I. Important Tax Updates

A. The Payroll Tax Holiday Extended.

1. The Act provides that the “payroll tax holiday period” means calendar years 2011 and 2012. (Sec. 601(c) of the 2010 Tax Relief Act, as amended by Act Sec. 1001(a))

2. Thus, the 2-percentage point payroll tax reduction and the 2-percentage point reduction in the OASDI tax under the SECA tax for the self-employed will apply through Dec. 31, 2012.

3. As a result, for 2012, employees will pay only 4.2% Social Security tax on wages up to $110,100 (wage base for 2012) and self-employed individuals will pay only 10.4% Social Security self-employment taxes on self-employment income up to $110,100.

a. The maximum savings for 2012 will be $2,202 (2% of $110,100) per taxpayer. If both spouses earn at least as much as the wage base, the maximum savings will be $4,404.

b. Additionally, the Act repeals the recapture provisions applying to taxpayers with wages exceeding $18,350 over the first two months of 2012. (Sec. 601(g) of the 2010 Tax Relief Act, as amended by TTCA Sec. 101(a), repealed by Act Sec. 1001(b)).

B. Repeal of Shifts in Estimated Payments Corporations.

1. Congress has on many occasions modified the estimated tax payment schedule for large corporations (those with assets of at least $1 billion, determined as of the end of the preceding tax year).

2. Under recent such shifts in estimated tax payments for large corporations:

a. Payments due in July, August or September of 2012, were to have been increased to 100.5% of the payment otherwise due;

b. Payments due in July, August, or September, 2014, were to have been increased to 174.25% of the payment otherwise due;

c. Payments due in July, August or September, 2015, were to have been increased to 163.75% of the payment otherwise due;

d. Payments due in July, August, or September 2016 were to have been increased to 103.5% of the payment otherwise due; and

e. Payments due in July, August or September, 2019, were to have been increased to 106.50% of the payment otherwise due.

3. All of the above shifts in estimated tax payments for large corporations are repealed.

C. Estates Qualifying for Extended Deadline to make Portability Election.

1. Portability in General

a. The Tax Relief Act of 2010 added a new portability feature for estates of decedents dying after 2010 and before 2013, under which the applicable exclusion amount is the sum of (1) the basic exclusion amount (i.e., $5 million with an adjustment for inflation after 2011), and (2) in the case of a surviving spouse, the deceased spousal unused exclusion (DSUE) amount. (Code Sec. 2010(c)(2))

b. The DSUE is the lesser of:

(1) the basic exclusion amount, or

(2) the excess of the basic exclusion amount of the last deceased spouse dying after Dec. 31, 2010, of the surviving spouse, over the amount on which the tentative tax on the estate of the deceased spouse is determined. (Code Sec. 2010(c)(4))

c. A surviving spouse may use the DSUE amount in addition to his or her own $5 million exclusion (as adjusted for inflation after 2011) for taxable transfers made during life or at death.

d. If a surviving spouse is predeceased by more than one spouse, the amount of unused exclusion that is available for use by the surviving spouse is limited to the lesser of $5 million (as adjusted for inflation after 2011) or the unused exclusion of the last deceased spouse. (Code Sec. 2010(c)(4)) This so-called "last deceased spouse" limitation applies whether or not the last deceased spouse has any unused exclusion, and whether or not his or her estate makes a timely election to allow the surviving spouse to use the DSUE amount.

e. A DSUE amount may not be taken into account by a surviving spouse unless the executor of the estate of the deceased spouse files an estate tax return on which the amount is computed, and makes an election on the return that the amount may be taken into account by the surviving spouse.

(1) Even if an estate isn't required to file a Form 706 (e.g., because the value of the gross estate is less than the exclusion amount), a Form 706 must be filed in ordered to make the election.

(2) The election, once made, is irrevocable. No election may be made if the estate tax return of the deceased spouse is filed after the due date (including extensions) for filing the return.

2. Notice 2012-21

a. Notice 2012-21 grants to qualifying estates (see below), for the purpose of making a portability election, a six-month extension of time for filing Form 706. The extension applies when the executor of a qualifying estate did not file a Form 4768 within nine months after the decedent's date of death, and therefore the estate did not receive the benefit of the automatic six-month extension.

b. An executor of a qualifying estate that wants to obtain the extension must file Form 4768 no later than 15 months after the decedent's date of death. With the extension granted by Notice 2012-21, the Form 706 of a qualifying estate will be due 15 months after the decedent's date of death. (Notice 2012-21,Sec.1).

3. <u>Qualifying Estates</u>

a. The extension is available to qualifying estates of decedents who are U.S. citizens or residents.

b. A qualifying estate is an estate in which:

(1) The decedent is survived by a spouse;

(b) The decedent's date of death is after Dec. 31, 2010, and before July 1, 2011; and

(c) The fair market value of the decedent's gross estate does not exceed $5,000,000. (Notice 2012-21, Sec. 4.01)

c. An estate is not a qualifying estate if it effectively requested an automatic six-month extension of time to file Form 706 under Reg. § 20.6081-1(b) by timely filing Form 4768 on or before the due date for filing Form 706. (Notice 2012-21, Sec. 4.02)

d. If it is later determined that an estate does not meet the requirements of a qualifying estate, no extension will be treated as granted under Notice 2012-21, and the Form 706, therefore, won't be timely. (Notice 2012-21, Sec. 4.03) .

D. <u>New Capitalization Rules</u>

1. The IRS has issued new regulations for determining whether amounts paid to acquire, produce, or improve tangible property may be currently deducted as business expenses or must be capitalized.

2. The regulations will affect virtually all taxpayers that acquire, produce, or improve tangible property.

3. They are comprehensive, voluminous and virtually rewrite the rules in this area. For example:

a. They provide detailed definitions of “materials and supplies” and “rotable and temporary spare parts”;

b. Prescribe new rules and elective *de minimis* and optional methods for handling their cost.

c. They also have rules for differentiating between deductible repairs and capitalizable improvements, among many other items.

d. The regulations generally are effective in tax years beginning after Dec. 31, 2011. However, to add to their complexity, some of the new rules in the regulations do not supersede prior IRS guidance

E. Reopen Voluntary Disclosure Program

1. The Service is reopening its amnesty program, which allows individuals with undeclared accounts abroad to turn themselves in and avoid criminal prosecution by paying any back taxes due plus penalties.

2. The previous two rounds of amnesty brought in more than $4 billion.

3. Now, the IRS is getting information on scofflaws from more Swiss banks, and it’s working on getting data from banks in other countries.

4. Unlike prior amnesty programs, the new version will have slightly higher penalties for those who failed to report large account balances and will continue indefinitely.

F. New Foreign Asset Reporting Guidance and Form

1. The IRS issued detailed guidance on the new law requiring individuals with an interest in a “specified foreign financial asset” during the tax year to attach a disclosure statement to their income tax return for any year in which the aggregate value of all such assets is greater than $50,000 (or a dollar amount higher than $50,000 as the IRS may prescribe).

