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National Association of Enrolled Agents

California Society of Enrolled Agents

## IMPORTANT TAX FILING DEVELOPMENTS

### Electronic Filing Required for most returns in 2012

Starting in January 2012, any paid preparer that expects to file 11 or more 1040 returns must use IRS e-file. However, if you file these forms yourself, you may choose to file by paper, even if I prepare the return for you. If you do not want your return filed electronically, we can give you a printed copy to mail to the IRS yourself. We will need to obtain a hand-signed and dated statement from you stating that you do not want your return e-filed.

Filing tax returns electronically has benefits and drawbacks. The benefit is that the returns are processed quickly and you should receive your return in much less time. The drawback is that it is easier for the IRS to analyze and scrutinize an electronic tax return.

### All 2012 Returns With Earned Income Credit Claims Must Attach Checklist

The IRS has issued proposed regulations that require paid tax return preparers to file a due diligence checklist with any federal return claiming the Earned Income Credit (EIC) beginning in 2011. In past years I have been required to complete this form and retain it in my client records. However, now it must be sent in with the tax return. To fill out the checklist, I am required to ask questions about a client's dependents, sources of support, living situation, and family relationships. Requiring that this checklist be submitted as part of the tax return raised its legal significance and subjects it to much greater scrutiny by the IRS. At this point, it is unclear as to what extent my clients will need to prove to me the accuracy of the information they are conveying. The IRS regulations state that I must "make reasonable inquiries if the information furnished appears to be incorrect, inconsistent, or incomplete." The penalty on tax preparers who do not exercise "due diligence" when determining a client's EIC has increased from $100 to $500 for *each* failure.

This change means that your tax return will be more complicated to complete and you can expect the IRS to more closely investigate your eligibility for the earned income credit.

#### EIC by the numbers

The earned income credit is targeted to low and moderate-income workers and working families, and the tax benefit varies by income, family size and filing status. Unlike most deductions and credits, the EIC is refundable– taxpayer can get it even if they owe no tax.

### 2012 inflation adjustments increase many tax benefits, social security wage base also up

The IRS has announced inflation adjustments for 2012 which increase the personal exemption and standard deductions, along with numerous other tax benefits. The maximum amount of earnings subject to Social Security taxes also has been increased to $110,000, up from $106,800 in 2011. Social Security benefits will rise due to a 3.6 percent cost of living adjustment starting in January 2012. Yearly contribution limits for 401(k) and similar retirement plans are increased to $17,000 from $16,500.

Here is a run-down of the new numbers:

### Personal Exemptions, Standard Deduction and Brackets

- The personal and dependent exemption is $3,800, up $150 from 2011.
- The standard deduction is $11,900 for married couples filing a joint return, $5,950 for singles and married individuals filing separately, and $8,700 for heads of household. Several tax benefits are unchanged in 2012. For example, the additional standard deduction for blind people and senior citizens remains $1,150 for married individuals and $1,450 if the individual is unmarried and not a surviving spouse.
- Tax bracket thresholds will be increased slightly for each filing status. For a married couple filing a joint return, for example, the taxable-income threshold separating the 15-percent bracket from the 25-percent bracket is $70,700 up from $69,000 in 2011.

#### Student Loan Interest Deduction

The $2,500 maximum deduction for interest paid on student loans begins to phase out for married taxpayer filing joint returns with adjusted gross income of $125,000 and phases out completely at $155,000. For single taxpayers, the phase-out range is between $60,000 and $75,000.

#### Credits, Deductions and Medical Savings Plan Limits

- For tax year 2012, the maximum earned income credit (EIC) rises to $5891. The maximum income limit

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for the EIC rises to $50,270.

- The foreign earned income deduction rises to $95,100.
- The adjusted gross income threshold at which the lifetime learning credit begins to phase out is $104,000 for joint filers and $52,000 for singles and heads of household.
- For 2012, annual deductible amounts for Medical Savings Accounts (MSAs) will increase from the 2011 amounts as shown at the bottom of the page.

### Nanny Taxes

The threshold amount for paying employment taxes on a domestic employee will rise from $1,700 to $1,800 per year. The dollar threshold applies separately to each domestic employee.

### Adoption Credit and Adoption Assistance Exclusion

The maximum credit allowed or adoption of a special needs child will be $12,650 in 2012. The maximum amount of adoption assistance a taxpayer may exclude from income is at the same amount, $12,650.

### Estate and Gift Tax

For an estate of any decedent dying during calendar year 2012, the exclusion from estate tax amount is $5,120,000 up from $5,000,000 for calendar year 2011. Also, if the executor chooses to use the special use valuation method for qualified real property the aggregate decrease in the value of the property resulting from the choice cannot exceed $1,040,000, up from $1, 020,000 for 2011.

The annual gift exclusion remains at $13,000.

### Transportation Benefits

- The monthly limit on the value of excludable parking benefits for employees rises to $240. However, the monthly limit on transportation in a commuter highway vehicle and on transit passes provided by an employer is reduced to $125 for 2012.

