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## 2012 NEW DEVELOPMENTS LETTER

### INTRODUCTION

2012 has been a busy year for tax developments. Over the past 12 months, the IRS and courts have released a series of regulations, rulings, and cases impacting almost every area of the tax law. Moreover, this summer, in the landmark decision of *National Federation vs. Sebelius*, the U.S. Supreme Court largely upheld the constitutionality of the "Patient Protection Act of 2010" (Health Care Act) which contains a host of new tax provisions **beginning in 2013**, including a **Medicare Surtax of .9%** on wages and self-employment income and a separate **Medicare Surtax of 3.8%** on "investment" income of higher-income individuals.

Keeping up with these rapidly changing tax provisions is extremely challenging. To help you with that task, we are sending this letter providing a summary of the key legislative, administrative, and judicial tax developments that we believe will have the greatest impact on our clients. **Caution!** We highlight only *selected* tax developments. If you have heard about other tax developments not discussed in this letter, and you need more information, please call our office for details.

**Planning Alert!** This letter also contains selected planning ideas. However, you cannot properly evaluate a particular planning strategy without calculating your overall tax liability (**including** the *alternative minimum tax*) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend that you call our firm before implementing any tax planning technique discussed in this letter, or if you need more information.

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## DEVELOPMENTS IMPACTING PRIMARILY "INDIVIDUALS"

### Recent Tax Legislation

#### Middle Class Tax Relief Act (Payroll Tax Cut Bill)

Last February, President Obama signed the **Middle Class Tax Relief and Job Creation Act of 2012**, that extended **through December 2012** the temporary reduction in the Social Security tax rate from 6.2% to 4.2% **for employees**, and from 12.4% to 10.4% for **self-employed individuals**. Therefore, **if you are an employee, for 2012**, the normal 6.2% "employee" portion of your Social Security tax rate has been reduced to 4.2%. Thus, your take-home pay for 2012 has been generally increased by 2% of each dollar of compensation that you earn. However, since Social Security taxes apply only to the first \$110,100 of compensation in 2012, your maximum savings for 2012 will generally be \$2,202 (i.e., \$110,100 x 2%). If you are married and you each earn at least as much as the wage base, your maximum combined savings will be \$4,404. Likewise, **if you are self-employed**, your Social Security taxes are reduced by 2% of your self-employment income for 2012 (up to \$110,100). Therefore, if your self-employment income is \$110,100 or more, your self-employment taxes will be reduced by \$2,202.

- **Tax Tip.** You and/or your spouse should consider accelerating into 2012 compensation (e.g., by accelerating a bonus, commission, etc.) or self-employed income (e.g., encouraging a customer or client to pay early) in order to save the 2% Social Security tax to the extent the income acceleration does not cause either of you to exceed the \$110,100 cap. Moreover, the compensation or self-employed income that you accelerate into 2012 will not be subject to the new .9% Medicare Surtax (discussed in the next segment) which is **not effective until 2013**. **Caution!** Before accelerating income into 2012 to save the 2% Social Security tax (and possibly the .9% Medicare Surtax), we should first evaluate the impact on your overall 2012 and 2013 "income" tax liability (state and Federal).

#### Supreme Court Upholds Patient Protection And Affordable Care Act (Health Care Act)

This past summer, in a much anticipated decision, the Supreme Court generally upheld the provisions of the **Patient Protection and Affordable Care Act (Health Care Act)**. Although the majority opinion concluded that the **individual mandate** requiring noncomplying individuals to purchase health insurance coverage (or face a monetary penalty) was a valid exercise of Congress's taxing power, this provision **is not effective until 2014**. However, by upholding the constitutionality of the **Health Care Act**, the Court has also upheld several key tax provisions included within the legislation that **become effective in 2013** and, therefore, impact tax strategies **for 2012**. Most notably, **starting in 2013**, the **Health Care Act: 1)** adds a new **Medicare Surtax of .9%** on the wages and self-employment income of higher-income individuals, **2)** imposes a new **Medicare Surtax of 3.8%** on "investment" income for higher-income taxpayers, **3)** generally increases the deduction threshold for medical expenses for taxpayers under age 65 from 7.5% of an individual's AGI to 10% of AGI, and **4)** places a \$2,500 cap on annual salary reduction contributions to a health "flexible savings account" (health FSA). The following highlights key aspects of each of these new provisions:

**Additional .9% Medicare Surtax On Earned Income Of Higher-Income Taxpayers.** Payroll taxes imposed on your W-2 earnings include both a Social Security tax and a separate Medicare tax. Under current law, the overall Medicare tax rate is 2.9% (1.45% imposed on the employee and an additional 1.45% imposed on the employer). If you are self-employed, you must pay the entire 2.9% Medicare tax on your income from self employment. However, as a self-employed individual, you are allowed to deduct one-half (1.45%) of your Medicare tax as an "above-the-line" deduction. Although the **Health Care Act** does not increase your Social Security taxes, it does increase the Medicare taxes for higher-income taxpayers. **Generally, effective for wages and self-employed earnings received after 2012** that exceed certain thresholds, the **Health Care Act** imposes an **additional .9% Medicare Surtax**. This surtax applies to the amount by which the sum of your **W-2 wages** and your **self-employed earnings** exceeds \$250,000 if you are married filing a joint return (exceeds \$200,000 if you are single, or \$125,000 if married filing separately). **Note!** For married individuals filing a joint return, the .9% Medicare Surtax will apply to the extent *the sum of both spouses' W-2 earnings* and the self-employed earnings exceed the \$250,000 threshold. Also, if you are self-employed, you will not be entitled to take an "income" tax deduction for any portion of the .9% surtax imposed on your self-employed income.

**Planning Alert!** Starting in 2013, employers will have a new withholding requirement for the .9% Medicare Surtax, as discussed in more detail later in this letter.

