of the approximately 143 million returns filed by individuals. The audit rate for individual returns with positive income of \$1 million or more was 8.4 percent for FY 2010. The FY 2010 audit rate for small corporations (corporations with assets below \$10 million) was 0.9 percent. The FY 2011 audit rate for large corporations was 16.6 percent.

**COMMENT.** The majority of individual audits in FY 2010 were correspondence audits. Nevertheless, a trend toward in-person audits for both individuals and businesses seems to be growing. The Treasury Inspector General for Tax Administration (TIGTA) reported in 2011 that the number of IRS revenue agents and tax compliance officers who conduct audits increased by four percent from FY 2009 to FY 2010. TIGTA also called for increased and more sophisticated audit strategies in connection with small businesses in which the noncompliance rate in some sectors is above 50 percent.

### Fast Track Settlement

The IRS made the Fast Track Settlement (FTS) program available to small businesses and self-employed taxpayers to expedite case resolution in the IRS Small Business and Self-Employed (SB/SE) Division. Under the FTS program, which has met with success in the large business sector, taxpayers can work with IRS Appeals while their cases are still under audit in the SB/SE Division. The IRS, however, limited the FTS SB/SE program to certain locations: Chicago, Houston, St. Paul, Philadelphia, Central New Jersey, and the San Diego/Riverside area of California.

**IMPACT.** The IRS has been actively promoting FTS programs for various taxpayers as a method to speed-up the resolution of cases. A case can take as long as 600 days to reach resolution in IRS Appeals, compared to 80-100 days in FTS.

### Worker Classification

The IRS announced a new program to enable employers to voluntarily reclassify their workers for federal employment tax purposes (IR-2011-95; Ann. 2011-64). The Voluntary Classification Settlement Program (VCSP) is open to employers that currently treat their workers as independent contractors and want to prospectively reclassify the workers as employees. In exchange for prospective treatment of the workers as employees, the IRS is offering a reduced penalty framework. Employers will not be liable for any interest and penalties on the amount and will not be subject to an employment tax audit with respect to the workers being reclassified.

**IMPACT.** The VCSP, the IRS explained, is intended to give employers a streamlined way to voluntarily reclassify their workers as employees. Employers must have consistently treated the workers as nonemployees and must have filed all required Forms 1099 for the workers for the three preceding calendar years (with a six-month grace period).

## SUNSET DATES OF SELECTED TAX INCENTIVES\*

State and local sales tax deduction	12/31/2011
Teacher's classroom expense deduction	12/31/2011
Higher education tuition deduction	12/31/2011
Charitable contributions from IRAs	12/31/2011
Code Sec. 25C energy efficiency credit	12/31/2011
Bush-era reduced income tax rates	12/31/2012
Bush-era reduced capital gains/dividends rates	12/31/2012

\*Sunset dates reflect tax law in effect as of publication of this briefing

**COMMENT.** *Employers under audit by the IRS cannot participate in the VCSP. They may, however, be eligible to participate in the IRS Classification Settlement Program (CSP).*

In other worker classification news, the Tax Court found that an adjunct professor who taught online courses was an employee and not an independent contractor (Schramm, TC Memo. 2011-112, CCH Dec. 58,746(M)). The court found that the university controlled the taxpayer's performance and treated the arrangement as an employer-employee relationship, despite the lack of brick-and-mortar surroundings.

### Broker Information Reporting

Starting with securities purchased in 2011, brokers are required to file information returns that not only provide the IRS and customers with details on the sales proceeds from each trade executed during the year but also the customer's adjusted basis in the security and whether any gain or loss is long- or short-term.

**COMMENT.** *The basis reporting requirement was enacted under the Emergency Economic Stabilization Act of 2008, but carried delayed effective dates to allow brokers time to comply. Basis reporting began for purchases of individual corporate stock on or after January 1, 2011; begins for purchases of mutual fund or dividend reinvestment plan shares using the average basis method on or after January 1, 2012; and begins for other securities as specified by the IRS on or after January 1, 2013.*

The IRS issued proposed regulations in 2011 on information reporting by brokers for transactions related to debt instruments and options (NPRM REG-102988-11). The proposed regulations build on regulations issued in 2010. The types of securities covered by the reporting requirement ("covered securities") include stock

in a corporation, notes, bonds, debentures and other evidence of indebtedness, commodities, commodity contracts or derivatives, and any other financial instrument for which the IRS determines reporting adjusted basis is appropriate.

Elaborating on other basis reporting rules, the IRS also clarified in Notice 2011-56 that a dividend reinvestment plan (DRP) does not fail the requirement that at least 10 percent of every dividend on any stock be reinvested in identical

"The IRS continued the recent trend in 2011 of issuing 'guidance' outside of the traditional Revenue Rulings, Notices and other official documents."

stock if it pays cash in lieu of fractional shares when the cost of a share is greater than the dividend amount. Further, in Notice 2011-18, the IRS provided a transition deadline of January 17, 2012 for corporations that must report any organizational action (such as a stock split, merger or acquisition) occurring in 2011 that affects the basis of stock.

### Limitations Period/Basis Overstatement

The Supreme Court agreed in late 2011 to resolve a split among the Circuit Courts of Appeal whether an overstatement of basis is an omission of gross income for purposes of the Code Sec. 6501(e) six-year limitations period (Home Concrete & Supply, LLC, 2011-1 USTC ¶50,207). In 2010, the IRS issued final regulations specifically applying the six-year limitations period, in contrast to the typical three years, to the assessment of tax attributable to partnership items.

### Merchant Payment Card Reporting

Code Sec. 6050W imposes information reporting requirements on payments made in settlement of payment card and third-party network transactions. The reporting requirement applies to payments made after December 31, 2011. The IRS finalized Form 1099-K, Merchant Card and Third Party Payments, in 2011, revised the rules for certain payment settlement entities making payments outside the U.S., and modified the rules for certain insurance companies. The IRS also delayed backup withholding for payment card transactions.