2. In addition, the IRS issued Form 8938 (Statement of Specified Foreign Financial Assets), which individual taxpayers will use starting in the 2012 tax filing season to report specified foreign financial assets for tax year 2011.

a. The guidance consists of detailed temporary regulations.

b. They define terms that apply for purposes of the reporting requirement; provide rules to determine if a specified individual must file a Form 8938 with their annual return; define what are specified foreign financial assets; detail what information needs to be reported; provide guidelines for valuing specified foreign financial assets; list exceptions to the reporting requirements; and describe the penalties that apply for failure to comply with the reporting requirements

G. Innocent Spouse.

1. Notice 2012-8, 2012-4 IRB, IR 2012-3 updating Rev Proc 2003-61, 2003-2 CB 296 was issue3d by the IRS revising threshold requirements for equitable relief and the factors used in evaluating IS requests under section 6015(f).

2. Section 4.03(2)(b) set minimum standards for the economic hardship equitable factor in determining whether relief should be granted. Further, the lack of finding hardship will not weigh against relief.

3. Section 4.03(2)(c)(i) states that actual knowledge of the item giving rise to an understatement or deficiency will no longer be weighed more heavily than other factors. Further, if the nonrequesting spouse abused the requesting spouse or maintained financial control over the household expenses, then that will weigh in favor of relief even if the requesting spouse had knowledge or reason to know of the items giving rise to the understatement or deficiency.

4. Section 4.03(2)(c)(ii) provides that the Service will consider whether or not the requesting spouse reasonably expected the nonrequesting spouse to pay the liability within a reasonably prompt time when determining whether the requesting spouse had knowledge or reason to know that the nonrequesting spouse would not pay the tax reported as due.

5. Section 4.03(2)(d) states that the IRS will consider the requesting spouse's legal obligation to pay as a factor in determining whether equitable relief should be granted.

6. Section 4.03(2)(f) includes the requesting spouse's subsequent compliance with all Federal income tax laws as a factor that may weigh in favor of relief.

H. Fresh Start Initiative

1. In General

a. On March 7, 2012, the Internal Revenue Service today announced a major expansion of its "Fresh Start" initiative to help struggling taxpayers by taking steps to provide new penalty relief to the unemployed and making Installment Agreements available to more people.

b. Under the new Fresh Start provisions, part of a broader effort started at the IRS in 2008, certain taxpayers who have been unemployed for 30 days or longer will be able to avoid failure-to-pay penalties.

c. In addition, the IRS is doubling the dollar threshold for taxpayers eligible for Installment Agreements to help more people qualify for the program.

2. Penalty Relief

a. The IRS announced plans for new penalty relief for the unemployed on failure-to-pay penalties, which are one of the biggest factors a financially distressed taxpayer faces on a tax bill.

b. To assist those most in need, a six-month grace period on failure-to-pay penalties will be made available to certain wage earners and self-employed individuals.

c. The request for an extension of time to pay will result in relief from the failure to pay penalty for tax year 2011 only if the tax, interest and any other penalties are fully paid by Oct. 15, 2012.

d. The penalty relief will be available to two categories of taxpayers:

- Wage earners who have been unemployed at least 30 consecutive days during 2011 or in 2012 up to the April 17 deadline for filing a federal tax return this year.
- Self-employed individuals who experienced a 25 percent or greater reduction in business income in 2011 due to the economy.

e. This penalty relief is subject to income limits. A taxpayer's income must not exceed $200,000 if he or she files as married filing jointly or not exceed $100,000 if he or she files as single or head of household. This penalty relief is also restricted to taxpayers whose calendar year 2011 balance due does not exceed $50,000.

f. Taxpayers meeting the eligibility criteria will need to complete a new *Form 1127A* to seek the 2011 penalty relief. The new form is available on IRS.gov.

g. The failure-to-pay penalty is generally half of 1 percent per month with an upper limit of 25 percent. Under this new relief, taxpayers can avoid that penalty until Oct. 15, 2012, which is six months beyond this year's filing deadline. However, the IRS is still legally required to charge interest on unpaid back taxes and does not have the authority to waive this charge, which is currently 3 percent on an annual basis.

h. Even with the new penalty relief becoming available, the IRS strongly encourages taxpayers to file their returns on time by April 17 or file for an extension. Failure-to-file penalties applied to unpaid taxes remain in effect and are generally 5 percent per month, also with a 25 percent cap.

3. Installment Agreements

a. The Fresh Start provisions also mean that more taxpayers will have the ability to use streamlined installment agreements to catch up on back taxes.

b. The IRS announced today that, effective immediately, the threshold for using an installment agreement without having to supply the IRS with a financial statement has been raised from $25,000 to $50,000. This is a significant reduction in taxpayer burden.

c. Taxpayers who owe up to $50,000 in back taxes will now be able to enter into a streamlined agreement with the IRS that stretches the payment out over a series of months or years. The maximum term for streamlined installment agreements has also been raised to 72 months from the current 60-month maximum.

d. Taxpayers seeking installment agreements exceeding $50,000 will still need to supply the IRS with a Collection Information Statement (Form 433-A or Form 433-F). Taxpayers may also pay down their balance due to $50,000 or less to take advantage of this payment option.

e. An installment agreement is an option for those who cannot pay their entire tax bills by the due date. Penalties are reduced, although interest continues to accrue on the outstanding balance. In order to qualify for the new expanded streamlined installment agreement, a taxpayer must agree to monthly direct debit payments.

f. Taxpayers can set up an installment agreement with the IRS by going to the On-line Payment Agreement (OPA) page on IRS.gov and following the instructions.

g. These changes supplement a number of efforts to help struggling taxpayers, including the “Fresh Start” program announced last year. The initiative includes a variety of changes to help individuals and businesses pay back taxes more easily and with less burden, including the issuance of fewer tax liens.

4. Offers in Compromise

a. Under the first round of Fresh Start, the IRS expanded a new streamlined Offer in Compromise (OIC) program to cover a larger group of struggling taxpayers. An offer-in-compromise is an agreement between a taxpayer and the IRS that settles the taxpayer’s tax liabilities for less than the full amount owed.

b. The IRS recognizes that many taxpayers are still struggling to pay their bills so the agency has been working to put in place more common-sense changes to the OIC program to more closely reflect real-world situations.

c. For example, the IRS has more flexibility with financial analysis for determining reasonable collection potential for distressed taxpayers.

d. Generally, an offer will not be accepted if the IRS believes that the liability can be paid in full as a lump sum or through a payment agreement. The IRS looks at the taxpayer’s income and assets to make a determination regarding the taxpayer’s ability to pay.

5. Tax Lien Thresholds

a. The IRS will significantly increase the dollar thresholds when liens are generally filed. The new dollar amount is in keeping with inflationary changes since the number was last revised. Currently, liens are automatically filed at certain dollar levels for people with past-due balances.

b. The IRS plans to review the results and impact of the lien threshold change in about a year.

c. A federal tax lien gives the IRS a legal claim to a taxpayer’s property for the amount of an unpaid tax debt. Filing a Notice of Federal Tax Lien is necessary to establish priority rights against certain other creditors. Usually the government is not the only creditor to whom the taxpayer owes money.

d. A lien informs the public that the U.S. government has a claim against all property, and any rights to property, of the taxpayer. This includes property owned at the time the notice of lien is filed and any acquired thereafter. A lien can affect a taxpayer's credit rating, so it is critical to arrange the payment of taxes as quickly as possible.