**New 3.8% Medicare Surtax On Net Investment Income.** Since the inception of the Medicare program, the Medicare tax has only been imposed on an employee's "wages" and a self-employed individual's "income from self employment." Starting in 2013, a new 3.8% Medicare Surtax is imposed on the *net investment income* (e.g., interest, dividends, annuities, royalties, rents, certain "passive" income, and capital gains – less applicable expenses) of **certain higher-income individuals**. The tax will apply to individuals with modified adjusted gross income (MAGI) exceeding the following "**threshold amounts**" – \$250,000 for married filing jointly; \$200,000 if single; and \$125,000 if married filing separately. More specifically, the 3.8% Medicare Surtax will be imposed upon **the lesser of** the individual's **1)** modified adjusted gross income (MAGI) in excess of the "threshold amount," **or 2)** net investment income. **Trusts and estates** that have *net investment income* and *adjusted gross income* (AGI) in excess of certain "**threshold amounts**" (discussed in more detail below) will also be required to pay the 3.8% Medicare Surtax, unless the income is timely distributed to beneficiaries. However, if the *net investment income* is timely distributed, the beneficiary of the trust or estate may be subject to the Medicare Surtax if the beneficiary's MAGI exceeds the thresholds for individuals (e.g., exceeds \$250,000 for joint filers).

- **Net Investment Income.** Generally, "**net investment income**" includes (net of allocable deductions) interest, dividends, annuities, royalties, rents, gains from the sale of property (e.g., long-term and short-term capital gains), and operating income from a business that trades in financial instruments or commodities. **It also generally includes** operating business income that is taxed to a "**passive**" owner (unless the operating income constitutes *self-employment* income to the owner that is subject to the 2.9% Medicare tax). For this purpose, an owner is considered "**passive**" in a business activity (excluding activities conducted through a C corporation) if the owner is subject to the passive loss limitation rules because the owner does not "**materially participate**" in the business. For example, you are deemed to **materially participate** (i.e., you're not "passive") if you spend **more than 500 hours** during the year working in the business.
  - **Special Rule For "Passive Income."** As mentioned above, business income reported by a "**passive**" owner is **not "net investment income"** if the income is subject to the 2.9% Medicare tax. Pass-through business income to a "**general**" partner **is** subject to S/E tax (including the 2.9% Medicare tax and the new .9% Medicare Surtax on "earned income"), regardless of whether the partner "materially participates" in the partnership's business activities. Therefore, pass-through business income to a **general** partner **is exempt** from the 3.8% surtax on *net investment income*. However, pass-through business income to an **S corporation shareholder** or a "**limited**" partner (other than "guaranteed payments") is **not subject** to S/E tax (including the 2.9% Medicare tax or the new .9% Medicare surtax on "earned income"). Therefore, if you are a **limited partner** or **S corporation shareholder**, your pass-through business income will generally be **net investment income** (and thus exposed to the 3.8% Medicare Surtax) **unless** you "**materially participate**" in the operations of the business.
- **Investment Income Exempt From The Surtax.** The following types of income are **not subject** to the 3.8% Medicare Surtax: tax-exempt bond interest; gain on the sale of a principal residence *otherwise excluded* under the **home-sale exclusion** rules (i.e., up to \$250,000 on a single return, up to \$500,000 on a joint return); and distributions from qualified plans (e.g., IRAs, §403(b) annuities, etc.). **Planning Alert!** Taxable distributions from qualified plans, traditional IRAs, etc. will increase your MAGI which could, in turn, push you over the \$250,000 (joint return) or \$200,000 (single return) thresholds, subjecting your *net investment income* to the 3.8% Medicare Surtax.
- **Observations And Planning Considerations.** The following are *selected* observations and planning considerations relating to the new 3.8% Medicare Surtax on *net investment income*:
  - **S Corporation Shareholders And Limited Partners Should Evaluate Passive Activity Classification.** As previously mentioned, if you are a higher-income **S corporation shareholder** or **limited partner**, and you do not **materially participate** in the business, you will generally be subject to the 3.8% Medicare Surtax on the pass-through *operating business* income (except for "guaranteed

payments” to limited partners). **Tax Tip.** To avoid the 3.8% Medicare Surtax on the *operating business income*, **S corporation shareholders** and **limited partners** should consider taking the steps necessary to “*materially participate*” in the activity (e.g., working in the entity for more than 500 hours during the year). **Caution!** If you have other “*passive*” activities generating losses, you may prefer to remain *passive* so that your operating income from the S corporation or partnership may be used to offset your *passive* losses of the other activities. **Planning Alert!** The following income that passes through to you from your S corporation, limited or general partnership, LLC, etc. will generally constitute *net investment income* regardless of whether you *materially participate* in the business activity: interest, dividends, annuities, royalties, rents, and income generated by the business’s “working capital.”

- **“Qualified Real Estate Professionals” May Avoid 3.8% Medicare Surtax On Real Estate Rentals.** Although rental income from leased real estate is generally subject to the 3.8% Medicare Surtax, a “**qualified real estate professional**” (**QREP**) may be able to avoid the surtax on the rental income. Generally, a *qualified real estate professional* is an individual **1)** who performs **more than 750 hours** of services during the year in “real property” trades or businesses (e.g., real estate development, management, construction, rental, leasing, brokerage), **2)** who materially participates in those businesses, **and 3)** who spends **more than 50%** of his or her total working hours for the year in “real property” trades or businesses. Thus, if a **QREP** “materially participates” (e.g., works more than 500 hours) in a real estate rental activity, it would appear that the rental income would not be “investment income,” and would therefore be exempt from the 3.8% Medicare Surtax. Furthermore, whether or not you are a **QREP**, real estate rentals are generally not considered “earned income,” and are therefore *exempt* from S/E tax (including the 2.9% Medicare tax and the .9% Medicare Surtax). **Tax Tip.** If you think that you may satisfy the requirements for a *qualified real estate professional*, please call us. There are certain tax elections relating to your rental real estate activities that may enhance your ability to qualify for these special rules.
- **Consider Roth IRA Conversions.** Tax-free distributions from a Roth IRA are exempt from the 3.8% Medicare Surtax, and do not increase your MAGI (and, thus will not increase your exposure to the Medicare Surtax). Therefore, these tax-favored features should be factored into any analysis of whether you should convert your existing IRA to a Roth IRA. However, if the Roth conversion occurs **after 2012**, the income triggered by the conversion itself increases your MAGI and therefore your potential exposure to the Medicare Surtax. Thus, by converting to a Roth **prior to 2013**, you may avoid any Medicare Surtax that would otherwise apply because of the conversion. **Planning Alert!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and this new Medicare Surtax is just one of many factors that you should consider. **Please call our firm** if you need help in deciding whether or not to convert to a Roth IRA.
- **Tax-Exempt Income Becomes More Valuable.** Investments that generate tax-exempt income will become more attractive. For example, tax exempt municipal bond interest will potentially provide higher-income individuals with a double tax benefit: **1)** the interest will not be included in the taxpayer’s MAGI thus reducing the chance that the taxpayer will exceed the income thresholds for the 3.8% Medicare Surtax, and **2)** the tax-exempt interest itself is exempt from the Medicare Surtax.
- **Additional Benefits For Contributions To Qualified Retirement Plans.** Similar to investments that generate tax-exempt income, maximizing your deductible contributions to qualified retirement plans (e.g., traditional IRAs, §401(k)s, SEPs, etc.), will potentially provide higher-income individuals with a double tax benefit: **1)** your contributions will reduce your MAGI and reduce your chance of exceeding the income thresholds that would expose your current *net investment income* to the Medicare Surtax, and **2)** the retirement plan distributions that you receive when you retire will be exempt from the 3.8% Surtax. **Planning Alert!** The retirement plan distributions would be included in your MAGI, and could cause you to exceed the MAGI threshold for paying the 3.8% Medicare Surtax on your investment income.