**IMPACT.** *Certain transactions do not need to be reported, such as a withdrawal of funds at an ATM by a payment card.*

**COMMENT.** *Form 1099-K is similar to other Forms 1099 used to report interest, dividends and other payments.*

### Bank Interest Reporting

The IRS issued proposed regulations (NPRM REG-146097-09) to expand information reporting on bank deposit interest paid to nonresident alien individuals who are residents of any foreign country. At the same time, the IRS withdrew regulations proposed in 2002, which had generally required reporting only in limited cases.

**IMPACT.** *The proposed regulations have generated controversy. Opponents predict the proposed regulations, if finalized, will encourage nonresident alien individuals to move their funds out of U.S. financial institutions.*

### Whistleblowers

Congress overhauled the IRS whistleblower rules in 2006. In 2011, the IRS announced several developments related to the reformed whistleblower rules. The IRS issued final regulations on disclosure of return information to whistleblowers

(T.D. 9516), and described the sources and withholding of whistleblower awards (PMTA 2010-60, 62, 63; PMTA 2011-01, 02).

**COMMENT.** *Under Code Sec. 7623(b) (4), any determination by the IRS regarding an award under Code Sec. 7623(b) may be appealed to the Tax Court within 30 days of the determination.*

**COMMENT.** *The Tax Court granted a whistleblower's request for anonymity, finding that the potential harm from disclosing the whistleblower's identity outweighed the public interest in knowing the whistleblower's identity (Whistleblower, CCH Dec. 58,830). However, the court denied the whistleblower's request to seal the record.*

### Collection Financial Standards

The IRS updated its collection financial standards in 2011. These are used in calculating repayment of delinquent taxes. National standards apply to food, clothing, health care, and certain other expenses. Local standards apply to housing, utilities and certain transportation costs.

### Tax Liens

The IRS announced some taxpayer-friendly changes in its lien processes in 2011 (IR-2011-20). Liens will be withdrawn immediately upon a taxpayer's request once full payment of taxes is made. The IRS will also

allow lien withdrawals for taxpayers entering into a direct debit installment agreement for payment of back taxes and will withdraw a lien if a taxpayer on a regular installment agreement converts to a direct debit agreement. Liens will be withdrawn after a probationary period demonstrating that direct debit payments will be made, the IRS explained.

**IMPACT.** *The distinction between release of a tax lien and withdrawal of a tax lien is important to a taxpayer's credit worthiness, the National Taxpayer Advocate told Congress in 2011. A tax lien that is released generally continues to be reflected on the taxpayer's credit report. When a lien is withdrawn, it is generally removed from the taxpayer's credit report. According to the National Taxpayer Advocate, the number of liens filed by the IRS increased from 168,000 in fiscal year (FY) 1999 to more than one million in FY 2010.*

## FOREIGN COMPLIANCE MEASURES

In enforcing the U.S. system of taxing worldwide income, the IRS has faced the dual challenges of identifying offshore assets or accounts that may generate taxable income and preventing existing rules from being "gamed" to either shelter foreign earnings or repatriate them tax free back into the U.S. In 2011, the IRS aggressively worked both sides of this problem.

### 2011 Offshore Voluntary Disclosure Initiative

The IRS launched a second offshore voluntary disclosure initiative (OVDI) in 2011. The 2011 OVDI (like a similar program in 2009) rewarded taxpayers with a reduced penalty framework in exchange for full disclosure of unreported offshore accounts. The 2011 OVDI covered the period 2003-2010 and closed in September 2011.

The 2011 OVDI generally required taxpayers to pay a penalty of 25 percent of the amount in the foreign bank account in the year with the highest aggregate account balance covering the 2003 to 2010 time period. Certain taxpayers may have qualified for reduced penalties of 12.5 percent and five percent. The 2011 OVDI had a higher penalty rate than the 2009 program; the IRS did not want to reward taxpayers who delayed coming forward. Participants were also required to pay back-taxes and interest for up to eight years as well as accuracy-related and/or delinquency penalties.

**IMPACT.** *The IRS reported in September 2011 that the 2009 offshore voluntary disclosure program resulted in 15,000 disclosures and the 2011 OVDI generated an additional 12,000 disclosures. IRS officials have indicated that there will not be a third disclosure initiative anytime in the near future.*

**COMMENT.** *If the IRS had initiated a civil examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities, the taxpayer was ineligible to come in under the 2011 OVDI. The IRS also prohibited taxpayers under criminal investigation from participating in the program.*

### FBAR

The Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued final rules on Form TD-F 90-22.1,

## INFORMATION REPORTING SCORECARD

Broker Basis Reporting:	
On traded stocks	Transactions after 12/31/10
On mutual fund shares	Transactions after 12/31/11
On "other securities"	Transactions after 12/31/12
Merchant Payment Card Reporting	Payments after 12/31/11
Business Information Reporting	Repealed for payment to corporations
Rental Property Expense Reporting	Repealed
W-2 Reporting of Health Coverage	Optional for 2011 tax year; Small employers exempt until guidance issued

Report of Foreign Bank and Financial Accounts (known as the “FBAR”) (RIN 1506-AB08). Generally, United States persons are required to file an FBAR if the United States person had a financial interest in or signature authority over at least one financial account located outside of the United States; and the aggregate value of all foreign financial accounts exceeded \$10,000 at any time during the calendar year to be reported. The final rules clarify which foreign accounts must be reported, revised the definition of signature authority and made other changes.

**IMPACT.** *The final rules identify which accounts qualify as foreign financial accounts. These include bank accounts and securities accounts. Certain accounts are exempted, including accounts of departments or agencies of the United States and correspondent accounts maintained by banks solely for the purpose of bank-to-bank settlements.*

**COMMENT.** *Reporting is generally required by June 30 of each year. During 2011, however, the Treasury Department and the IRS postponed certain FBAR related deadlines. They announced a one-year extension until June 30, 2012 for filing the FBAR by certain financial professionals with only signature authority over foreign financial accounts (IR-2011-57, FinCEN Notice 2011-1).*

**COMMENT.** *FinCEN announced in 2011 that FBAR filers may opt to file the FBAR electronically.*

## FATCA Reporting

The Foreign Account Tax Compliance Act (FATCA), enacted as part of the Hiring Incentives To Restore Employment Act of 2010, requires certain U.S. taxpayers holding foreign financial assets to report information about those assets on a new form that must be attached to the taxpayer’s annual tax return. FATCA also requires foreign financial institutions (FFIs) to report directly to the IRS certain information about financial accounts held by U.S.

taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

The IRS issued guidance addressing individual reporting of foreign financial assets in late 2011 (TD 9567). The IRS also set forth requirements for certain domestic entities to report foreign financial assets in the same manner as individual taxpayers. Taxpayers will file new Form 8938, Statement of Foreign Financial Assets. The IRS also described the penalties for failing to file Form 8938. However, Form 8938 is not required of individuals who do not have a return filing requirement, the IRS advised.