6. <u>Tax Lien Withdrawals</u>

a. The IRS will also modify procedures that will make it easier for taxpayers to obtain lien withdrawals.

b. Liens will now be withdrawn once full payment of taxes is made if the taxpayer requests it. The IRS has determined that this approach is in the best interest of the government.

c. In order to speed the withdrawal process, the IRS will also streamline its internal procedures to allow collection personnel to withdraw the liens.

7. <u>Direct Debit Installment Agreements and Liens</u>

a. The IRS is making other fundamental changes to liens in cases where taxpayers enter into a Direct Debit Installment Agreement (DDIA). For taxpayers with unpaid assessments of $25,000 or less, the IRS will now allow lien withdrawals under several scenarios:

(1) Lien withdrawals for taxpayers entering into a Direct Debit Installment Agreement.

(2) The IRS will withdraw a lien if a taxpayer on a regular Installment Agreement converts to a Direct Debit Installment Agreement.

(3) The IRS will also withdraw liens on existing Direct Debit Installment agreements upon taxpayer request.

b. Liens will be withdrawn after a probationary period demonstrating that direct debit payments will be honored.

c. In addition, this lowers user fees and saves the government money from mailing monthly payment notices. Taxpayers can use the Online Payment Agreement application on IRS.gov to set-up with Direct

Debit Installment Agreements.

I. <u>CPA Charged with Ordering the Murder of his clients</u>

1. A former Internal Revenue Service agent and CPA, Martinez, was charged with mail fraud, procuring a false tax return, fraudulent use of a Social Security number of another person, aggravated identity theft, making false tax return, money laundering, and aiding and abetting, in an attempt to scheme money from his wealthy clients.

2. He would prepare the clients' federal and state income tax returns which showed the client owed a substantial amount of tax to either entity. He would have the client submit a check to him payable to nominee entities, and then claimed he would forward the cash to the IRS or State tax Board. He would then prepare false returns, showing less tax owed, and would submit those to the government agencies.

3. Two former clients were expected to testify against Martinez during his trial on charges that he defrauded the government of $11 million (*United States v. Martinez*, S.D. Cal., No. 11-cr-01445-WQH, *complaint filed* 3/2/12).

4. Martinez offered a former employee $100,000 to "eliminate" the two former clients. The employee contacted the FBI, and worked with them to record conversations about the murder plot with Martinez and his former limo driver, who was going to arrange payment once the murders were com

J. <u>Freddie Mitchell Indicted</u>

1. Former Philadelphia Eagle wide receiver Freddie Mitchell was indicted in Florida for his role in a false tax return scheme.

2. Mitchell, along with Jaime Russ-Walls and Richard Walls, husband and wife, allegedly filed false returns claiming refunds ranging from $170,000 to $1,9 million. Mitchell was recruited by Walls and Russ-Walls to recruit professional athletes as clients.

3. One professional athlete, referred to as A.G., made an $100,000 down payment, and the false returns were filed without his knowledge. Russ-Walls was alleged to receive $600,000 and Mitchell $280,000 from filing the false returns.

4. Walls and Russ-Walls also filed false returns for Mitchell's company, Chameleon Enterprises, claiming more than $2 million for refund.

According to Howard Eskin, Mitchell is claiming he was scammed and not part of the scheme.

K. Good News for Gamblers

J. Jumbo Mortgages

II. Recent Cases and Rulings

A. Interest paid to State Tax Exempt

1. Interest paid to Pennsylvania under a formal settlement agreement on installment payments to taxpayers from an eminent domain suit were exempt from federal tax under §103.

2. Gross income does not include interest on any State or local bond, but only when the obligation arises from the State's borrowing power, not by operation of law.

3. The petitioner won an eminent domain suit against Pennsylvania and were entitled to just compensation.

4. The formal settlement agreement was for $40.9 million, which was allocated between principal and interest.

5. The petitioner excluded the interest payments from their gross income and the IRS assessed tax on that amount.

6. The Court held that Pennsylvania's obligation to the petitioner and the interest rate applied to this amount arose from a settlement negotiated at arms-length, not by operation of law.

7. After the eminent domain suit, the state's obligation transformed from a mandatory one to a voluntary one when they sat down at the bargaining table.

B. Tax Attorney cannot deduct expenses of travel

1. An attorney's travel expenses for commuting between his home and law firm officer were commuting expenses and not deductible business expenses.

2. The taxpayer was a partner at a law firm 62 miles from his home. During the year in question, he split it time approximately 60/40 between his home office and his firm office, which he went to only a few days a week.

3. The taxpayer deducted all of his travel expenses between his home and office and to meet clients on his Schedule C.

4. The court held that these expenses were not deductible because the taxpayer did not establish that his home office was his primary office and his working from home was more for his convenience.

a. Also, he did not establish that his mileage was not reimbursable by his employer or clients.

b. It is implied that mileage from meeting clients and generating new business for the firm could have been reimbursable had the taxpayer produced a description of his mileage.

C. Douglas R. Caton v. Commissioner, TC Memo 2012-92

1. Petitioner filed "zero returns" for taxable years 2004 and 2005, but received almost $200,000 in wages for each year.

a. Petitioner claimed on his W-4 filed with his employer that he was exempt from income tax, so none was withheld by the employer.

b. Respondent (IRS) did not accept the returns filed by petitioner, and subsequently filed Substitute For Returns (SFR), and issued a deficiency in tax. Respondent added penalties for fraudulent failure to file under Section 6651(f), failure to pay under Section 6651(a)(2), and failure to pay estimated tax under Section 6654.

2. Petitioner conceded that he received the money, but maintained that it was not taxable income.

3. Court held that the respondent met its burden in each of the arguments and therefore petitioner received taxable wages, petitioner was liable for 6651(f) fraudulent failure to file penalty, failure to pay penalty under Section 6651(a)(2), failure to pay estimated taxes under Section 6654, and that petitioner had to pay a $5,000 penalty for raising frivolous or groundless positions in front of the court under Section 6673(a)(1).

D. Court invalidates Special Use Valuation Reg barring Partial election under 25%

1. In Carolyn Finfrock v. U.S. (DC IL 3/20/2012) 109 AFTR 2d ¶ 2012-596, the District Court in applying the so-called "Chevron test", found that Treasury Regulation 20.2032A-8(a)(2) is invalid.

2. Under step one of the Chevron test, the Court looks to the language of the statute, Section 2032A, to determine if it is silent or ambiguous on the issue – "whether an executor can elect for special valuation property that constitutes less than 25% of the gross value of the adjusted value of the gross estate."

3. The Court found that the statute was unambiguous in providing that an executor can do so. The Court then determined that the treasury regulation did not support the plain meaning of the above statute because the regulation imposed an additional requirement that was in direct contradiction to the plain language of the statute.

4. As such, the regulation was determined to be invalid. The case remains open pending resolution of other matters.

E. Volunteer Chairman of Tax Exempt Organization was liable for Trust Fund Penalty

1. In *Bunch v. U.S.*, a district court concluded that the volunteer chairman of the board of a tax-exempt organization, who was seeking a refund of his payment of Sec. 6672 trust fund recovery payment, failed to carry his burden of proving that he wasn't a responsible person who willfully failed to pay over withholding taxes.