- **“Tax-Deferred” Investments May Reduce Medicare Surtax Exposure.** The 3.8% Medicare Surtax does not apply to earnings generated by a *tax-deferred annuity* (TDA) contract **until the income is distributed**. Thus, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the Medicare Surtax income thresholds.
- **Recognizing Capital Gains in 2012.** With the scheduled increase in the maximum long-term capital gains rates from 15% to 20% in 2013, and the imposition of the new 3.8% Medicare Surtax on capital gains starting in 2013, timing your sales of stocks, bonds, or other securities for 2012 is even more important than in previous years. If you are a higher-income taxpayer, you may save taxes by selling your appreciated long-term capital investments **that have peaked in value** in 2012, instead of waiting until 2013 or later. Likewise, overall tax savings may occur if you postpone selling investments producing a capital loss until 2013 or later, so that those losses can shelter capital gains that otherwise would be subject to the higher 20% capital gains rate and the 3.8% Medicare Surtax. **Tax Tip.** Under the so-called “wash sale” rules, you are not allowed to recognize a loss on the sale of securities if, within 30 days before or after the sale, you acquire substantially identical securities. However, the “wash sale” rules **do not** apply if you sell securities at a gain. Thus, you can accelerate gain by selling your appreciated securities before 2013, even if you purchase substantially identical securities at any time before or after the sale. Furthermore, by purchasing the replacement securities at their current appreciated values, you will obtain a higher tax basis in the newly-acquired securities. This higher basis in the securities will reduce any gain you recognize after 2012 from a disposition of the securities, and thus may reduce your exposure to the 3.8% Medicare Surtax. **Caution!** If the replacement securities go down in value after your purchase, you could face the “capital loss” limitations when you sell the investment. Also, you should always **consider the economics** of a sale or exchange first! **Planning Alert!** Although the maximum capital gains tax rate is currently scheduled to increase from 15% to 20% after 2012, it is possible Congress could extend the 15% rate (and other tax breaks that expire after 2012) beyond 2012. As we approach the end of 2012, feel free to call us for an update on the status of the scheduled 2013 tax rate increases.
- **Distributing Investment Income From A Trust Or Estate.** A trust or estate (filing an “income” Tax Form 1041) that has *undistributed* “net investment income” must pay the 3.8% Medicare Surtax on the **lesser of** the trust’s or estate’s 1) **“adjusted gross income”** in excess of a **“threshold amount,”** or 2) its **“undistributed net investment income.”** The **“threshold amount”** is the dollar level where the **highest income tax rate** for trusts and estates begins (as we completed this letter, the **threshold amount** is “unofficially” projected to be \$11,950 for 2013). **Tax Tip.** A trust or estate can avoid the 3.8% Medicare Surtax by timely distributing its *net investment income* to its beneficiaries. Distributions will avoid the 3.8% Surtax altogether where the beneficiaries have MAGI below the Medicare Surtax thresholds for individuals (e.g., \$250,000 for joint returns). **Planning Alert!** Where the trust or estate does not plan to distribute its *net investment income*, the trust or estate should consider tax-deferral techniques (e.g., investing in long-term growth securities) and tax-exempt income (e.g., purchasing municipal bonds) to avoid the 3.8% surtax.

**Deduction Threshold For Medical Expenses Raised From 7.5% To 10% Of AGI.** Under current law, individuals are generally allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums), but only to the extent that the expenses exceed 7.5% of adjusted gross income (10% for alternative minimum tax purposes). **Starting in 2013,** the *Health Care Act* generally increases the threshold for claiming an itemized deduction for un-reimbursed medical expenses from 7.5% of adjusted gross income (AGI) to 10% of AGI. **Exception For Seniors.** If either you or your spouse is **age 65 or older** before the close of the tax year, the 7.5% of AGI threshold will continue to apply **through 2016** (whether you file a joint return or separate returns). **Planning Alert!** Since the alternative minimum tax (AMT) treatment of the itemized deduction for medical expenses is not changed, medical expenses will continue to be deductible for AMT purposes only to the extent they exceed 10% of AGI, even if the taxpayer (or the taxpayer’s spouse) is age 65 or older before the close of the tax year. **Tax Tip.** If you will be subject to the 10% threshold in 2013, you should consider accelerating (i.e., bunching) your anticipated discretionary medical expenses into 2012 if your total medical expenses will exceed the 7.5% threshold, but not the 10% threshold.

**Annual Contributions To Health FSAs Will Be Capped At \$2,500.** Employer-sponsored cafeteria plans are one of the most popular tax-free fringe benefits offered to employees. Under these plans, employees can

generally select certain tax-free benefits or taxable cash payments. Benefits provided under a cafeteria plan may be funded through employer contributions, employee salary reductions, or a combination of both. One common option under these plans is a *health care flexible spending arrangement* (Health FSA). These Health FSAs have become especially popular because they allow an employee to lower income taxes by paying for common medical expenses with *before-tax* dollars. Through 2012, there is no limit (except as imposed by the plan itself) on the amount an employee can elect to contribute to a health FSA through salary reductions. **Starting in 2013**, cafeteria plans will be required to cap the annual salary reduction contribution to a health FSA at \$2,500. The \$2,500 cap will be adjusted for inflation after 2013. **Planning Alert!** The IRS has recently announced that if you work for two unrelated employers, each maintaining a health FSA, you may contribute up to \$2,500 to each plan. Also, the IRS says if you have a grace period (up to 2 months and 15 days) after the 2012 plan year to use your 2012 health FSA account, the unused portion that is carried over from 2012 into the 2013 grace period **will not count toward** your \$2,500 limit for 2013.