**IMPACT.** *The foreign financial asset reporting required under FATCA is mandated under the Internal Revenue Code and is separate from the FBAR requirements under the Bank Secrecy Act. Different account levels, disclosure information, filing deadlines and mailing instructions apply to each.*

**Foreign Financial Institutions.** The IRS announced that it intends to provide for a phased implementation of certain FATCA provisions for foreign financial institutions (FFIs) (IR-2011-76, Notice 2011-53). Generally, the IRS will begin accepting FFI applications no later than January 1, 2013.

## Foreign Tax Credit

The IRS issued final regulations on the reduction of foreign tax credit limitations under Code Sec. 904(d) as amended by the American Jobs Creation Act of 2004 (2004 Jobs Act). These regulations continue a strict “baskets” approach, fine-tuning certain recapture and safe harbor rules. The IRS also issued final regulations targeting highly-structured cross-border transactions used by certain taxpayers to artificially generate higher foreign tax credits (T.D. 9535, T.D. 9536).

**COMMENT.** *The 2004 Jobs Act reduced the number of limitations categories to two: passive category income and gen-*

*eral category income. Under this basket system, the total amount of foreign tax credit available to the taxpayer for the tax year in each basket is limited to its portion of U.S. tax liability allocated to that basket. Prior law used a system of nine baskets that Congress in 2004 decided was too complex.*

## Triangular Reorganizations

The IRS issued final regulations to prevent use of triangular reorganizations to repatriate earnings (T.D. 9526). The so-called “Killer B” regulations target what the IRS views as an abusive practice by certain entities to repatriate the earnings of a foreign subsidiary tax-free.

**IMPACT.** *Some corporations have used the triangular reorganization structure to transfer property held offshore to a domestic parent or subsidiary tax free. The IRS, however, has viewed this tax-free treatment as an abusive device to repatriate earnings from a foreign subsidiary to the parent and now has the force of a Treasury regulation to enforce that position.*

## HEALTH CARE REFORM

The tax law is an integral component of the new health care reform package (the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act), providing tax incentives to promote certain behavior or directions and tax penalties to discourage others. Developments in 2011 illustrated the key role that the IRS plays in the tax component of health reform.

## W-2 Reporting

The IRS expanded interim relief from reporting the cost of employer-provided health insurance coverage on Forms W-2 as required by the Patient Protection and Affordable Care Act (PPACA) for small employers (Notice 2011-28). Small employers are excused from reporting until further guidance is issued.

**IMPACT.** *A small employer for purposes of Notice 2011-28 is an employer required to file fewer than 250 Forms W-2 for the preceding calendar year.*

### Small Employer Tax Credit

The IRS reminded small employers about the Code Sec. 45R small employer health insurance tax credit. Small employers may be eligible to claim the credit to offset the costs of providing health insurance to employees. Through 2013, the Code Sec. 45R credit reaches 35 percent (25 percent for tax-exempt employers). For 2014-2015, the Code Sec. 45R credit reaches 50 percent (35 percent for tax-exempt employees).

**COMMENT.** *The Treasury Inspector General for Tax Administration (TIGTA) reported in 2011 that the Code Sec. 45R credit is under-utilized by small employers. TIGTA attributed under-utilization to the complexity of ascertaining who is a qualified employee for purposes of the credit, the temporary nature of the credit and a general unawareness of the credit among small businesses.*

### Branded Prescription Drug Fees

The PPACA imposes an annual fee on manufacturers and importers of certain branded prescription drugs offered for sale in the United States (Code Sec. 9008). In 2011, the IRS created a dispute resolution process for covered entities that disagree with the agency's calculation of their preliminary Code Sec. 9008 fee (Rev. Proc. 2011-24).

### Employer Shared Responsibility

The PPACA imposes assessable payments on certain large employers after 2013 that generally fail to offer full-time employees the opportunity to enroll in minimum essential coverage under an employer plan or that offer full-time employees the opportunity to enroll in minimum essential coverage but the coverage is deemed unaffordable (in addition to other requirements). In 2011, the IRS described how it may implement the employer shared

responsibility provisions of the PPACA (IR-2011-50, Notice 2011-36). The IRS also requested comments on how an "employer" should be defined, the calculation of the number of full-time employees, and the calculation of an employer's assessable payment and more.

### Premium Assistance Tax Credit

The IRS issued proposed regulations on the Code Sec. 36B refundable health insurance premium assistance tax credit under the PPACA (NPRM REG-131491-10). Eligibility for the credit, the IRS explained, would

"The economic downturn continued to play a role during 2011 in the area of business deductions and credits, generally—but not always—encouraging the IRS to interpret relevant tax law more liberally."

be based on a number of factors, including income and family size. An individual must be enrolled in a qualified plan through an American Health Benefit Exchange.

**IMPACT.** *The PPACA generally requires individuals to carry minimum essential coverage for themselves and their dependents after 2013. Individuals with household incomes within certain ranges of the federal poverty line may qualify for the Code Sec. 36B refundable health insurance premium assistance tax credit to offset the cost of securing coverage through an American Health Benefit Exchange. Congress used this premium assistance tax credit twice in 2011 tax legislation to offset the costs of repealing other provisions. The 1099 Taxpayer Protection Act increases the amount of excess credit required to be*

*repaid and the 3% Withholding Repeal and Job Creation Act adjusts the Social Security income component in calculating the credit.*

**COMMENT.** *Under the PPACA, states generally must establish an American Health Benefit Exchange by January 1, 2014 to provide qualified individuals access to health plans.*

### Plan Benefits Summary

The IRS, along with the U.S. Departments of Health and Human Services (HHS) and Labor (DOL), issued proposed regulations on the PPACA's requirement that summaries of plan benefits be in "plain English" (NPRM REG-140038-10). The agencies developed a template for plans to use.

