

# Tax Law: Important Tax Developments from the First Quarter of 2012

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The following is a summary of the most important tax developments that have occurred in the first quarter of 2012 that may affect you, your family, your investments and your business.

**Payroll tax cut extended for all of 2012.** On February 22, 2012, President Obama signed the “Middle Class Tax Relief and Job Creation Act of 2012” into law. It extended the 2% payroll tax cut through the end of 2012. Earlier legislation had extended it for only the first two months of 2012. Thus, the 2% payroll tax reduction and the 2% reduction in the OASDI tax under the SECA tax for the self-employed applies through December 31, 2012. As a result, for 2012, employees pay only 4.2% Social Security tax on wages up to \$110,100 (wage base for 2012) and self-employed individuals pay only 10.4% Social Security self-employment taxes on self-employment income up to \$110,100. The maximum savings for 2012 is \$2,202 (2% of \$110,100) per taxpayer. If both spouses earn at least as much as the wage base, the maximum savings is \$4,404.

**Some estates get more time to make estate tax portability election.** The IRS issued Notice 2012-21 giving certain estates of married individuals who died during the first six months of 2011 an extension of the deadline to make the portability election to pass the decedent’s unused estate and gift tax exclusion amount to the surviving spouse. The election is made on the Form 706 (estate tax return). Significantly, even if the estate is not required to file a Form 706 (e.g., because the value of the gross estate is less than the exclusion amount), the Form 706 must be filed in order to make the election.

The extension is available to qualifying estates of decedents who are U.S. citizens or residents. A qualifying estate is an estate in which:

- The decedent is survived by a spouse;
- The decedent’s date of death is after December 31, 2010, and before July 1, 2011; and
- The fair market value of the decedent’s gross estate does not exceed \$5,000,000.

The IRS will grant the executor of a qualifying estate a six-month extension of time until 15 months after the decedent’s date of death to file Form 706 if the executor files an appropriately designated Form 4768 with the IRS no later than 15 months from the decedent’s date of death.

**Retirement security initiative.** The U.S. Departments of the Treasury and Labor announced a sweeping initiative which is designed to broaden the availability of retirement plan options in order to provide greater certainty in retirement and minimize the risk of retirees outliving or underutilizing their retirement savings. It includes the following:

- **Partial annuity options.** Proposed Treasury Regulations § 1.417(e)-1(d)(7) and (8) would change the rules to make it simpler for defined benefit pension plans to offer combinations of lifetime income and a single-sum cash payment. They would allow retirees to receive a steady stream of income for the duration of their lifetimes while keeping a portion of their savings invested in assets with the flexibility to respond to liquidity needs.
- **“Longevity” annuities.** Proposed Treasury Regulations § 1.401(a)(9)-6 would make it easier for retirees to use a limited portion of their savings to purchase guaranteed income for life starting at an advanced age, such as average life expectancy. These annuities would provide an efficient way for 65- or 70-year-olds to address the risk of outliving their assets by purchasing a predictable income stream starting at age 80 or 85.
- **Spousal protection rules and deferred annuities.** In Revenue Ruling 2012-3, IRS has clarified that employers can offer their employees the option to use Code Sec. 401(k) savings to purchase deferred annuities and still satisfy spousal protection rules with minimal administrative burdens.
- **Purchase of annuities from defined benefit plan.** In Revenue Ruling 2012-4, IRS has explained how the rules apply when employees are given the option to use a single-sum Code § 401(k) payout to obtain a low-cost annuity from their employer’s defined benefit pension plan.
- **Code § 401(k) fee disclosure.** Final Labor Department regulations under Employee Retirement Income Security Act of 1974 (ERISA) § 408(b)(2) require service providers to furnish information that will enable plan fiduciaries to determine both the reasonableness of compensation paid to the service providers and any conflicts of interest that may impact a service provider’s performance under a service contract or arrangement.

**Relief for certain taxpayers.** In IRS News Release 2012-40, the Service made available to certain wage earners and self-employed individuals a six-month grace period on failure-to-pay penalties. Form 1127-A, Application for Extension of Time for Payment of Income Tax for 2011 Due to Undue Hardship, had to be completed to seek the relief and had to be postmarked on or before April 17, 2012. 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 October 15, 2012. Subject to income and balance due limits, the penalty relief applied for these two categories of taxpayers:

- Wage earners who had 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% or greater reduction in business income in 2011 due to the economy

A taxpayer’s income could not exceed \$100,000 if he or she filed as single or head of household (\$200,000 for joint filers). The penalty relief was not available to taxpayers whose calendar year 2011 balance due exceeded \$50,000.

In addition, in IRS News Release 2012-31, IRS has raised the threshold for using an installment agreement without having to supply IRS with a financial statement from \$25,000 to \$50,000.

**Residence interest limits for unmarried co-owners.** The Tax Court has held that limitations on deductions for qualified residence interest (\$1 million of acquisition indebtedness and \$100,000 of home equity indebtedness) are applied on a per-residence basis, and not per-individual basis. 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.

**Luxury auto depreciation limits for 2012.** Under special “luxury automobile” rules, a taxpayer’s otherwise available depreciation deduction for business autos, light trucks, and minivans is subject to additional limits, which operate to extend depreciation beyond its regular period. The IRS has released the inflation-adjusted depreciation limits for business autos, light trucks and vans (including minivans) placed in service in 2012—e.g., the first-year depreciation limit is \$3,160 for autos and \$3,360 for light trucks or vans first placed in service in 2012. However, for vehicles that qualify for bonus depreciation, the otherwise applicable first-year limit is increased by \$8,000 to \$11,160 for autos and \$11,360 for light trucks or vans first placed in service in 2012.

**S corporation underpaid employment taxes.** A federal appeals court, in *Watson, P.C. v. Commissioner*, 668 F.3d 1008 (8<sup>th</sup> Cir. 2012), affirming a Federal district court in Iowa, held that an S corporation shareholder-employee’s salary was unreasonably low. As a result, it allowed the IRS to reclassify as salary a substantial amount of dividend payments made to the officer during the years at issue. This resulted in the corporation owing employment taxes on the reclassified dividend payments.

**FinCEN gives taxpayers more time to e-file FBARs.** The Treasury’s Financial Crimes Enforcement Network (“FinCEN”) has announced in FinCEN Notice 2012-1 that electronic filing (e-filing) of TD F 90-22.1, Report of Foreign Bank and Foreign Accounts (“FBAR”), will not be required until June 30, 2013. Each U.S. person who has a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year, must report that relationship each calendar year by filing TD F 90-22.1, Report of FBAR with the Department of the Treasury on or before June 30, of the succeeding year. Although FinCEN reports generally must be e-filed from July 1, 2012, FinCEN has announced a general exemption from mandatory electronic filing of FBARs until July 1, 2013. The temporary e-filing exemption does not relieve any person of the obligation to file an FBAR and does not affect the required date by which any given FBAR must be received by Treasury.