2. Perceptions, Inc. was a non-profit corporation that provided supportive living services for developmentally disabled clients and received funding from the state of Tennessee.

3. The petitioner was Perceptions Chairman of the Board from the initial organization until dissolution. He never received a paycheck and was not initially involved in Perceptions financial affairs, but played an active role in the organization.

4. In December of 2006, the petitioner learned that the third quarter 2006 taxes were unpaid, and lent Perceptions money to pay these taxes.

5. In June of 2007, petitioner became actively involved in the financial affairs of Perceptions.

6. In March of 2008, IRS assessed a trust fund recovery penalty against The petitioner, who made a payment of $193,952 for the second and fourth quarters of 2006 and all four quarters of 2007.

7. Petitioner then sought a refund in court. He acknowledged that

he was a responsible person for the payment of taxes after June 2007, when he became actively involved in Perceptions financial affairs, but argued that he wasn't one before that date.

8. The district court held that the petitioner failed to carry his burden of proving he wasn't a responsible person for the entire period at issue since he had the status, as Chairman of the Board, and the authority required to be a responsible person.

a. Although he had no ownership interest, did not hire or fire employees, or have check writing authority, the petitioner exerted significant and substantial control over its financial affairs by acting as a de facto line of credit.

b. By simply withholding his periodic loans, he had the ability to force Perceptions out of business and thus, the court found that he could have exercised almost total control over Perceptions, certainly to the extent of assuring payment of trust fund taxes.

c. The fact that the petitioner chose not to exercise his authority or acquire available knowledge did not absolve him of his responsibility to see that withholding taxes were paid.

d. Even if the petitioner did not have actual knowledge of the tax delinquency, his conduct was found to have constituted the requisite recklessness to meet the willfulness element.

F. <u>Executor personally liable for Estate Tax</u>

1. In *US v. David A. Tyler & Louis J. Ruch (DC PA 03/13/2012)* Co-Executors of a decedent's estate were personally liable for the decedent's unpaid taxes under the federal priority status because they distributed assets from the estate, the distributions rendered the estate insolvent, and it took place after they had actual knowledge of the decedent's liability for the unpaid taxes.

2. The decedent owned property in Pennsylvania with his wife as tenants by the entirety.

3. After the tax was assessed, the decedent transferred the property to his wife for $1 and then the IRS filed a notice of federal tax lien. The decedent died a few years later and his wife died shortly thereafter.

4. The co-Executors (of both estates) transferred the property to

one of the Executors for $1 and that Executor later sold the property for $300,000.

5. The court held that the federal tax lien survived the death of the decedent because he terminated the tenancy by the entirety before his death, the spouse was not a §6323 purchasers, and that the IRS had followed all the collection procedures. Therefore, the co-Executors were personally liable as fiduciaries.

G. Past Basis miscalculation kills S shareholders pass-through loss deduction

1. In Barnes, TC Memo 2012-80, husband and wife shareholders in an S-Corporation has a suspended loss that could not be deduct because they each had zero basis in their stock.

2. However, each reported a gain on their individual 1996 return which was not reflected on the K-1's. In 1997, the shareholders contributed capital to increase their basis and claimed a deduction for a portion of the suspended loss even though there was sufficient basis to deduct the entire suspended loss.

3. The shareholders failed to adjust their basis in the stock due to the loss pass through. In 2003, the S-corporation reported another loss, and the shareholders deduct the entire amount on their individual returns. The 2003 deduction was partially disallowed because the Service claimed the shareholders had insufficient basis to take the entire loss deduction.

4. The Court held that the upward basis adjustment in 1996 was unfounded and denied; that the basis in 1997 was reduced by the entire amount of each shareholders pro rata share of the loss, even if the shareholder does not claim the entire amount on his individual return; that the tax benefit rule under Section 111 did not apply; and, that the record did not provide evidence that 1997 created a net operating loss that could be carried forward to 2003, an argument the taxpayers did not raise until after trial.

H. Fifth Circuit holds that attorneys were employees of S corporation law firm

1. The Court of Appeals for the Fifth Circuit held that associate attorneys and a law clerk were employees of an S corporation law firm, resulting in the law firm being liable for employment taxes and penalties in 2003 and 2004.

2. The Donald G. Cave Professional Law Corp. was incorporated in 1993 as a professional law corporation, and was an S corporation for Federal

Income Tax purposes in 2003 and 2004.

3. Donald Cave was the firm's president and sole shareholder.

4. In those years, Cave believed it was appropriate for the Firm to treat three associate attorneys and a law clerk as independent contractors because he did not have sufficient control over their work.

5. The IRS determined that the associate attorneys and clerk were the Firm's employees for 2003 and 2004 and that the firm was liable for employment taxes and penalties.

6. The Tax Court agreed with the IRS.

7. On appeal, the Fifth Circuit concluded that the Tax Court did not clearly err in its factual findings and correctly determined that attorneys and law clerk were firm employees rather than independent contractors because: (i) the attorneys and law clerk were not exposed to losses, (ii) the firm provided offices and equipment, which showed the attorneys and clerk made no investment in the facilities of the business, and (iii) because the attorneys maintained continuous and exclusive relationships with the firm and did not offer their services to the public in any capacity other than as attorneys of the Cave Law firm.

I. <u>Justice Shuts down Alleged $300 Million Tax Scheme</u>

1. The defendants set up two offshore companies that they claimed operated plans that provided benefits to participating companies' employees.

2. They would target high-income professionals who owned small businesses.

3. The business would make tax-free transfers to these offshore companies for the insurance plans. The money was then transferred to other offshore accounts for "investment," but these other accounts were actually owned by the initial transferors.

4. Therefore, the businesses were getting back, tax-free, the money they had transferred tax-free.

J. <u>Taxpayers who Willfully Failed to Pay over Withholding Taxes was Liable for Trust Fund Penalty</u>

1. In *Kobus v. US* (Ct. Fed. Cl. 02/28/2012) - the U.S. Court of Federal Claims has concluded that a taxpayer was a responsible person liable for the §6672 trust fund recovery penalty because he willfully failed to pay over

withholding taxes.

2. Under §6672(a), if an employer fails to properly pay over its payroll taxes, IRS can seek to collect a trust fund recovery penalty equal to 100% of the unpaid taxes from a "responsible person," i.e., a person who: (i) is responsible for collecting, accounting for, and paying over payroll taxes; and (ii) willfully fails to perform this responsibility.

3. A responsible person is willful if he: (i) pays other creditors after he knows of the employer's failure to pay the withheld funds to IRS; or (ii) recklessly disregarded a known risk that the taxes weren't being paid over.

4. A person doesn't act willfully if the corporation has no funds that can be paid to IRS. Nor is a person liable for failing to pay over to IRS funds in which another creditor has a lien or interest that is superior to IRS's interest.

L. Residence Interest Limits for Unmarried Co-owners Apply on a Per-residence Basis

1. In consolidated cases, the Tax Court has concluded that the §163(h)(3) limitations ($1 million of acquisition indebtedness and $100,000 of home equity indebtedness) are applied on a per-residence basis, and not per-individual basis.