**IMPACT.** *Under the proposed regulations, all health insurance issuers and group health plans must make available the plain English summary by March 23, 2012.*

## BUSINESS ENTITIES

Many business tax strategies increasingly rely on advantageous "entity selection" to more effectively recognize income and distribute profits. In 2011, "pass-throughs" and "disregarded entities" continued to predominate choice of entity concerns.

### Disregarded Entities

IRS regulations treat disregarded entities as corporations for employment tax purposes. As a result, they cannot qualify for the FICA and FUTA exceptions because the individual owner is no longer considered the employer. In response to concerns from business owners, new temporary, proposed and final regulations apply the family and religious member FICA and FUTA exceptions to disregarded entities (T.D. 9554).

**IMPACT.** *A disregarded entity will continue to be treated as a corporation*

*for all employment tax purposes, except the entity will be disregarded for the limited purposes of applying the family and religious member FICA and FUTA exceptions.*

## Partnerships

The IRS proposed to remove an existing regulation that exempts *de minimis* interests in a partnership from being tested for their substantial economic effect (NPRM REG-109564-10). According to the IRS, the change is necessary to prevent improper use of the *de minimis* rule.

The IRS also issued proposed regulations updating the definition of an interest in a limited partnership as a limited partner for purposes of the Code Sec. 469 passive activity loss (PAL) rules (NPRM REG-109369-10). The proposed regulations would treat an interest in a limited liability company (LLC) as a limited partnership for purposes of the Code Sec. 469 PAL rules.

## S Corporations

The Court of Federal Claims held in 2011 that a taxpayer who conducted his business as an individual and through several S corporations created a “unified business enterprise” engaged in a business for profit (Morton, 2011-1 USTC ¶50,346). As a result, one or more of the S corporations could deduct expenses and take depreciation deductions because the taxpayer could impute his business activities and the business activities of one entity to his other entities.

**COMMENT.** *According to the IRS, the largest segment of the S corporation universe is retail and wholesale trade. This sector makes up about 15 percent of all S corporations.*

## BUSINESS DEDUCTIONS/ CREDITS

The economic downturn continued to play a role during 2011 in the area of business

deductions and credits, generally—but not always—encouraging the IRS to interpret relevant tax law more liberally than it might otherwise. Inflation-adjusted vehicle caps and mileage rates also helped many businesses owe a little less tax in 2011.

## Bonus Depreciation

The 2010 Small Business Jobs Act extended the placed-in-service date for the 50-percent additional first year depreciation deduction to property placed in service before 2011 (before 2012 in the case of certain longer-lived and transportation property). The 2010 Tax Relief Act boosts 50-percent bonus depreciation to 100-percent for qualified investments made after September 8, 2010, and before January 1, 2012. The 2010 Tax Relief Act also makes 50-percent bonus depreciation available for qualified property placed in service after December 31, 2011 and before January 1, 2013. Certain long-lived property and transportation property is eligible for 100-percent expensing if placed in service before January 1, 2013.

In 2011, the IRS issued much-anticipated guidance on bonus depreciation under the 2010 Small Business Jobs Act and the 2010 Tax Relief Act (Rev. Proc. 2011-26). The IRS explained how taxpayers can elect to take 50-percent, rather than 100-percent, bonus depreciation, retroactive application of 50 percent bonus depreciation and more.

**IMPACT.** *Rev. Proc. 2011-26 provides a safe harbor method of accounting which provides relief from an anomalous result caused by the interaction of the 100 percent bonus depreciation rate and the Code Sec. 280F depreciation limits for passen-*

*ger automobiles. Without the safe harbor, a taxpayer will only be able to deduct during the vehicle's regular recovery period an amount equal to the first-year cap.*

## Small Business Expensing

Enhanced Code Sec. 179 small business expensing is scheduled to continue through 2012 but at less generous amounts than in 2011. The Code Sec. 179 dollar limit for tax years beginning in 2012 is \$139,000 (adjusted for inflation) and the investment limit for tax years beginning in 2012 is \$560,000 (adjusted for inflation).

**COMMENT.** *The Code Sec. 179 expense deduction is available for off-the-shelf computer software placed in service in tax years beginning in 2012.*

## 2011 Vehicle Depreciation Limits

The IRS issued limitations on depreciation deductions for owners of passenger automobiles and trucks and vans first placed in service by the taxpayer during calendar year 2011 (Rev. Proc. 2011-21). The maximum depreciation limits under Code Sec. 280F for passenger automobiles first placed in service during the 2011 calendar year are: \$11,060 for the first tax year (\$3,060 if bonus depreciation is not taken); \$4,900 for the second tax year; \$2,950 for the third tax year; and \$1,775 for each tax year thereafter.

The maximum depreciation limits under Code Sec. 280F for trucks and vans first placed in service during the 2011 calendar year are: \$11,260 for the first tax year (\$3,260 if bonus depreciation is not taken); \$5,200 for the second tax year; \$3,150 for

## SELECTED 2012 INFLATION ADJUSTMENTS\*

Standard deduction (singles)	\$5,950
Standard deduction (married couples filing jointly)	\$11,900
Personal exemption amount	\$3,800
“Kiddie tax”	\$900
Gift tax annual exclusion	\$13,000

\*Source: Rev. Proc. 2011-51

the third tax year; and \$1,875 for each tax year thereafter.

### Mileage Rates

**Mid-year adjustment.** In 2011, the IRS made a mid-year adjustment to the optional mileage rates to reflect an increase in gasoline prices (IR-2011-69; Ann. 2011-40). The business standard mileage rate increased from 51 cents-per-mile to 55.5 cents-per-mile for business miles driven on or after July 1, 2011 and on or before December 31, 2011. The medical/moving standard mileage rate increased from 19 cents-per-mile to 23.5 cents-per-mile for medical/moving miles driven on or after July 1, 2011 and on or before December 31, 2011.