### Expensing Limits for Depreciable Assets

The amount a business taxpayer can write off for tangible personal property in the first year the asset is placed in service will be reduced in 2012. The higher limits we have had for a few years are expiring. In 2011, $500,000 could be expensed. In 2012, up to $139,000 of eligible property costs can be deducted immediately. However, this amount must be reduced dollar for dollar if a taxpayer's aggregate purchases for the year exceed $560,000.

### Pension Plan Limitations for 2012

The IRS also announce cost of living adjustments to dollar limitations for pension plans and other retirement plans for tax year 2012. The contribution limit for employees who participate in 401(k), 403 (b), most 457 plans and the federal government's Thrift Savings Plan is increased from $16,500 to $17,000.

- The catch-up contribution limit for those aged 50 and over remains unchanged at $5,500.
- The deduction for contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have AGIs between $58,000 and $68,000. For married filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $92,000 to $112,000. For those IRA contributors who are not covered by an employers plan but the spouse is, the deduction is phased out if the couple's income is between $173,000 and $183,000.
- The AGI phase-out range for contributions to a Roth IRA is $173,000 to $183,000 for married filing joint; $110,000 to $125,000 for single and head of household. For a married filing separate individual who is covered by a retirement plan at work, the phase-out range remains $0—$10,000.
- The AGI limit for the saver's credit for low– and moderate-income workers is $57,500 for married filing jointly; $43,125 for head of household; and $28,750 for married filing separately and single taxpayers.

## Congress Repeals 3% Withholding For Government Contractors, Passes Veteran Hiring Credits

Congress has passed and sent to the President H.R. 674, a bill that repeals the 3% withholding on government contractors which was set to go into effect in 2013. President Obama has indicated he will sign the legislation. The measure also includes the Returning Heroes Credit which would give employers up to $2,400 for hiring post 9/11 veterans who have been unemployed for four weeks. The credit would be up to $5600 if the veteran has been unemployed for six months or more. Additionally a $4,800 Wounded Warriors tax credit would be available to employers who hire a disabled veteran who has been unemployed for four weeks. The credit increases to $9600 if the veteran has been out of work for six months or more. The credits are allowed for veterans hired after November 21, 2011.

To pay for the bill a provision was included that allows a continuous 100% levy on payments to federal vendors for goods and services if the vendor owes back taxes.

## Trade Bill Raises Health Credit Coverage For Displaced Workers

President Obama has signed into law several related trade bills which contain tax provisions. One Bill increases the rate of Health Coverage Tax Credit programs that provides health insurance benefits to workers eligible for trade adjustment assistance and for retirees who were covered by pension plans taken over by Pen-

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| Medical Savings Accounts (MSA) | Self –only Coverage | Family Coverage |
|---|---|---|
| Min. Annual Deductible | $2,100 | $4,200 |
| Max. Annual Deductible | $3,150 | $6,300 |
| Max Out-of Pocket Expense | $4,200 | $7,650 |

sion Benefit Guaranty Corporation who have lost their employer-sponsored coverage. (The Trade Adjustment Assistance Program is a federal program that aids U.S. workers who have lost their jobs as a result of foreign trade.) The legislation subsidizes 72.5 percent of the cost of the health care premium, provides workers with retroactive payments to help cover the up-front costs of obtaining health coverage, an provides coverage for the worker's spouse and dependents.

## Tax Provisions Set to Expire at the end of 2011

Below is a list of major tax provisions set to expire at the end of 2011 unless Congress acts to extend them.

### Individual Provisions

- Temporary 2% Payroll Tax Cut
- Increased Individual Alternative Minimum Tax (AMT) exemption and Nonrefundable Personal Tax Credits Allowed Against the AMT
- Deductions for State and Local Sales Taxes. (Note: This will make a huge difference for taxpayers who live in states with no state income tax– and taxpayers who are planning to buy expensive items, such as appliances, motor homes, and boats.
- Tuition and Fees Deduction for Higher Education.
- Itemized Deduction for Mortgage Insurance Premiums.
- $250 Deduction for Teacher Classroom Expenses
- Direct Charitable Contributions from an IRA

### Business Provisions

- 100 Percent bonus Depreciation
- Enhanced $500,000 Expensing of Depreciable Property (not including real estate)
- Small Business Stock Exclusion
- Research and Development Tax Credit
- Work Opportunity Tax Credit for Employers
- New Markets Tax Credit

### Energy Incentives

- Nonbusiness Energy Credit for Energy Efficient Building Improvements and Residential Energy Property, such as furnaces, central air conditioners, water heaters, heat pumps and similar components.
- Electric-drive Vehicles and Plug-in Conversions
- Energy–Efficient Home Construction Credit
- Energy-Efficient Appliance Credit

## Tax Planning

### Depreciation And Expensing Elections In 2011, 100% Write-offs Possible

In an effort to stimulate the sluggish U.S. economy, Congress and the Administration over the last few years have put in place extremely generous options for writing off the cost of depreciable business property. These business tax incentives can provide you with significant, immediate tax savings if you placed assets in service in 2011 and you make the necessary elections. Three different types of cost recovery for your investments can come into play in tax year 2011: Section 179 expensing bonus depreciation, and the regular modified accelerated cost recovery (MACRS). All three types of cost recovery reduce your basis in the asset, which will increase your gain when the asset is sold. Note that your State may not allow bonus depreciation. After considering a number of factors discussed below, we will have to decide which combination of the three programs will be the most beneficial to you.