2. Thus, unmarried co-owners were collectively limited to a deduction for interest paid on a maximum of $1.1 million, rather than $2.2 million, of acquisition and home equity indebtedness.

M. PLR201214014 – Conversion of partnership to corporation treated as Section 351 exchange

1. Under a Section 351 exchange no gain or loss is recognized on property transferred to a corporation solely in exchange for stock, if the transferor(s) are in control of the corporation immediately after the transfer.

2. Under Section 357(a), if the corporation assumes liabilities in connection with the above exchange, the exchange still remains tax-free, unless the liabilities assumed exceed the transferor's adjusted basis in the transferred property, then gain is recognized to the extent of the excess under Section 357(c)(1).

N. Taxpayer can't use Mailbox Rule

III. Estate and Gift Tax

A. Transfer of Lottery ticket – Taxable Gift

1. In Dickerson, TC Memo 2012-60, the taxpayer, who worked as a waitress, received a winning lottery ticket from a customer. The following day, her family created an S-Corporation, with the taxpayer being a 51% owner, and three family members holding a 17% interest each. The taxpayer transferred the lottery to the corporation, and then claimed the prize a few days later on the corporation's behalf.

2. The taxpayer was unable to claim the prize because of a claim against a share of the ticket by her coworkers. After several years in court disputing the claim by the coworkers, the Alabama Supreme Court held that the taxpayer was entitled to all of the lottery winnings.

3. In 2007, the taxpayer filed a gift tax return, but claimed that there was no taxable gift resulting from the transfer to the corporation. The taxpayer argued that there was a binding and enforceable contract under state law for her to transfer the lottery ticket to the family corporation based on the family's oral agreement to share lottery winnings should a member of the family ever win.

4. The Tax Court held that there was no enforceable contract because there was no written agreement, and the statements made regarding an oral agreement were too indefinite, uncertain, incomplete, and made over several years. The Tax Court held that the alleged agreement would have been void under Alabama's antigambling statute. The Court further held that there was not a partnership among the family members nor that the partnership was the owner of the lottery ticket. The Court cited to the lack of a pattern buying lottery tickets, and that the father, not the family as a whole, decided how the proceeds would be divided. See also Reg 25.2511-1(h)(1).

5. The taxpayer was able to win on the valuation argument and the Court held that the value should be discounted for the claim made against it by the co-workers because a hypothetical buyer would have been aware of the lawsuit and would not have paid full value for the disputed portion of the lottery ticket.

B. Lottery Case Shows IRS Stays Hot on Trail of Unpaid Gift Tax Years Later

1. The Dickerson case is perhaps indicative of the IRS's stated interest in unreported gift transfers.

2. In December 2011, Department of Justice sought to enforce John Doe summonses requiring California to turn over information regarding

parties that may have failed to pay the required federal gift tax on property transfers.

C. Real Estate transferred to FLP escapes inclusion in Estate - CP 3/06

1. In *Estate of Beatrice Kelly, et al (TC Memo 2012-73*), the Tax Court held that neither the value of certain assets transferred from a widow to a FLP, nor the value of the partnership interests gifted to her children, were includable in her gross estate because she had valid nontax reasons for the asset transfers.

2. The court based its decision on several facts: (i) the transferor's inability to manage the assets transferred to the FLP, (ii) the reduction in her personal liability after the transfer, (iii) her receipt of partnership interests equal in value to the contributed assets, and (iv) the fact that she did not retain an interest in the transferred partnership interests.

3. The court determined that the widow wanted to ensure the equal distribution of her estate among her children and reduce her liability on the property because some of them had dangerous activities (quarries). Post transfer, she had retained sufficient assets to meet her personal needs.

D. Property transferred to FLPs not in estate –

1. In *Estate of Joanne Harrison Stone* (TC Memo 2012-48), the Tax Court held that real estate transferred to a FLP did not have to be included in the transferor's gross estate under §2036 because the transfer was a bona fide sale for an adequate and full consideration in money or money's worth.

2. The court found that there were nontax purposes for creating the FLP, namely they wanted to keep the land together as a family asset for subsequent sale and they wanted to protect it from division by partition.

3. Although some of the subsequent partners failed to respect the partnership formalities, the decedent did not depend on the distributions, the property was in fact transferred to the FLP, there was no comingling of the funds, and the interests that the decedent gifted were not discounted for gift tax purposes.

E. PLR 201208039—IRA Subaccounts Permitted where Estate was Named IRA Beneficiary

1. The IRS allowed a decedent's IRA naming the estate as beneficiary to be subdivided into IRA subaccounts for the beneficiaries of the estate.

2. This allowed each beneficiary more latitude over withdrawals, and also enabled each to separately invest his or her share of the decedent's IRA.

3. The minimum distributions were still based on decedent's life expectancy.

F. Incidents of Ownership in Life Insurance Policy

1. In *Estate of David Kahanic. -* The issue was whether the decedent held incidents of ownership in an insurance policy subject to a court ordered marital settlement.

2. The court found that estate of the decedent business owner was required to include the full value of life insurance policy proceeds in the gross estate, even though ex-wife was entitled to those proceeds pursuant to marital settlement agreement (MSA) modification order obligating decedent to retain ex-wife as sole beneficiary to secure outstanding child and spousal support obligations.

3. Despite limitations imposed by MSA modification, proceeds still had to be included in gross estate pursuant to Code Sec. 2042(2) absent proof that decedent's reversionary interest didn't exceed 5% of policy's value.

3. The estate, admitting that it had no such proof, instead raised only insupportable argument that policy itself was worthless/had zero value, even though it was clear from policy terms, including its no-lapse provision, and facts surrounding decedent's premium payments that there was at least some value.

G. Sec 2036 FLP Estate of Turner

1. P filed a motion for reconsideration of our Memorandum Opinion Estate of Turner v. Commissioner T.C. Memo. 2011-209 [TC Memo 2011-209] (Estate of Turner I) the decedent (D) transferred property to a family limited partnership (FLP) in exchange for limited and general partnership interests.

2. D transferred portions of the limited FLP interest as gifts during his lifetime. In Estate of Turner the Court held that the inter vivos transfer of property to the FLP was subject to I.R.C. sec. 2036.

3. Among other arguments, the estate contends that under D's will, the surviving spouse's right to the formula pecuniary marital bequest allows the surviving spouse to receive assets equal to the amount necessary to reduce the estate taxes to zero, and, because of the application of the marital deduction

under I.R.C. sec. 2056, the estate has no estate tax deficiency.

4. The court held that D's estate is not entitled to claim the marital deduction with respect to the FLP interest or the assets attributable to the FLP interest that D gave as gifts during his lifetime.

H. Marital Deduction Denied on Full Value

1. In *Alan Bear Revocable Trust v. United States,* the decedent's transferred shares of a non-publicly traded stock owned by the decedent to a trust.

2. The trust provided that if the trustee sold the stock for more than the decedent's basis ($4.8 million) during the surviving spouse's lifetime, the trust was to distribute $1.3 million in cash to twenty-three named beneficiaries.