**IMPACT.** *Taxpayers are not permitted to average the two rates for 2011. The 2011 mid-year adjustment requires taxpayers to maintain two records of miles driven in 2011 (one for the first six months of 2011 and another for the second half of 2011).*

**2012 rates.** For 2012, the business standard mileage rate remains 55.5 cents per mile and the medical/moving rate is 23 cents-per-mile (IR-2011-116). The charitable rate, which is determined by statute and not the IRS, remains at 14 cents per-mile for 2012.

### Business Travel

The IRS issued the simplified per diem rates that taxpayers can use to reimburse employees for expenses incurred for business travel after September 30, 2011. The IRS also abandoned plans to discontinue the “high-low” method for substantiating travel expenses (Notice 2011-82; Rev. Proc. 2011-47).

**COMMENT.** *The IRS-approved per diem rate for high cost areas for 2012 is \$242 (\$177 for lodging and \$65 for meals and incidental expenses). The IRS-approved per diem for all other areas for 2012 is \$163 (\$111 for lodging and \$52 for meals and incidental expenses).*

### Employer-Provided Cell Phones

The IRS issued guidance on the treatment of employer-provided cell phones as an excludible fringe benefit. Generally, when an employer provides an employee with a cell phone primarily for noncompensatory business reasons, the business and personal use of the cell phone is nontaxable to the employee. The IRS also announced in a memorandum to examiners a similar administrative approach that applies with respect to arrangements common to small businesses that provide cash allowances and reimbursements for work-related use of personally-owned cell phones.

**IMPACT.** *The change in treatment is intended to simplify recordkeeping requirements for employers and employees. The IRS also recognized that cell phones, once rare for business use, have become commonplace, indeed necessary, in everyday business and personal use.*

**COMMENT.** *The Small Business Jobs Act of 2010 removed cell phones and similar telecommunications equipment from the “listed property” designation for tax years beginning after December 31, 2009.*

### Real Estate Activities

The IRS released procedures in 2011 to allow qualified real estate professionals to make a late election to aggregate rental real estate interests for applying the passive activity loss rules under Code Sec. 469 (Rev. Proc. 2011-34). The new procedure, the IRS explained, is in lieu of the letter ruling procedure that would otherwise be used to obtain relief for a late election.

### Economic Substance Doctrine

The IRS issued updated instructions to examiners on the codified economic substance doctrine (LB&I-4-0711-015). The IRS instructions detailed the various steps

examiners must take to determine if the codified economic substance doctrine is applicable to a particular taxpayer.

**COMMENT.** *The Health Care and Education Reconciliation Act of 2010 codified the economic substance doctrine. Since codification, the IRS appears to be taking a measured approach to applying the doctrine.*

### Compensation

Code Sec. 162(m) generally provides that compensation paid to certain highly-compensated employees by publicly-held corporations is not deductible if it exceeds \$1 million; however, there is an exception for certain performance-based compensation. The IRS issued proposed regulations addressing the treatment of performance-based compensation attributable to stock options and stock appreciation rights (NPRM REG-137125-08).

### Goodwill

The Ninth Circuit Court of Appeals found that goodwill proceeds from the sale of a dental practice belonged to the personal service corporation (PSC) and were not personal assets, subject to taxation as long-term capital gain (Howard, 2011-2 USTC ¶50,602). The taxpayer had entered into an employment agreement with the PSC that included a non-competition provision. The economic value of the personal relationships he established belonged to the PSC because of the employment agreement and the non-competition provision.

### Advance Pricing Agreements

The IRS announced that the agency’s Advance Pricing Agreement (APA) program and its Mutual Agreement Program (MAP) will move to the Large Business and International (LB&I) Division to form a new Advance Pricing and Mutual Agreement Program. The IRS predicted that the merged program will reduce the time needed to complete advance pricing agreements

and to resolve transfer pricing disputes with treaty partners.

### Notional Principal Contracts

The IRS issued final, temporary and proposed regulations intended to broaden the rules allowing nontaxable transfers of notional principal contracts and other derivative contracts (T.D. 9538; NPRM REG-109006-11). The regulations describe when the transfer or assignment of a derivative contract is not a taxable exchange to the nonassigning counterparty.

## TAX ACCOUNTING DEVELOPMENTS

Timing considerations and the method under which business income and expenses are recognized can become complicated, often adding costs and uncertainties to what should be otherwise routine tax accounting matters. 2011 saw the IRS develop “safe harbors” and other pro-business timing and reporting rules to help.

### Accounting Methods

The IRS updated the procedures to obtain automatic consent for a change in accounting method in Rev. Proc. 2011-14. The IRS added to the list of automatic consent changes in accounting method relating to the deduction of amounts paid or incurred for energy efficient property under Code Sec. 179D. The IRS also provided for automatic consent for changes in accounting method related to California franchise taxes, modified the procedures relating to certain employee compensation bonuses, and clarified certain LIFO provisions.

### Employee Bonuses

The IRS revisited employee bonuses in Rev. Rul. 2011-29. The agency determined that an employer, using an accrual method of accounting, can establish “fact of liability” under the first prong of Code Sec. 461’s all events test for bonuses payable to a group of employees. The IRS will allow this treat-

ment even though the employer would not know the identity of any specific recipient and the exact amount payable to that recipient until after the end of the tax year.

**IMPACT.** *Rev. Rul. 2011-29 stands in contrast to the IRS’s prior position on this issue that the taxpayer had to know the identity of the recipient and the exact amount payable to the recipient before claiming any deduction. In Washington Post Co, 405 F.2d 1279 (1969), the U.S. Court of Claims held that an employer incurred a liability to pay bonuses under a plan maintained for the benefit of its circulation dealers as a group. If a dealer did not meet certain specified conditions, a portion of the dealer’s share would be forfeited and reallocated to other dealers. As a result, even though the amount and time of actual payout to individual recipients were, at least in part, not determined, the court held that the total amount of the liability was fixed at the end of the tax year. The IRS announced in Rev. Rul. 76-345 that it would not follow Washington Post. The IRS revoked Rev. Rul. 76-345 in Rev. Rul. 2011-29.*

**COMMENT.** *Any change in a taxpayer’s treatment of bonuses to conform with Rev. Rul. 2011-29 is considered a change in accounting method.*

### Gift Cards

In Rev. Proc. 2011-17, the IRS provided a safe harbor method of accounting for accrual method merchants that issue gift cards to customers in exchange for returned merchandise. In Rev. Proc. 2011-18, the IRS allowed merchants to defer

recognizing in gross income advance payments received from the sale of gift cards redeemable for goods or services of the taxpayer or a third party.