### **Non-Legislative Developments Impacting Primarily “Individuals”**

**New IRS Guidance Provides Potential Tax Planning Opportunities For Damage Awards.** If you are considering filing a lawsuit, depending on the nature and structure of the damage award, the payment(s) could be totally taxable, partially taxable, or fully tax free. Also, again based on the nature and structure of the damage award, the resulting attorneys' fees could be fully deductible, partially deductible, or not deductible at all. The IRS has recently released “audit guidelines” for IRS examiners providing detailed instructions for audits of taxpayers who have received a damage award (whether by actual litigation or by settlement due to threatened litigation). These guidelines provide an excellent checklist of the types of issues the IRS examiners will be looking for relating to **1)** the taxation of a damage award, **2)** the reporting requirements for those who pay the damage award, and **3)** the deductibility of related attorneys' fees. **Planning Alert!** Seeking tax advice **early in the process** of pursuing a damage award provides the best chance to maximize tax savings. The IRS audit guidelines make it clear that last minute, tax saving maneuvers are suspect and will be closely scrutinized. **Tax Tip.** If you are considering filing a lawsuit, please call our firm. We will review with you the various rules that apply to the taxation of a damage award, and suggest the steps that you should consider to maximize tax savings. If you are contemplating a lawsuit where you experienced a “**physical**” injury (e.g., car accident), it is possible that all (or a portion) of your potential damage award could be tax free.

**Tax Court Highlights Common Tax Trap For Non-Spouse Beneficiaries Of Inherited IRAs.** If a spouse dies naming the surviving spouse as the beneficiary of the deceased's IRA, the surviving spouse has the option to “roll over” the IRA into his or her own name. In fact, the surviving spouse may even take a direct distribution from the IRA and, within 60 days, roll the funds over into surviving spouse's own IRA. However, if the named beneficiary of a decedent's IRA is not the decedent's spouse (e.g., the child or sibling of the deceased), the non-spouse beneficiary may not transfer the IRA into another IRA titled in the beneficiary's own name. Instead, the beneficiary may only transfer the IRA funds to another properly-titled “inherited IRA” in the name of the previously-deceased owner (e.g., “John Smith, Deceased, F/B/O John Smith Jr.”). The Tax Court recently affirmed the requirement that, for a transfer from a decedent's IRA to an “inherited IRA” to be effective, it must be a “**trustee-to-trustee**” transfer. The court held that a non-spouse beneficiary who took the funds out of the decedent's IRA and later transferred those funds within 60 days back into properly-titled “inherited IRA,” was taxed on the initial distribution. **Planning Alert!** If you are named as a non-spouse beneficiary of a decedent's IRA (or qualified retirement plan account), please call us before transferring the funds to a new account. We will be glad to help you determine the most tax efficient way to transfer the funds.

**Courts Are Denying Charitable Contribution Deductions Where Taxpayer Failed To Receive Qualifying Receipt.** If you contribute \$250 or more to a charity, you are allowed a deduction only if you receive a **qualifying written receipt** from the charity **by the time** you file your return (provided that you received the receipt no later than the due date of your return). The **qualifying written receipt** must contain the following information: **1)** the amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** a statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** a description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). In addition, for all noncash contributions, the receipt must contain the date of the charitable contribution and a description of the property contributed. Furthermore, to take a charitable contribution deduction for property valued in excess of \$5,000, you must have both a



*qualifying written receipt*, as just described, and an *appraisal by a qualified appraiser*. Moreover, if you are claiming a deduction of more than \$500 for a vehicle, a boat, or an airplane you contributed to charity, the law requires that you obtain a *Form 1098-C* as well as a *qualifying written receipt* from the charity in order to deduct your contribution.

- **Planning Alert!** Over the last 12 to 18 months, the IRS has successfully taken several taxpayers to court denying a charitable deduction for those **who failed to timely** obtain a **qualifying written receipt**. For example, a taxpayer was denied a \$22,000 deduction because the written receipt from the church **did not include a statement that no goods or services were provided**; another taxpayer was denied a charitable deduction of \$1,870,000 for a donation of a “conservation easement” on real estate because the taxpayer failed to obtain a timely *qualifying written receipt*.
- **Caution!** Whether you are contributing property or cash, the IRS may deny your charitable contribution deduction unless you strictly comply with the technical documentation rules for the contribution. Consequently, please call us if you have any questions regarding these mandatory documentation requirements.

### **Tax Court Says That Unmarried Co-Owners Of Home Must Split The Maximum Home Mortgage Interest Deduction Caps.**

An individual (whether filing a single return or married filing a joint return) may generally deduct interest on the mortgage incurred to purchase his or her qualifying residence to the extent the mortgage balance does not exceed \$1 million. In addition, an individual may deduct interest for a qualifying home equity loan to the extent the loan balance does not exceed \$100,000. The Tax Court has recently held that two unmarried individuals who co-financed the purchase of their single principal residence, were required to split the \$1 million cap on the purchase of their single principal residence, and also split the \$100,000 cap on any qualifying home equity loan amount on that principal residence. In this case, an unmarried couple co-financed the purchase of their single principal residence by incurring a mortgage of \$2.7 million. The Court concluded that the overall \$1 million and the \$100,000 mortgage caps must be prorated between the two co-owners of the single residence. Thus, each co-owner was allowed to deduct interest on only \$550,000 of the aggregate \$2.7 million mortgage.

- **Tax Tip.** Generally, single taxpayers who have owned and lived in their principal residence for at least 2 out the previous 5 years, may sell the residence and exclude up to \$250,000 of the gain on the sale from their taxable income. Unlike the home mortgage interest deduction, the IRS regulations state that unmarried co-owners of their principal residence who both qualify for this home-sale gain exclusion rule, **do not** have to split the \$250,000 cap. That is, “each” unmarried co-owner who satisfies the 2-out-of-5 year rule can exclude up to \$250,000 of his or her share of the gain on the sale of their co-owned principal residence.