3. The trust made a QTIP election was made under Section 2056(b)(7).

4. The estate reported that the fair market value of the stock was $10.9 million. The Service denied the marital deduction for the full value of the contingent bequests.

5. The estate subsequently revalued the stock at $850,000 and filed for a refund.

6. The District Court found that the value of the stock at the decedent's date-of-death was "essentially zero" and could not satisfy the contingent bequests, which were therefore effectively extinguished.

a. The Court held the estate was entitled to a refund of the tax deficiency assessed on the contingent bequests.

b. In the AOD, the IRS maintains that the contingent bequests, themselves, rendered the value of the stock ineligible for QTIP treatment under Section 2056(b)(7)(B)(ii)(II) because no person can have the power to appoint the property to any person other than the surviving spouse.

c. However, the Court's error of law would not impact the value of the refund.

IV. IRS Announcements

A. IRS Releases Automatic Method Change Guidance for Repair Regs

Transitions

1. On March 7, 2012, the IRS released transition guidance that outlines procedures by which taxpayers may obtain automatic method changes to comply with the temporary regs on capitalization of tangible assets.

2. The two revenue procedures, 2012-19 and 2012-20, modify the automatic method change revenue procedure (Rev. Proc. 2011-14) by adding a total of 19 new automatic changes and by waiving the scope limitations for two years.

3. The guidance in the revenue procedures gives taxpayers some breathing room, as the scope limitations would otherwise have generally required some taxpayers to get explicit consent of the IRS commissioner before a method change could be made.

4. The two year window will allow taxpayers that inadvertently failed to capture everything in the first year to fix it in the subsequent year.

5. Most of the new automatic method changes are made with a section 481(a) adjustment, and taxpayers may use the statistical sampling procedures provided in Rev. Proc. 2011-42.

6. In some areas, the guidance requires a modified section 481(a) adjustment based on inclusion of only those amounts paid or incurred in tax years beginning on or after January 1, 2012.

B. IRS Criminal Investigations Unit Boasts 94% Conviction Rate

1. IRS criminal investigations sent to the tax division have a 94% conviction rate, which is the highest rate of conviction in law enforcement.

2. Most of the time is spent investigating offshore tax evasion and more international banks are under investigation than ever.

C. IRS Reminds Employers of April 30, 2012 Deadline for Adopting Pre-Approved Defined Benefit Plans

1. Employers that have pre-approved defined benefit plans must adopt their restated plan, approved for EGTRRA, by April 30, 2012 to be eligible for retroactive remedial amendment and reliance.

2. If the plan does not adopt an updated defined benefit plan by this date, the plan may lose its qualified status for tax benefits.

D. Depreciation Dollar Limits Released for 2012 Business Autos, Light Trucks, and Vans

1. The IRS has released the inflation-adjusted §280F depreciation limits for business autos, light trucks and vans (including minivans) placed in service by the taxpayer in 2012, and the annual income inclusion amounts for such vehicles first leased in 2012.

2. Most depreciation deduction limits are $100 higher than those that applied for 2011.

3. The new income inclusion tables require smaller income inclusion amounts for vehicles first leased by the taxpayer in 2012.

4. The applicable depreciation limits are as follows:

If the bonus first year depreciation rules don't apply to an auto (not a truck or van):

- $3,160 for the placed in service year;
- $5,100 for the second tax year;
- $3,050 for the third tax year; and
- $1,875 for each succeeding year.

If the bonus depreciation rules do apply to an auto (not a truck or van):

- $11,160 for the placed in service year;
- $5,100 for the second tax year;
- $3,050 for the third tax year; and
- $1,875 for each succeeding year.

If the bonus depreciation rules don't apply to a light truck or van (passenger auto built on a truck chassis, including minivan and sport-utility vehicle (SUV) built on a truck chassis):

- $3,360 for the placed in service year;
- $5,300 for the second tax year;
- $3,150 for the third tax year; and
- $1,875 for each succeeding year.

If the bonus depreciation rules do apply to a light truck or van:

- $11,360 for the placed in service year;
- $5,300 for the second tax year;

- $3,150 for the third tax year; and
- $1,875 for each succeeding year.

E. New Requirement for Health Plans to Disclose Benefits

1. As of March 23, 2012, the Patient Protection and Affordable Care Act requires group health plans and health insurance issuers offering group health insurance coverage to disclose to participants and beneficiaries a summary of plan benefits and coverage and a uniform glossary of terms used by the plan.

2. If a group health plan, other than one maintained by a governmental entity, fails to comply with the requirements, and excise tax of $100 per day per individual for each day that the plan fails to comply is generally imposed, and a plan sponsor of designated administrator is subjected to a fine of not more than 1,000 for each failure to provide a summary of benefits and coverage.

3. In August of 2011, proposed reg § 54.9815-2715 was issued, which carried detailed rules for what would have to be included in the summary, and when the information would have to be provided by group health insurance issuers to group health plans and by group health issuers and group health plans to plan participants and beneficiaries.

F. Ten Tips if You Can't Pay Your Tax

Here are ten tips from the IRS for taxpayers who owe money tax:

1. Tax bill payments - If you get a bill this summer for late taxes, you are expected to promptly pay the tax owed including any penalties and interest. If you are unable to pay the amount due, it is often in your best interest to get a loan to pay the bill in full rather than to make installment payments to the IRS.

2. Additional time to Pay - Based on your circumstances, you may be granted a short additional time to pay your tax in full. A brief additional amount of time to pay can be requested through the Online Payment Agreement application at www.irs.gov or by calling 800-829-1040.

3. Credit card payments - You can pay your bill with a credit card. The interest rate on a credit card may be lower than the combination of interest and penalties imposed by the Internal Revenue Code. To pay by credit card contact one of the following processing companies: Link2Gov at 888-PAY-1040 (or www.pay1040.com), RBS WorldPay, Inc. at 888-9PAY-TAX (or

www.payUSAtax.com), or Official Payments Corporation at 888-UPAY-TAX (or www.officialpayments.com/fed).

4. Electronic Funds Transfer - You can pay the balance by electronic funds transfer, check, money order, cashier's check or cash. To pay using electronic funds transfer, use the Electronic Federal Tax Payment System by either calling 800-555-4477 or using the online access at www.eftps.gov.

5. Installment Agreement - You may request an installment agreement if you cannot pay the liability in full. This is an agreement between you and the IRS to pay the amount due in monthly installment payments. You must first file all required returns and be current with estimated tax payments.

6. Online Payment Agreement - If you owe $25,000 or less in combined tax, penalties and interest, you can request an installment agreement using the Online Payment Agreement application at www.irs.gov.

7. Form 9465 - You can complete and mail an IRS Form 9465, Installment Agreement Request, along with your bill in the envelope you received from the IRS. The IRS will inform you (usually within 30 days) whether your request is approved, denied, or if additional information is needed.

8. Collection Information Statement - You may still qualify for an installment agreement if you owe more than $25,000, but you are required to complete a Form 433F, Collection Information Statement, before the IRS will consider an installment agreement.

9. User fees - If an installment agreement is approved, a one-time user fee will be charged. The user fee for a new agreement is $105 or $52 for agreements where payments are deducted directly from your bank account. For eligible individuals with lower incomes, the fee can be reduced to $43.