### OID Accruals

The IRS issued a proposed revenue procedure to allow taxpayers to use a simplified method of accounting to allocate original issue discount (OID) on a pool of credit card receivables to an accrual period (Notice 2011-99). The method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity of the pool that is paid by cardholders during the period.

### Electric Utilities

The IRS issued guidance providing a safe harbor method of accounting for determining whether to deduct or capitalize certain electric transmission and distribution property expenses (Rev. Proc. 2011-43). The guidance also identifies certain expenses that are *per se* capital expenditures.

### Advance Payments

IRS Chief Counsel explained how a taxpayer under examination, wanting to change its method of accounting for advance payments under Rev. Proc. 2011-14 may satisfy the requirement to file a copy of the application with the IRS during certain window periods (CCA 201145013).

**COMMENT.** *The IRS also issued instructions to examiners about accounting method changes for advance payments (LB&I-4-1111-018).*

## MANDATORY E-FILING FOR SPECIFIED TAX RETURN PREPARERS\*

Year	Threshold
Returns filed in 2011	100 or more covered returns
Returns filed in 2012	11 or more covered returns

\* Source: [www.irs.gov](http://www.irs.gov)

## INDIVIDUALS/ PERSONAL TAX

Given the varied profiles of the 175 million individuals projected to file 2011 tax returns, the potential impact of significant developments for 2011 cover a wide range of issues. However, the most controversial issue raised during 2011 for individual taxpayers – whether to extend all or a part of the Bush-era income tax rates beyond 2012—remained unresolved.

### *Innocent Spouse Relief*

The IRS abandoned its two-year limitations period for requesting Code Sec. 6015(f) equitable innocent spouse relief (IR-2011-80; Notice 2011-70). The IRS successfully defended the two year limitations period in several court cases (Mannella, CA-3, 2011-1 USTC ¶50,159; Lantz, CA-7, 2010-1 USTC ¶50,446). However, the Tax Court found the two-year limitations period was contrary to Congress' intent (Lantz, CCH Dec. 57,784).

### *Domestic Partners*

The IRS described the tax treatment of registered domestic partners in community property states on its website ([www.irs.gov](http://www.irs.gov)). The IRS reviewed the filing status of registered domestic couples, Schedule C filed by registered domestic couples and various tax credits and registered domestic couples.

**COMMENT.** *Under the Defense of Marriage Act (DOMA), registered domestic couples and same-sex couples married under state law cannot file their federal income tax returns using a married filing jointly (or separately) status. The Senate Judiciary Committee approved legislation in 2011 to repeal DOMA but the bill failed to win enough support to pass in the Senate.*

### *Disaster Relief*

The IRS issued numerous guidance items in response to natural disasters in 2011. The guidance detailed filing and payment relief

for victims of devastating storms across the southern United States, victims of Hurricane Irene and Tropical Storm Lee, and many other disasters.

### *Ponzi Schemes*

The IRS modified previously-released guidance on claiming a theft loss from a Ponzi scheme (Rev. Proc. 2009-20). The modified guidance expands the optional safe harbor for claiming a theft loss to include situations in which the lead figure in a Ponzi scheme has died (Rev. Proc. 2011-58).

### *Tax Scams*

The IRS warned taxpayers about various tax scams around the country (IR-2011-73). The IRS advised taxpayers to be alert for offers of “refunds” of Social Security taxes; inflated claims for the earned income credit (EIC), and claims for expired tax credits, among other false claims.

### *Medical Costs*

The Tax Court found that amounts paid for long-term care of an individual with dementia were deductible under Code Sec. 7702B(c) (Estate of Baral, CCH Dec. 58,685). The individual's physician had determined that she needed 24-hour care; therefore the costs of employing two caregivers were qualified long-term care services and deductible.

### *Conservation Easements*

The Tax Court ruled in 2011 on a series of cases about charitable contributions of conservation easements (Kaufman, CCH Dec. 58,588; Boltar, CCH Dec. 58,593; Tempel, CCH Dec. 58,594). In Kaufman, the Tax Court found that the façade easement contribution failed to comply with IRS regulations. In Boltar, the Tax Court found that it was within its discretion to reject a valuation prepared by the taxpayer's experts. In Tempel, the Tax Court found that the sale of a state conservation easement generated short term capital gain as opposed to ordinary income.

### *Contribution Substantiation*

IRS Chief Counsel determined that a charitable organization's Form 990 could not substitute as an acknowledgment of a taxpayer' donation (CCA 201120022). The Tax Code imposes various substantiation requirements on donations of money, property and other items to charitable organizations. In this case, the taxpayer failed to obtain a contemporaneous written acknowledgment from the charity for his contribution. Chief Counsel determined that the taxpayer could not satisfy the contemporaneous written acknowledgment requirement by reference to Form 990.

**COMMENT.** *The Omnibus Budget Reconciliation Act of 1993 required that taxpayers obtain a contemporaneous written acknowledgment for certain contributions. The Pension Protection Act of 2006 expanded and enhanced the contemporaneous written acknowledgment requirement.*

## RETIREMENT DEVELOPMENTS

Replenishing depleted retirement savings was a common theme in the retirement planning community in 2011. In 2011, the IRS issued guidance on a variety of retirement savings plans and announced the 2012 cost-of-living limits for qualified plans.

### *2012 COLA Limits for Qualified Plans*

Cost-of-living adjustments (COLAs) for qualified plans for 2012 reflect an uptick in inflation, the IRS announced (IR-2011-103). Among the highlights are (not an exhaustive list):

- The limits on elective deferrals for employees who participate in 401(k), 403(b), 457 plans and the federal government's Thrift Savings Plan increase from \$16,500 for 2011 to \$17,000 for 2012.