**IRS Releases New Guidance On Innocent Spouse Relief.** Married couples filing a joint return are *jointly and severally* liable for any taxes, interest and penalties arising from their joint returns. There are three provisions in the law that potentially allow an “*innocent*” spouse to avoid this liability. One of those provisions will allow relief if a spouse can demonstrate that it would be “inequitable” to hold that spouse responsible for the tax liability, interest, and penalties arising from the joint return. However, the IRS has historically argued that in order to qualify for this “equitable” relief, the spouse must submit an “equitable innocent spouse relief” request to the IRS no later than two years from the first collection activity against the innocent spouse. However, last year the IRS announced that it will **no longer apply this rigid 2-year filing deadline** for equitable innocent spouse relief. More recently, the IRS issued additional guidance that streamlines the procedures for seeking *equitable innocent spouse relief*, and enhances the potential availability of the relief. For example, the new guidance says that the IRS will be more flexible as to the economic hardship on the innocent spouse, and will give more consideration for relief where the innocent spouse was in an abusive situation.

- **Planning Alert!** If you have previously signed a joint return, you believe you have exposure to the liability of unpaid taxes on that return, and you think that you might benefit from innocent spouse relief, please call us. We will be glad to advise you on these new rules, and assist you in the process of seeking relief from the IRS. **Caution!** Even though the 2-year requirement for seeking “equitable innocent spouse relief” no longer applies, there are other time limits for seeking relief that do apply. Therefore, it is critical that

you call us as soon as possible if you have been contacted by the IRS concerning payment of taxes on a joint return.

**IRS Releases Guidance For Reporting Certain "Foreign" Investments Or Accounts.** Taxpayers who own certain foreign investments or foreign accounts may have to disclose those investments and/or accounts to the IRS and the Treasury Department. If you own foreign investments or assets, you should be aware of the following:

- **FBARs (Form TD F 90-22.1).** Any U.S. person having interests in (or signature authority over) foreign financial accounts that in the aggregate exceed \$10,000 at any time during the calendar year is required to file a foreign bank account report, Form TD F 90-22.1 (FBAR), disclosing those accounts to the Department of Treasury. The FBAR is due **by June 30** of the following year. Civil penalties for non-willful failure to file the FBAR can range up to \$10,000 per violation. The criminal penalties for willful failure to file a FBAR include a monetary penalty of up to \$500,000 and a prison term of up to 10 years. Under the FBAR reporting rules, a "financial account" generally includes a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a foreign financial institution. A financial account also includes a commodity futures or options account, an insurance or annuity policy with a cash value, and shares in a mutual fund or similar pooled fund. Generally, a "foreign financial account" is a financial account located outside of the United States. For example, under the FBAR reporting rules, an account maintained with a branch of a United States bank that is physically located outside of the United States is a foreign financial account. However, an account maintained with a branch of a foreign bank that is physically located in the United States is not a foreign financial account.
  - **Tax Tip.** The IRS recently clarified that owners and beneficiaries of IRAs or qualified retirement plans are not required to report a foreign financial account held in the IRA or qualified plan. In addition, IRS says that financial accounts maintained with a financial institution located on a U.S. military installation is not required to be reported.
  - **Planning Alert!** FBARs may be filed electronically by "e-filing." The IRS has recently announced that FBARs are **required** to be filed electronically **effective July 1, 2013**. Thus, you may still file a paper form for filings **through June 30, 2013**. Also, if you have not filed FBARs in previous years, the IRS recently re-opened its "offshore voluntary disclosure program" (OVDP) which may, if you meet certain conditions, allow you to file for back years with reduced penalties. If you need to file, or are uncertain whether or not you need to file a FBAR, please call our firm and we will be glad to assist you.
- **Specified Foreign Financial Assets (Form 8938).** Although the FBAR reporting rules have been in effect for years, **starting 2011**, Congress imposed a new reporting requirement on individuals who hold interests in "**specified foreign financial assets**" (SFFAs) exceeding certain threshold amounts. For example, the IRS says reporting is required for individuals living in the U.S. who file a joint return where the aggregate SFFAs are greater than \$100,000 at the end of the year or greater than \$150,000 at any time during the year. For singles living in the U.S., the threshold is greater than \$50,000 at the end of the year or greater than \$75,000 anytime during the year. The filing thresholds are higher for U.S. citizens living abroad. **SFFAs** include a **financial account maintained by a foreign financial institution** (e.g., foreign bank, foreign mutual fund, foreign hedge fund, foreign insurance company). If the financial account is maintained by a U.S. financial institution (e.g., U.S. bank, U.S. mutual fund, U.S. insurance company), it is **not** a SFFA, whether maintained in a domestic or foreign branch of the U.S. institution. Also, IRAs and qualified U.S. retirement plans are excluded from SFFAs. **In addition**, SFFAs include other **directly-owned** foreign financial assets held for investment (i.e., not held in an account with a financial institution), including: stock in foreign corporations; interests in foreign partnerships; notes, bonds and debentures, issued by foreign persons; interests in foreign trusts or estates; an interest in a foreign retirement plan; an interest in a foreign-issued insurance contract or annuity with a cash surrender value; and several other types of foreign investment assets. SFFAs are required to be reported on **Form 8938**. Form 8938 is filed along with an individual's income tax return for the applicable year. The penalty for failing to timely file Form 8938 generally ranges from \$10,000 to \$50,000.

- **Planning Alert!** The IRS has recently announced that real estate located in a foreign country (e.g., a second home or rental property) is not an SFFA if owned directly. However, if the foreign real estate is held **through a foreign entity** (e.g., foreign corporation, partnership, or trust), the IRS says the foreign entity is an SFFA.
- **Tax Tip.** For the vast majority of individuals subject to this new reporting requirement, 2011 was the first year that the Form 8938 was required to be filed. If you need to file, or are uncertain whether or not you need to file a Form 8938, we will be glad to assist you.
- **Are Business Entities Required To File Form 8938?** Last year, the IRS issued “*proposed*” regulations requiring the filing of Form 8938 by entities (e.g., corporation, partnership, LLC) “*formed or availed of for purposes of holding*” SFFAs. However, these proposed regulations also say that such entities will not be required to file Form 8938 until these proposed regulations are released in “final” form. As we complete this letter, these proposed regulations have not been finalized.