10. Check withholding - Taxpayers who have a balance due may want to consider changing their W-4, Employee's Withholding Allowance Certificate, with their employer. A withholding calculator at www.irs.gov can help taxpayers determine the amount that should be withheld.

G. LBI issues directive on examination of repair v. capitalization rules - RIA 3/19/12

1. IRS's Large Business & International Division has issued a

memorandum providing direction to the field on examinations involving the repair vs. capitalization issue in light of recently issued temporary regs under Code Sec. 162(a) and 263(a), which affect virtually all taxpayers that acquire, produce, or improve tangible property.

2. On March 7, 2012, IRS issued Rev. Proc. 2012-19 and 2012-20, which provides procedures for taxpayers to obtain automatic IRS consent to change accounting methods provided in the temporary regs.

3. Under both Revenue Procedures, the scope of limitations in Rev. Proc. 2011-14 (for taxpayers under examination) do not apply to a taxpayer that makes a change for its first or second tax year beginning after Dec. 31, 2011.

4. The new Directive applies to the exams relating to positions taken on original returns relating to (i) whether costs incurred to maintain, replace, or improve tangible property must be capitalized under 263(a) and (ii) any correlative issues involving the disposition of structural components of a building or dispositions of tangible depreciable assets, other than a building or its structural components.

a. The Directive refers to these as the “Issues”.

b. The Directive provides that for examinations of a return for a tax year on or after January 1, 2012, but before January 1, 2014, examiners should perform a risk assessment regarding the method change if the taxpayer has filed a form 3115 in accordance with Rev. Proc. 2012-19 or 2012-20.

c. If the taxpayer hasn’t done so and the waiver period to file such change is still open, the examiner should allow the taxpayer to file a method change.

d. If the waiver period has passed, the examiner should perform a risk assessment regarding the Issues.

e. For examinations of tax years after January 1, 2014, the examiner should apply the regs in effect and follow normal exam procedures.

f. When performing a risk assessment of the Code Sec. 481(a) adjustment for the Issues, the examiner should (i) consider if the adjustment properly accounts for amounts paid to acquire, produce, or improve tangible property that were computed under the taxpayer’s prior method and previously deducted under Code Sec. 162; (ii) determine if the code sec. 481(a) adjustment(s) resulting from any prior year change was taken into account, and (3) consider the accuracy of the 481(a) adjustment.

H. <u>What are your chances of being audited?</u> RIA 3/26/12

Following are selected audit rates for individuals not claiming the EITC:

- For business returns other than farm returns showing total gross receipts of $100,000 to $200,000, 4.3% of returns were audited in FY 2011, down from 4.7% in FY 2010.

- For business returns other than farm returns showing total gross receipts of $200,000 or more, 3.8% of returns were audited in FY 2011, an increase from 3.3% in FY 2010.

- Of the returns showing farm (Schedule F) income, .6% were audited in FY 2011 versus .4% in FY 2010.

- For returns showing total positive income of $200,000 to $1 million, 3.2% of returns not showing business activity were audited, and 3.6% of returns showing business activity were audited. The audit rate for such returns was higher than the 2.5% and 2.9% respective rates for the previous year.

- For FY 2011, the audit rate for returns with total positive income of $1 million or more was 12.5%, close to forty nine percent higher than the 8.4% rate for FY 2010.

Select audit rates for business returns were as follows:

- For all corporate returns other than Form 1120S, 1.5%, versus 1.4% for the year before.

- For small corporations with balance sheet returns showing total assets of: $250,000 to $1 million, 1.6%; $1–$5 million, 1.9%; and $5–10 million, 2.6%. For FY 2010, the percentages were, respectively, 1.4%, 1.7%; and 3%.

- For large corporations with returns showing total assets of $10 million or more, the overall audit rate was 17.6%, up from 16.6% for FY 2010. The audit rate for these corporations increased with the size of the entity. For example, the audit rates were 13.3% for those with total assets of $10–$50 million (slight decrease from 13.4% for FY 2010); 17.4% for those with $250–$500 million (versus 16.1% for

FY 2010); 50.5% for those with \$5–20 billion (up from 45.3% for FY 2010), and 95.6% for those with \$20 billion or more (down from 98% for FY 2010).

- For partnership and S corporation returns, the audit rate was .4%, the same as for the year before.

I. <u>CRS examines effect of propose entity-level tax on large pass-through</u>

1. Government reports have indicated that there is a large shift away from the corporate form to avoid double taxation. Corporate tax revenue, as a share of GDP, has declined since the earliest fifties, dropping from 6.1% in 1952 to 1.3% of GDP currently. According to the Congressional Research Service, CRS, report this may have caused revenues to drop between \$13 and \$47 billion per year.

2. The report suggests that large pass-throughs should be taxed as corporations and that corporate tax preferences and loopholes should be reduced or eliminated to broaden the tax base.

3. It compares companies by receipts received and by assets. Under the receipts analysis, the report found that 30% of S corporation receipts are generated by the largest 0.3% of S corporations, 41% of partnership receipts are generated by the largest 0.2% of partnerships, and 83% of corporation receipts are generated by the largest 0.8% of corporations.

   a. Based on assets, 43% of S corporation assets are held by the largest 0.2% of firms, 78% of partnership assets are held by the largest 1.1% of firms, and 98% of corporate assets are held by the largest 1.5% of firms.

   b. These numbers show that an added corporate-level tax on large pass-throughs would affect a relatively small percent of firms, but could generate significant revenue. In the alternative, the report suggests using other measurements to determine "large pass-throughs," such as, profit-based, employment-based, composite measures or industry specific measures.

4. Another CRS report, "Who Earns Pass-Through Business Income An Analysis of Individual Tax return Data," shows that the burden that would pass through on the individual level, would bear the greatest burden on higher-income taxpayers because taxpayers with incomes of \$250,000 or more accounted for 6% of returns, but represented 62% of pass-through income.

J. Ponzi scheme victims allowed theft losses despite lack of direct investment with perpetrator

1. Chief Counsel Advice 201213022 addresses whether taxpayers, a husband and wife, could claim a theft loss because, although they were victims of a Ponzi scheme, they invested through an Associate of the Perpetrator and arguably lacked privity with the Perpetrator.

2. To deduct a theft loss, a taxpayer must show that "the loss resulted from a taking of property that is illegal under the law of the state where it occurred, and that the taking was done with criminal intent." (Rev. Rul. 72-112).

3. In many cases, this requires that the perpetrator have specific intent to deprive the victim of his property, which in turn requires a degree of privity between the perpetrator and the victim. (Marr, TC Memo 1995-250).

4. The CCA examines case law and ultimately concludes that the losses were theft losses under Sec. 165.

5. In *Jensen,* TC Memo 1993-393, the Tax Court found that privity existed between the taxpayers and perpetrators because the business associate through whom they invested was "a conduit to the scheme."

   a. The Court determined that it wasn't necessary for the investor to have direct contact with the entity in which he is investing in order to have privity.

   b. In this instance, the taxpayers' property ended up at the disposal of the Perpetrator, they obtained their interests after reading about the fund in the Associate's newsletter and paying into the fund, and they made their investment based on Perpetrators reputation.

   c. There was no intermediate step where the fund managers invested in Perpetrators scheme.

   d. The taxpayers invested in the vehicles used by the Perpetrator to operate his scheme, and the Perpetrator clearly intended to appropriate their property.

   e. Thus, the IRS found that the facts showed there was privity between the taxpayers and the Perpetrator despite the fact that they invested through fund managers, and the taxpayers' investment losses are theft losses under Sec. 165.