- The limitation for Code Sec. 415(c)(1) (1) defined contribution plans increases from \$49,000 for 2011 to \$50,000 for 2012.

**COMMENT.** *The catch-up amount for individuals age 50 and over to an IRA, 401(k) plan and certain other savings arrangements remains unchanged for 2012 at \$5,500.*

## Social Security Wage Base

The Social Security wage base increases from \$106,800 for 2011 to \$110,100 for 2012, the Social Security Administration (SSA) announced ([www.socialsecurity.gov](http://www.socialsecurity.gov)). The SSA also announced that the domestic employee coverage threshold is \$1,800 for 2012; earnings below the threshold are not subject to Social Security tax.

**IMPACT.** *Because of the calendar year 2011 employee-side payroll tax holiday, an employee pays \$4,485.60 on earnings of \$106,800 or more.*

## Contributions

The Tax Court in 2011 rejected the IRS's attempts to recast a payment of dividends to an IRA as an excess contribution (Ohsman, CCH Dec. 58,617(M)). According to the Tax Court, the IRS failed to challenge the income tax treatment of the dividend distributions and could not rely on the substance over form doctrine to recharacterize the dividend payments.

## Actuarial Tables

The IRS finalized regulations on the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. The final regulations reflected the most recent-available census data.

## Church Plans

The IRS announced that church organizations applying for a letter ruling regarding the status of the church's retirement plan

under Code Sec. 414(e) must give notice to plan participants and other interested persons (Rev. Proc. 2011-44)

## Plan Amendments

The IRS issued a sample plan amendment that plan sponsors may adopt to satisfy Code Sec. 436 regarding limitations on the accrual and payment of benefits under certain underfunded single employer defined benefit plans (Notice 2011-96). The IRS also extended the deadline to amend a plan to satisfy Code Sec. 436 and the period during which such an amendment is eligible for relief from the anti-cutback requirements of Code Sec. 411(d)(6).

**COMMENT.** *The Pension Protection Act of 2006 enacted Code Sec. 436, which generally provides for limitations on the accrual and payment of benefits under an underfunded plan.*

## ESTATE PLANNING

After passing estate tax provisions in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, Congress did not act on any other estate tax proposals in 2011. The IRS issued guidance on the estate tax provisions in the 2010 Tax Relief Act in 2011.

### Decedents Dying in 2010

The 2010 Tax Relief Act revived the federal estate tax for 2010 with an exclusion of \$5 million and a maximum rate of 35 percent. The 2010 Tax Relief Act also gave estates of decedents dying in calendar year 2010 an election to opt out of the federal estate tax (known as the "Code Sec. 1022 election") and apply a modified carryover basis regime. The IRS developed Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent," for estates of decedents dying in 2010 to make the Code Sec. 1022 election.

**COMMENT.** *Form 8939 is generally due January 17, 2012. The IRS provided*

*certain limited exceptions for filing Form 8939 after January 17, 2012.*

**COMMENT.** *For 2012, the applicable unified estate and gift tax exclusions are \$5,120,000 (an increase of \$120,000 from 2011).*

## Spousal Portability

The IRS provided guidance for estates electing to transfer the unused federal estate tax exclusion of a deceased spouse to a surviving spouse (a portability election) (IR-2011-97, Notice 2011-82). The 2010 Tax Relief Act provides for portability of the exclusion between spouses for decedents dying after December 31, 2010 and before January 1, 2013.

## Protective Estate Tax Claims

The IRS explained how decedents' estates can file protective claims for a refund of estate taxes based on a potential deduction for an unpaid claim or expense (Rev. Proc. 2011-48). The protective claim must describe in detail the claim or expense, the ground on which the refund is claimed and more.

## EXEMPT ORGANIZATIONS

In 2011, the IRS took a number of steps to help tax-exempt organizations that may have inadvertently lost their exempt status. The IRS also issued guidance impacting exempt organizations and generally recorded an uptick in audits of exempt organizations of all sizes, from hospitals and foundations to community-based charities.

### Reinstatement of Exempt Status

The IRS announced a special program to help organizations whose tax-exempt status was automatically revoked to regain their status. Small tax-exempt organizations must apply for reinstatement of tax-exempt status and pay a reduced user-fee. Generally, the application for reinstatement of tax-exempt status must be made within 15 months of revocation of tax-exempt status.

**COMMENT.** *The Pension Protection Act of 2006 (PPA) requires all tax-exempt organizations, with the exception of churches and church-related organizations, to file an information return with the IRS. An organization that fails to file for three consecutive years automatically loses its tax-exempt status.*

**COMMENT.** *The 15-month period is measured from the later of the revocation letter or the posting of the organization's name on the IRS's website on the list of organizations whose tax-exempt status has been automatically revoked.*

### Gift Tax Examinations

The IRS announced that it would not pursue gift tax examinations of contributions to Code Sec. 501(c)(4) organizations while the agency reviews the need for additional guidance or legislation in this area (IRS website announcement). The IRS also issued instructions to its examiners not to pursue gift tax examinations of contributions to Code Sec. 501(c)(4) organizations.

**COMMENT.** *Code Sec. 501(c)(4) organizations are social welfare organizations. To be tax-exempt, an organization must not be organized for profit and must be operated exclusively to promote social welfare.*

## RETURNS AND RETURN PREPARATION

The IRS continued its concerted push to move more taxpayers to electronic filing.

The IRS also implemented more phases of its return preparer oversight initiative in 2011.

### Electronic Filing

Specified tax return preparers are subject to new electronic filing requirements (T.D. 9518). Beginning January 1, 2011, specified tax return preparers who reasonably expected to file 100 or more covered returns in calendar year 2011 generally had to file those returns electronically. The threshold for mandatory electronic filing by specified tax return preparers is 11 or more covered returns in calendar year 2012 and subsequent years.