**IRS Releases Proposed Guidance On The Portability Of Estate And Gift Tax Exclusion Amounts Between Spouses.**

Over the years, the estate tax has generally been imposed only on estates exceeding a certain dollar amount (“applicable exclusion amount”). In 2001, Congress increased the estate tax *applicable exclusion amount* in stages and, by 2009, the estate tax applied only to taxable estates in excess of \$3.5 million. The *applicable exclusion amount*, which may be used to reduce either estate or gift taxes, was increased to **\$5,000,000** for **2011**, and to **\$5,120,000** for **2012**. For 2011 and 2012, the maximum estate and gift tax rates are 35% (down from the 55% historical maximum rate). **Caution!** For individuals **dying after 2012** and for lifetime **gifts made after 2012**, the *applicable exclusion amount* is currently scheduled to drop to \$1 million, and the top tax rate is scheduled to go back up to 55%.

- **Unused “Applicable Exclusion Amount” (Up To \$5,120,000 for 2012) Of First Spouse To Die May Be Transferred To Surviving Spouse.** Historically, although each spouse’s estate has been entitled to a full *applicable exclusion amount*, technical estate tax planning structures and strategies (e.g. credit shelter trusts) were often necessary to ensure that the *applicable exclusion amount* of the first spouse to die was not partially or completely wasted. As a result of recent legislation, for individuals **dying in 2011 or 2012** who **leave a surviving spouse**, the executor or administrator of the deceased spouse’s estate may “elect” for the unused portion of the deceased spouse’s *applicable exclusion amount* (up to \$5,120,000 for deaths in 2012) to be available to the surviving spouse. Thus, under this new (but temporary) “portability” rule, a surviving spouse could actually end up with an exclusion amount of up to \$10,240,000 (i.e., where the first spouse died in 2012 with no assets, the estate made the “portability” election, and no “taxable gifts” were made prior to death). Moreover, a deceased spouse’s *applicable exclusion amount* that is transferred to the surviving spouse may be used by the survivor to shelter lifetime gifts from gift tax, as well as sheltering the survivor’s estate from estate tax. **Planning Alert!** Unless this portability feature is extended by Congress, a deceased spouse’s unused exclusion amount may only be used by a surviving spouse’s estate where the surviving spouse **passes away before 2013**, or for **gifts made** by the surviving spouse **before 2013**.
- **Making The Portability Election.** The IRS has recently released “proposed” (and detailed) regulations providing guidance for: **1)** how the *applicable exclusion amount* of the estate of the first spouse to die is computed, **2)** the steps the executor or administrator of the first spouse’s estate must take to make an effective *portability election*, and **3)** how the surviving spouse can utilize the pre-deceased spouse’s *applicable exclusion amount*.
- **Planning Alert!** Although the proposed regulations are too long and technical to discuss in detail in this letter, certain time-sensitive actions must be taken for an estate to make an effective *portability election*. To make the *portability election*, the estate **must file** a timely (including extensions), properly-completed estate tax return (Form 706), **even if** the value of the spouse’s estate **is below the dollar threshold** requiring a return to be filed (\$5,120,000 for deaths in 2012). The estate tax return must be filed within 9 months of the spouse’s death, unless the estate timely requests a 6-month extension (which would allow the estate tax return to be filed within 15 months of the decedent’s death). Missing these filing deadlines could cause the surviving spouse to lose all of the pre-deceased spouse’s unused *applicable exclusion amount*. Consequently, if you are involved with

the estate (of any size) of a person who **died in 2011 or 2012** and **who left a surviving spouse**, please call our firm before these filing deadlines expire. We will help you evaluate whether filing an estate tax return for the deceased spouse's estate is advisable.

## **DEVELOPMENTS IMPACTING PRIMARILY "BUSINESSES"**

### **Recent Legislation**

#### **Middle Class Tax Relief Act (Payroll Tax Cut Bill)**

**Temporary Payroll Tax Relief Extended Through 2012.** As discussed previously in this letter, the ***Middle Class Tax Relief and Job Creation Act*** extended ***through December 2012*** the temporary reduction in the Social Security tax rate from 6.2% to 4.2% **for employees**, and from 12.4% to 10.4% for **self-employed individuals**. **Planning Alert!** Employers should remind employees that effective January 1, 2013, the employee-share of Social Security taxes is scheduled to revert back to 6.2% (unless the 2012 payroll tax holiday is extended by Congress).

#### **Three Percent Withholding Repeal And Job Creation Act**

**Work Opportunity Tax Credit (WOTC) Extended To 2012 Only For "Qualified Veterans."** The popular Work Opportunity Tax Credit (WOTC) for hiring workers from certain disadvantaged groups **expired for individuals hired after 2011, except for "qualified veterans"**. Congress continued the WOTC for "qualified veterans" to encourage employers to hire certain military veterans. To qualify, the new employee must be a **"qualified veteran"** who is hired **after November 21, 2011** and **before 2013**. Depending on the "tax" classification of the **"qualified veteran,"** the maximum credit runs from \$2,400 to \$9,600. In addition, unlike previous credits under the WOTC, tax-exempt employers (other than government agencies) that hire **"qualified veterans"** may receive a **"refundable"** credit of 65% of the credit allowed for taxable employers.

- **Tax Tip.** To qualify for the credit, all employers (including tax-exempt employers) must have the veteran complete IRS **Form 8850** ("Pre-Screening Notice and Certification Request for the Work Opportunity Credit"), and submit that form to the state employment security agency **no later than 28 days** after the employee begins work. You can locate Form 8850 at [www.irs.gov](http://www.irs.gov), and the instructions to the form provide detailed information on the definition of a **"qualified veteran."**
- **Planning Alert!** Although **during 2012**, the WOTC is allowed **only for** hiring a **"qualified veteran,"** it is possible that later in 2012 (or early in 2013) Congress may retroactively extend the WOTC for hires from the traditional targeted groups. Consequently, employers should continue having all new 2012 hires complete Form 8850 (and submit the form within 28 days to the applicable state employment agency). That way, the employer will have complied with the strict WOTC filing requirements if Congress ultimately retroactively extends the WOTC through 2012 for all targeted groups. **Please call our firm** if you want a status report on whether Congress has passed such a retroactive extension, or if you need additional information on the current credit for **"qualified veterans"** (including the "refundable" WOTC for tax exempt organizations).