K. <u>IRS Issues Urgent Warning about a Mushrooming Tax Scam that Targets the Elderly</u>

1. The IRS issued a warning that perpetrators are obtaining personal information from low-income and elderly people by telling them they qualify for nonexistent stimulus payment based on the American Opportunity Tax Credit.

2. Some of the warning signs to look for are: (i) fictitious refund or rebate claims that rely on false statements; (ii) unfamiliar for-profit tax services promoting refund and credit schemes to congregations of local churches; (iii) Internet offers prompting individuals to call a toll-free telephone number and reveal their Social Security numbers; (iv) homemade advertising material flouting that credits or refunds are there for the asking without proof of eligibility;(v) offers of free money without documentation; (vi) promises of refunds for "low income - no documents tax returns" offers; (vii) claims involving the expired Economic Recovery Credit Program or economic stimulus payments; (viii) offers to prepare a return and split the refund that come out of the blue; and (ix) unknown tax preparation firms soliciting business from distant locales.

L. <u>IRS Offers Points Regarding Mortgage Debt Forgiveness</u>

1. The IRS has published information on 10 key points regarding mortgage debt forgiveness.

2. While canceled debt is normally taxable, there is one exception available to homeowners whose mortgage debt is partly or entirely forgiven during tax years 2007 through 2012.

3. Among the key points enumerated are the following:

a. Under the Mortgage Forgiveness Debt Relief Act of 2007, a taxpayer may be able to exclude up to $2 million of debt forgiven on his or her principal residence;

b. The limit is $1 million for a married person filing a separate return; a taxpayer may exclude debt reduced through mortgage restructuring, as well as mortgage debt forgiven in a foreclosure;

c. To qualify, the debt must have been used to buy, build or substantially improve a principal residence and be secured by that residence; and refinanced debt proceeds used for the purpose of substantially improving a principal residence also qualify for the exclusion.

V. Tax Practitioner's Corner

A. New, Changes, & Expired Provisions Affect 2012 Individual Estimated Tax

1. April 17, 2012 is the due date for affected calendar year taxpayers to make their first installment of 2012 estimated tax. There aren't any changes in the estimated tax rules themselves for 2012. However, there are a number of new, changed and expired provisions that will affect some individuals' estimated tax computations for 2012.

2. When and how much to pay. For 2012 estimated tax, in general, a taxpayer must pay 25% of a "required annual payment" by April 17, 2012, June 15, 2012, September 17, 2012 and January 15, 2013 to avoid an underpayment penalty. The required annual payment for most taxpayers is the lower of 90% of the tax shown on the 2012 return or 100% of the tax shown on the 2011 return, even if filed late ("prior year exception").

3. New items not reflected on Form 1040-ES. The Form 1040-ES instructions do not reflect these new law changes:

- *Reduced expensing.* For a tax year beginning in 2012, the maximum Code Sec. 179 expensing election is $139,000, with a $560,000 investment-based ceiling (down from $500,000/$2 million last year). Additionally, for a tax year beginning after 2011, expensing can no longer be claimed for qualified real property (see Federal Taxes Weekly Alert 08/25/2011).

- *No parity for exclusion from income for employer-provided mass transit and parking benefits.* The exclusion for qualified parking rises from $230 to $240 due to an inflation adjustment, but falls from $230 to $125 for employer-provided transit and vanpooling benefits (see Federal Taxes Weekly Alert 12/01/2011).

- *Changed provisions.* In calculating 2012 estimated tax, an individual should consider the following changed provisions:

- *Alternative minimum tax (AMT) exemption amount decreased.* The AMT exemption amount is decreased to $33,750 ($45,000 if married filing jointly or a qualifying widow(er); $22,500 if married filing separately).

- *Certain credits not allowed against the AMT.* The credit for child and dependent care expenses, credit for the elderly or the disabled, education credits, mortgage interest credit, and carryforwards of the District of Columbia first-time homebuyer credit are not allowed against the AMT and a new tax liability limit applies. For most people, this limit is regular tax minus any tentative minimum tax.

- *Increased standard deductions.* The basic standard deduction amounts have increased for most categories of taxpayers for 2012.

- *Standard mileage rates.* The rate for business use of a vehicle remains at 55.5¢ a mile. The rate for use of a vehicle to get medical care or move is decreased to 23¢ a mile. The rate of 14¢ a mile for charitable use is unchanged.

- *Personal exemption increased.* For tax years beginning in 2012, the personal exemption amount is increased to $3,800.

- *Income limits for excluding education savings bond interest increased.* In order to exclude interest, the taxpayer's modified adjusted gross income (MAGI) must be less than $87,850 ($139,250 if married filing jointly or a qualifying widow(er)).

- *Lifetime learning credit income limits increased.* In order to claim a lifetime learning credit, the taxpayer's MAGI must be less than $62,000 ($124,000 if married filing jointly).

- *Adoption credit and exclusion.* The maximum adoption credit is $12,650 and the credit is no longer refundable. The maximum amount of adoption assistance that can be excluded from gross income is $12,650. The amount of the credit or excludable assistance begins to phase out for taxpayers with MAGI in excess of $189,710 and is completely phased out for taxpayers with MAGI of $229,710.

- *Earned income credit.* There are increases in the maximum credit, the maximum AGI a taxpayer can have and still get the credit, and the maximum investment income a taxpayer can have and still get the credit.

- *Foreign earned income exclusion.* The maximum exclusion has increased to $95,100.

- *Extended health coverage tax credit.* The credit for the cost of health insurance is 72.5% and COBRA benefits continue for trade adjustment assistance (TAA) recipients, alternative TAA recipients, reemployment TAA recipients, Pension Benefit Guaranty Corporation pension recipients, and certain of their family members.

B. REV. RUL. 2012-13 TABLE 1

Applicable Federal Rates (AFR) for May 2012

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short Term				
AFR .	.28%	.28%	.28%	.28%
110% AFR	.31%	.31%	.31%	.31%

120% AFR	.34%	.34%	.34%	.34%
130% AFR	.36%	.36%	.36%	.36%

Mid Term

AFR	1.30%	1.30%	1.30%	1.30%
110% AFR	1.44%	1.43%	1.43%	1.43%
120% AFR	1.57%	1.56%	1.56%	1.55%
130% AFR	1.70%	1.69%	1.69%	1.68%
150% AFR	1.96%	1.95%	1.95%	1.94%
175% AFR	2.29%	2.28%	2.27%	2.27%

Long Term

AFR	2.89%	2.87%	2.86%	2.85%
110% AFR	3.18%	3.16%	3.15%	3.14%
120% AFR	3.47%	3.44%	3.43%	3.42%
130% AFR	3.76%	3.73%	3.71%	3.70%