**IMPACT:** *The electronic filing requirement applies to any return of income tax imposed by subtitle A of the Internal Revenue Code on individuals, estates and trusts. At this time, the IRS has noted several administrative exemptions to mandatory electronic filing, including forms which the agency cannot process electronically.*

**COMMENT.** *Firms must compute the number of covered returns, in the aggregate, they reasonably expect to file as a firm. If that number is 11 or more in calendar year 2012 and subsequent years, all members of the firm must electronically file their returns.*

**COMMENT:** *Specified tax return preparers may request a waiver from mandatory electronic filing because of undue hardship. The IRS has cautioned it intends to grant few waivers.*

**COMMENT.** *The IRS reported in 2011 that more than one billion tax returns have been filed electronically since the electronic filing program rolled out nationwide more than 20 years ago.*

### Return Preparer Oversight

The IRS fine-tuned its return preparer oversight initiative in 2011. The IRS unveiled a registered tax return preparer examination (IR-2011-111) and provided more details about continuing education for registered tax return preparers (IR-2011-115). The IRS also began enforcing its new requirement that all return preparers who prepare returns for compensation use a preparer tax identification number (PTIN) (IR-2011-47; Ann. 2011-29). Additionally, the IRS issued final Circular 230 Rules of Practice (T.D. 9527).

**IMPACT.** *At this time, the IRS is exempting certified public accountants (CPAs), enrolled agents (EAs), attorneys, supervised preparers, non-Form 1040 series preparers, and certain other individuals from taking the registered tax return preparer examination. However, the IRS has indicated it may revisit this treatment in the future.*

**COMMENT.** *The IRS's proposal to fingerprint certain PTIN applicants generated controversy. The IRS announced in 2011 that it would delay the fingerprinting proposal pending further study.*

### Refunds

The Treasury Department launched a pilot program in 2011 to issue federal income tax refunds to individuals on prepaid debit cards. Individuals can make cash withdrawals from the prepaid debit cards at ATMs.

**COMMENT.** *In November 2011, the IRS reported that it had \$153.3 million in undelivered tax refunds.*

### Documents

The IRS issued final regulations under Code Sec. 7502(c) on how to show evidence of

## REGULATORY REVIEW

At the request of President Obama, all federal departments and agencies identified areas for regulatory reform. The Treasury Department described more than 40 areas in which existing regulations could be streamlined, clarified or repealed.

**IMPACT.** *Some of the IRS regulations identified under the Treasury plan include (but are not limited to) accuracy-related penalties, the home office deduction and substantiation of charitable contributions.*

delivery of documents to the agency in cases where there is no direct proof of actual delivery. The IRS described when registered or certified mail is prima facie evidence of delivery. The IRS also extended the prima facie evidence of delivery rule under Code Sec. 7502(c) to services provided by a designated private delivery service.

### Schedule UTP

In 2011, the IRS clarified its “policy of restraint” in connection with Schedule UTP, Uncertain Tax Positions. Under the IRS policy of restraint, if a document is otherwise privileged under the attorney-client privilege, the Code Sec. 7525 tax advice privilege, or the work product doctrine, and the document was provided to an independent auditor as part of an audit of the taxpayer’s financial statements, the IRS will not assert during an examination that privilege has been waived by such disclosure. In 2011, the IRS indicated that the policy of restraint with respect to Schedule UTP would apply to documents requested by Appeals.

**COMMENT.** *Beginning with the 2010 tax year, certain taxpayers with both uncertain tax positions and assets equal to or exceeding \$100 million are required to file Schedule UTP if they or a related party issued audited financial statements. Affected taxpayers (at this time) are corporations required to file a Form 1120, U.S. Corporation Income Tax Return, insurance companies required to file a Form 1120-L, U.S. Life Insurance Company Income Tax Return or Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return; and foreign corporations required to file Form 1120-F, U.S. Income Tax Return of a Foreign Corporation.*

### Schedule M-3

The IRS clarified the reporting of research and development expenditures on Schedule M-3, Net Income (Loss) Reconciliation for Corporations with Total Assets of \$10 Million or More. The IRS made the clarification in a frequently asked question (FAQ) on its website.

### Filing Deadlines

The IRS finalized regulations providing an automatic five-month extension to file most partnership, estate and trust returns (T.D. 9531). The IRS explained that the five-month period, in contrast to alternative proposals, reduces the overall burden and strikes the most reasonable balance for taxpayers.

### Code Sec. 6707A Penalties

The IRS issued final regulations on the Code Sec. 6707A reportable transaction penalty (T.D. 9550). The final regulations reflect modifications to the Code Sec. 6707A penalty made by the Small Business Jobs Act of 2010. The IRS also identified various factors it will take into account when considering whether to rescind a Code Sec. 6707A penalty.

**IMPACT.** *The 2010 Small Business Jobs Act revised the amount of the Code Sec. 6707A penalty to make the penalty proportionate to the decrease in tax shown on the taxpayer’s return as a result of the reportable transaction (or which would have resulted from the reportable transaction if it were respected for federal tax purposes). The 2010 Small Business Jobs Act also established maximum and minimum penalty amounts.*

**IMPACT.** *Under the 2010 Small Business Jobs Act, the penalty for failure to make a disclosure in an SEC filing is no longer treated exclusively like a Code Sec. 6707A penalty for failure to disclose a listed transaction as required by Code Sec. 6011. The final regulations adopt the rule that the Code Sec. 6707A(e) penalty for failing to disclose certain penalties in SEC filings will be rescinded if the IRS rescinds in full the Code Sec. 6707A penalty for failing to disclose under Code Sec. 6011 the reportable transaction that underlies the Code Sec. 6707A(e) penalty.*

### Online Tools

The IRS launched a new app (IRS2Go) in 2011 for smartphones allowing users to check the status of their refunds. The IRS app also provides tax tips and access to IRS news. The IRS also posted on its website a new tool to enable taxpayers to obtain tax transcripts.

### IRS Buyouts

The IRS announced in November 2011 that it offered buyouts and early outs to approximately 5,400 employees. The IRS reported that employees who accept the buyouts (Voluntary Separation Incentive Payments) and early outs (Voluntary Early Retirement) would go off the agency’s payroll by December 31, 2011.

**IMPACT.** *Employee-related expenses account for the majority of the IRS’s budget. In the face of possible budget cutbacks, IRS Commissioner Douglas Shulman said that buyouts and early outs for back-office personnel would be two tools to reduce expenses. The IRS employs more than 100,000 individuals.*