#### **Patient Protection And Affordable Care Act (Health Care Act)**

As discussed previously, last summer the Supreme Court largely upheld the provisions of the ***Patient Protection and Affordable Care Act (Health Care Act)***. **Starting in 2014**, the ***Health Care Act*** will generally require certain larger employers to offer and contribute to their employees' **qualified** health insurance coverage, or pay a penalty. This so-called **play-or-pay** penalty contains a host of technical provisions that is too lengthy to address in this letter. However, all businesses should be aware of the following **tax provisions** in the ***Health Care Act*** that will generally apply **starting in 2013**:

**New .9% Medicare Surtax Employer Withholding Requirements.** As discussed previously in this letter, **starting in 2013**, the ***Health Care Act*** imposes a new .9% Medicare Surtax on the amount by which the sum of an employee's W-2 wages (and self-employed earnings) exceeds \$250,000 if married filing a joint return (exceeds \$200,000 if single, or \$125,000 if married filing separately). The IRS has recently announced that,

**starting in 2013**, employers must begin withholding this .9% surtax on wages paid to an employee once the wages exceed **\$200,000** in a calendar year. An employer is required to begin withholding the Medicare Surtax in the pay period in which it pays cumulative wages for the year in excess of \$200,000 to an employee. **For example**, let's assume that an employer paid one of its employees wages of \$180,000 through November 30, 2013. On December 31, 2013, the employer paid the same employee a single payment of \$50,000 (for total 2013 compensation of \$230,000). The employer would be required to withhold the .9% Medicare Surtax on \$30,000 of the \$50,000 December payment, but would not withhold the .9% on the remaining \$200,000 of compensation paid to the employee. **Planning Alert!** This withholding requirement is imposed on the employer even if the employee is married and files a joint return with combined W-2 wages under \$250,000 and, therefore, is not subject to the .9% Medicare Surtax.

**Excise Tax On Sale Of Medical Devices.** Subject to certain exceptions, manufacturers, producers, and importers of *taxable medical devices* will generally be subject to a 2.3% tax on the sales price of those devices **sold after 2012**. Early in 2012, the IRS released proposed regulations providing detailed guidance on this new excise tax. These rules are quite technical, please call our firm if you need details.

**Employer's Deduction For Medicare Part D Payments To Retirees Reduced By Subsidy.** If your business provides a *qualified retiree prescription drug plan*, it is entitled to a special federal subsidy of a percentage of the *allowable* retiree drug costs under the plan. This federal subsidy is excluded from taxable income. However, under current law, an employer is allowed a tax deduction for the total cost of the qualified retirement prescription plan, unreduced by the tax-free subsidy from the federal government. **For tax years beginning after 2012**, the *Health Care Act* will require employers to reduce their business deduction for the retiree prescription drug plan by the federal subsidy. Thus, the federal subsidy will still be tax free, but the employer's tax deduction for the plan's cost will be reduced by the subsidy.

**Compensation Deduction For Health Insurance Companies Limited To \$500,000.** Generally, under the *Health Care Act*, health insurance providers will not be able to deduct *current* annual compensation to any single officer, director, or employee in excess of \$500,000, **paid in tax years beginning after 2012**. **Planning Alert!** For *deferred* compensation arrangements, the limit applies to compensation paid in **tax years beginning after 2012**, that is attributable to services performed in a **tax year beginning after 2009**.

### **Non-Legislative Developments Impacting Primarily "Businesses"**

**IRS Releases Long-Awaited "Repair vs. Capitalization" Regulations.** One of the most significant "tax" issues confronting business taxpayers is whether expenditures involving an existing business asset **1)** may be **immediately deducted** as a "repair and maintenance" expense, or **2)** must be **capitalized** as an "improvement" and depreciated over the life of the underlying asset. For example, let's assume that a storm damaged the roof of your commercial building causing you to incur \$50,000 to bring the roof back to its pre-damaged condition. If you are allowed to treat the expenditure as a "repair and maintenance" expense, you could deduct the entire \$50,000 immediately. By contrast, if you are required to "capitalize" the expenditure as an "improvement" to the building, you would be required to deduct the \$50,000 over the depreciable life provided for a commercial building (i.e., over 39 years). Virtually every business, large and small, eventually confronts this "repair" vs. "capitalization" issue. In late December, 2011, the IRS released long-awaited guidance on this issue as it relates to "tangible" property (known as the "repair/capitalization" regulations). These regulations are intended to clarify the standards for capitalization of specific expenses associated with business assets, and provide comprehensive guidelines and examples for applying the standards. The IRS has also issued procedures explaining how taxpayers can automatically change their accounting methods to a method permitted or required under these regulations.

- **Practice Alert!** These new regulations, for the most part, are effective retroactively and apply to prior years. However, the IRS has provided a grace period for taxpayers to comply with these new rules, allowing taxpayers to change their accounting methods to comply either in the first or second "tax" year **beginning after 2011**. We will be discussing the implications of these new regulations with you as we complete your accounting and tax work.

**New IRS Guidance For Self-Employed Individuals Deducting Health Insurance Premiums (Including Medicare Premiums).** Generally, if you are a self-employed individual, a partner in a partnership, or a more-

than-2% shareholder of an S corporation, you may qualify for an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums you pay for yourself, your spouse, your dependents or your children who have not reached age 27 by the end of the tax year (even if a child is not your dependent). Until recently, there had been some confusion as to whether Medicare premiums paid by a self-employed individual, a partner in a partnership, or a more than 2% shareholder of an S corporation, qualified for this treatment. The IRS recently confirmed that if you otherwise qualify for an *above-the-line* deduction for health insurance premiums, you may be able to deduct your Medicare premiums (including **Part B** and **Part D**). **Planning Alert!** The recent IRS guidance says that a self-employed taxpayer may take the above-the-line deduction for a Medicare premium if the premium is paid "directly." The guidance does not, however, explain specifically what constitutes a "direct" payment of a Medicare premium. Presumably, if your Medicare premium is withheld from your social security payments (which is common), this would constitute a "direct" payment by you.

