

# CLIENT LETTER

## 2011 First Quarter Federal Tax Developments

Dear Client:

During the first quarter of 2011, there were many important federal tax developments. This letter highlights some of the more important federal tax developments for you. As always, please give our office a call or send us an email if you have any questions about these developments.

### **Federal taxes**

President Obama released his fiscal year (FY) 2012 federal budget recommendations in February. The president proposed to extend the Bush-era income tax rate reductions for all taxpayers except for higher income taxpayers (which the White House defines as individuals with incomes over \$200,000 and married couples with incomes over \$250,000). The president also proposed, among other things, to make permanent the American Opportunity Tax Credit and extend some popular but temporary individual tax incentives. For businesses, the president proposed, among other things, to make permanent the research tax credit.

### **Bonus depreciation**

The IRS issued much-anticipated guidance on 100 percent bonus depreciation (enacted by the Tax Relief, Unemployment Reauthorization Extension and Job Creation Act of 2010). The IRS explained the relationship between 100 percent bonus depreciation and 50 percent bonus depreciation (enacted by the Small Business Jobs Act of 2010). The IRS also allowed, among other things, businesses to elect to deduct 50 percent bonus depreciation instead of 100 percent bonus depreciation in certain situations.

### **Information reporting**

Congress passed the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 (2011 Taxpayer Protection Act) to repeal expanded information reporting on Form 1099 for certain business payments and rental property expense payments. The provisions had been widely criticized as being unduly burdensome on taxpayers, especially small businesses.

### **Filing season**

Due to observance of Emancipation Day in the District of Columbia on Friday April 15, 2011, taxpayers received extra time to file their 2010 individual income tax returns. The filing deadline moved to Monday, April 18, 2011. By law, holidays in the District of Columbia impact federal tax deadlines.

In other filing season news, some taxpayers experienced delays in the processing of their returns because of tax legislation passed by Congress in late 2010. The IRS needed additional time to program its computer systems for the late legislation. Most programming issues were resolved by mid-February 2011. However, the IRS continued to experience difficulties processing returns claiming the first-time homebuyer tax credit.

### **Basis overstatement**

The Seventh Circuit Court of Appeals held that a six-year statute of limitations applies to overstatements of basis. (Beard, January 26, 2011). The Court of Appeals for the Federal Circuit also ruled in favor of the IRS (Grapevine Imports, Ltd., March 11, 2011). The decisions uphold IRS regulations that specifically apply the six-year limitation period to the assessment of tax attributable to partnership items. The decisions also continue a split among the circuit courts of appeal whether an overstatement of basis is an omission of gross income for purposes of the Code Sec. 6501(e) six-year limitations period. In February, two other courts of appeal ruled against the IRS. The Fourth Circuit Court of Appeals (in Home Concrete & Supply, February 7, 2011) and the Fifth Circuit Court of Appeals (in Burks, February 9, 2011) found that an overstatement of basis is not an omission of gross income.

### **Vehicle depreciation**

The IRS issued limitations on depreciation deductions for owners of passenger cars and trucks and vans first placed in service in calendar year 2011. The IRS also provided revised tables of depreciation limitations for vehicles first placed in service (or first leased by the taxpayer) during 2010 to which bonus depreciation applies.

### **Offshore accounts**

The IRS announced a second offshore voluntary compliance initiative in February. The 2011 initiative is similar to one offered to taxpayers in 2009 but with a different penalty framework. The initiative is scheduled to run through August 31, 2011 and is designed to encourage taxpayers to disclose unreported offshore accounts. Generally, taxpayers must pay a penalty of 25 percent of the amount in the foreign bank account with the highest aggregate account balance covering the 2003 to 2010 period. Some taxpayers may be eligible for reduced penalties of 12.5 percent (generally taxpayers whose offshore accounts did not surpass \$75,000 in any calendar year covered by the initiative) or five percent (generally taxpayers who meet very narrow criteria, including but not limited to, infrequent and minimal contact with the foreign account). In related news, the Treasury Department issued final rules on the filing of Form TD-F 90-22.1 (Report of Foreign Bank and Financial Accounts), known as "FBAR." The Bank Secrecy Act requires each United States person to file an FBAR if the person has a financial interest in, or signature authority over, one or more accounts in a foreign country and the aggregate value of those accounts exceeds \$10,000 at any time during the calendar year.

## **IRS liens**

The IRS announced new measures to help taxpayers struggling during the economic slowdown. The agency is revising its lien processes, making changes to installment agreements for small businesses, and expanding a streamlined offer in compromise (OIC) program. Among other changes, liens can now be withdrawn immediately once full payment of taxes is made if the taxpayer so requests. The IRS also announced it will increase the dollar thresholds when liens are generally filed. Streamlined installment agreements will be made available to more small businesses.

## **Flexible spending arrangements**

Health care reform legislation enacted in 2010 made some important changes to flexible spending arrangements (FSAs). Beginning January 1, 2011, the costs of over-the-counter (OTC) medications and drugs may be reimbursed under an FSA only if the medications and drugs are purchased with a prescription (subject some exceptions). Previously, taxpayers could use FSA dollars to purchase OTC medications and drugs without a prescription. The IRS issued guidance on the use of FSA debit cards for prescribed OTC medications and drugs early in 2011.

## **Gift cards**

As store gifts cards have grown in popularity, so have questions about accounting for gift cards and tax treatment. The IRS answered some of those questions in new guidance. Revenue Procedure 2011-17 provides a safe harbor method of accounting for accrual method merchants that issue gift cards to customers in exchange for returned merchandise. Revenue Procedure 2011-18 allows taxpayers to defer recognizing in gross income advance payments received from the sale of gift cards that are redeemable for goods or services of the taxpayer or a third party.

## **IRS regulations**

Every year, the IRS issues regulations to implement the provisions in the Tax Code. Sometimes, taxpayers challenge the IRS regulations as exceeding the agency's authority or for other reasons. In January, the U.S. Supreme Court held that IRS regulations are entitled to a high level of deference (*Mayo Foundation*, S. Ct., January 11, 2011). The Supreme Court's decision may make it more difficult for taxpayers to challenge IRS regulations.

## **Innocent spouse relief**

In January, the Third Circuit Court of Appeals upheld a two-year deadline for seeking equitable innocent spouse relief (*Mannella*, January 19, 2011). The Third Circuit found that the IRS regulations, which set a two-year deadline, are reasonable. However, some courts have found that the IRS regulations are not reasonable. The dispute may one day be decided by the U.S. Supreme Court.

## **Exempt organizations**

The IRS announced that more small tax-exempt organizations would be eligible to file a simplified annual information return. For tax years beginning on or after January 1, 2010, tax-exempt organizations with annual gross receipts of \$50,000 or less can file Form 990-N, Electronic Notification e-Postcard. The threshold previously was \$25,000 in annual gross receipts.

### **Health care reform**

Several federal district courts weighed-in on the constitutionality of health care reform legislation enacted in 2010. A federal district court in Mississippi rejected a constitutional challenge to the legislation (Bryant, DC-Miss., February 2, 2011). However, federal district courts in Florida and Virginia found that the health care reform legislation was unconstitutional (Florida, DC-Fla., January 31, 2011, Sebelius, DC-Va., December 13, 2010). The Third Circuit Court of Appeals is expected to be the first appellate court to rule on the constitutionality of health care reform. The Third Circuit has scheduled a hearing on the Virginia case in May.

These are just some of the many federal tax developments during the first quarter of 2011. Please contact our office if you have any questions about these or any tax developments.

Sincerely yours,

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