- **What About Previous "Open" Years?** The IRS has also recently told us that if you are self-employed and failed to take this deduction for Medicare premiums in prior years for which the statute of limitations is still open (generally, three years back), we may be able to amend those returns and take the deduction. **Please contact us if you think this applies to you, and we will help you determine whether we may amend prior year returns and take the deduction.**
- **Partners And 2% S Corporation Shareholders.** If you are a partner in a partnership or a more-than-2% shareholder in an S corporation and you are paying your 2012 health insurance premiums directly (including Medicare premiums), the IRS says that you should have the partnership or S corporation reimburse you for those premiums **before the end of 2012** to qualify for the *above-the-line* deduction. The IRS also says that, if you are an S corporation shareholder, the premium reimbursement must be included in your W-2. For partners in a partnership, the premium reimbursement must be treated by the partnership as a "guaranteed payment." If you are in this situation, please call our office and we will help you structure the reimbursement of the premiums to maximize your deduction.

#### **Tax Court Confirms Passive Loss Trap When Leasing Property To Your Closely-Held Business.**

Owners of closely-held businesses frequently own certain fixed assets (e.g., the business office building, warehouse, operating equipment, etc.) through a separately-owned "*leasing*" entity (e.g., LLC, S corporation), which is used to lease those assets to their separately-owned "*operating*" business entity. This so-called "brother-sister" ownership arrangement is often recommended for various reasons, including to help protect the leased office building, warehouse, equipment, etc. from potential claims of the *operating* entity's creditors. However, two recent Tax Court decisions agreed with the IRS that this leasing arrangement between controlled entities can create a "passive loss" trap. More specifically, both cases concluded that if the *leasing* entity generates **net rental income** and the owners of the *leasing* entity also **materially participate** in the business operations of the *operating* entity, the *net rental income* will **not be** classified as "**passive.**" Therefore, the *net rental income* will not be able to offset "passive" losses from other sources. Moreover, if the same *leasing* entity generates a **net rental loss**, the loss will generally be classified as a "**passive**" loss that must be suspended, and will not be deductible unless and until the owners have passive income. **Tax Tip.** One way to avoid this "*passive loss trap*" is to make sure the *leasing* entity sets the lease payments high enough (assuming the lease amount is reasonable) so that the property does not generate a tax loss. Please call us if you have this type of leasing arrangement as soon as possible, so we will have sufficient time to review your lease arrangement before the end of 2012.

#### **IRS Releases Guidance For Determining How An S Corporation Shareholder May Generate "Basis"**

**From Loans To The Corporation.** If you own stock in an S corporation that is generating a tax loss, you will not be able to deduct that loss on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your S corporation "basis" will carry over to succeeding years. You generally have basis to the extent of the amounts **paid for your stock** (adjusted for net pass-through income, losses, and distributions), **plus** any amounts you have **personally loaned** to your S corporation ("debt basis"). However, the IRS has frequently argued that you have not created *debt basis* in your S corporation if you financed the losses of your S corporation by loans, advances, or transfers of funds that originated from other entities that you control. These issues often involve attempts by an S corporation shareholder to obtain **debt basis** by borrowing from a controlled entity, and then loaning the proceeds to the shareholder's S corporation (a **back-to-back** loan transaction). Alternatively, a shareholder might seek to

**restructure a pre-existing loan or advance** directly from one controlled entity to the S corporation, into a **back-to-back** loan. Based on the specific facts of each case, the courts have frequently agreed with the IRS and denied **debt basis** when these back-to-back loan arrangements have been used between commonly-controlled entities. In order to provide more certainty to this long-standing controversy, the IRS has released "proposed" regulations providing guidance for determining whether an S corporation shareholder is allowed **debt basis** for loans to the corporation.

The proposed regulations generally provide that a shareholder will obtain **debt basis** in the S corporation (whether a **back-to-back** loan arrangement or a **restructure of an existing loan** arrangement is used) if, based on all of the facts and circumstances, the loan constitutes a "**bona fide indebtedness**" from the S corporation to the shareholder under general Federal tax principles. **Planning Alert!** Although the regulations do not provide a precise definition of what constitutes a **bona fide indebtedness**, it is clear that, at a minimum, there should be proper and timely documentation establishing the specific terms and conditions of the loan. Moreover, once the terms of the loan are established and documented, the shareholder and S corporation should comply with the precise terms of the loan agreement (e.g., make all principal and interest payments in a timely manner).

- **Tax Tip.** Making sure that you have sufficient basis is particularly important in 2012 if your S corporation anticipates generating losses from the 50% §168(k) bonus depreciation deduction, or if the business has experienced a temporary downturn causing pass-through losses. If an S corporation anticipates financing losses through borrowing from an outside lender, the best way to ensure the shareholder gets **debt basis** is to: **1)** have the shareholder personally borrow the funds from the outside lender, and **2)** then have the shareholder formally (with proper and timely documentation) loan the borrowed funds to the S corporation. It also may be possible to **restructure** (with timely and proper documentation) a pre-existing outside loan to your corporation in a way that will give you debt basis. **Caution!** You cannot get debt basis by merely guaranteeing a third-party loan to your S corporation.

**Tax Court Concludes That Pass-Through Income To Law Firm Partners Operating As A Limited Liability Partnership (LLP) Was Subject To Social Security And Medicare Taxes.** "General" partners of businesses operating as partnerships are generally subject to Social Security and Medicare taxes (SECA tax) on their business income from the partnership. By contrast, "limited" partners are generally exempt from SECA tax on the partnership's business income (except for "guaranteed payments" they receive). However, it has never been entirely clear whether and to what extent pass-through business income to the owner of a Limited Liability Company (LLC) or Limited Liability Partnership (LLP) is subject to SECA tax.

In a recent case, the Tax Court held that owners of a law firm operating as a "limited liability partnership" (LLP) should be treated as "general" (not "limited") partners and, therefore, should be subject to SECA tax on all pass-through business income from the LLP (whether or not distributed). The Court generally concluded that an owner of an LLP qualifies for the "limited partner" exception to SECA taxes *only if* the LLP owner is a "**mere investor**" who does not "**actively participate**" in the business operations of the LLP. Since the lawyers in this case were not mere investors and actively participated in the firm's law practice, the Court imposed SECA tax on their business income from the partnership.

- **Practice Alert!** Although this case dealt with an LLP and not a "limited liability company" (LLC), the IRS could extend the rationale of this decision to LLC owners.

## **FINAL COMMENTS**

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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