**Expensing:** Expensing is the immediate write-off of the cost of business property in the first year the property is placed in service. This is allowed under Section 179 of the Internal Revenue Code and is commonly referred to by this Code section. Only tangible, depreciable personal property qualifies, not real property (with a few exceptions). Off—the-shelf computer software also can be expensed in 2011. There are limits on how much you can expense each year. For 2011, the limits have been at an all-time high- $500,000. The catch is that you must reduce this amount by the amount that your total purchases of eligible property exceed $2 million for the year. For example, if you purchase a total of $2, 200,000 for the year, you can only expense $300,000, which is the $500,000 allowance reduced by the $200,000 that you went over the purchase limit.

Another consideration is that your Section 179 expensing deductions cannot create a business loss. So, if you do not have enough income to absorb the deductions, you have to carry it over to future years when you may have the business income to cover it.

**Bonus Depreciation:** Also available in 2011—100% "bonus depreciation". Bonus depreciation is not subject to an allowance limit or a purchase limitation. It also is not limited by business income.

**MACRS:** The Modified Accelerated Cost Recovery System is the current system of depreciation used for personal, not real, property. Most real property has to be depreciated under the straight-line method over 30+ years with level deduction amount each year. The MACRS system allows a percentage write-off each year which starts out high and then declines over the life of the asset.

**Considerations** Because bonus depreciation does not have the same limitations as Section 179expensing, this may be your best option for the most immediate deduction, especially if you do not have the business income to cover your Section 179 deduction. Section 179 expensing deductions cannot create a business loss, but bonus depreciation write-offs can. Therefore, you can use bonus depreciation to create a net operating loss that can be carried forward and offset income in future years. Be aware, however that if you take bonus depreciation, when you sell the asset, the entire gain will be taxed at ordinary income rates rather than capital gains rates under the "recapture" rules. You must also elect out of bonus depreciation

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or the IRS will assume you took it and reduce your basis in the asset.

There are some situations when you may not want to accelerate your depreciation deductions. If you are in a low tax bracket this year and expect your income to rise, you may want to delay accelerated write-offs until years when your income is higher. The deduction will be worth more to you then.

## Special Rules for Automobiles

Special rules and different limits apply to automobiles used in business. The write-offs for this type of asset are restricted, but still generous for tax year 2011, too. Different rules apply based on the weight of the vehicle. I will be glad to evaluate your business' eligibility for a vehicle depreciation write-off if you have purchased business vehicles in 2011.

### Mileage Deductions Add Up Quickly!!

As 2011 began, IRS has set the allowance at .51¢ mile. Recently IRS says we may use 55.5¢ for miles after mid-year. You must segregate the two halves of 2011

**Who can Claim Miles?** Driving must relate to your trade or business, investments, or to charity. Personal driving never gives deductions.

**Self-Employed & Landlords** get full value for driving related to the activity. Don't miss any!

**Job, Investment & Charity** You must be able to itemize your deductions to benefit. Driving for job or investment s also has a "floor of 2% of your income before you get a benefit from mileage deductions.

**Commuting** is any drive between home and a business site. For trade or business driving IRS uses special rules. To find deductible drives, they distinguish between "regular" and "temporary " business sites.

**"Business" sites** are any places you have a legitimate business reason to visit.

**"Regular" sites** are ones you visit 35 or more times in a given year. This commute is *not* deductible. Most have a single "regular" business location but some have more.

**"Temporary" sites** are ones you visit fewer than 35 times a year. A drive between home and one of these sites *is* deductible.

**"Business to Business"** driving is always deductible. Leave work to visit a customer or make a delivery, and then return to work– you have deductible driving.

**Charity and Investments** IRS allows all legitimate driving for these purposes. If you read to children at the library every Saturday deduct each trip, even though you have more than 35 visits. The drawback for driving for charity is the rate is only 14¢ a mile.

The mileage deduction is not for everyone. They apply to most , but not all. Different rules come into play for special circumstances. If you think you might be eligible for the mileage deduction, call me. We can discuss whether you are eligilble for the deduction.

Mileage deductions demand *written* records! Be sure to keep a log of some sort. A thorough log lists date, purpose of the trip, location, and odometer readings.

## Small Business Health Care Tax Credit

If you are a small employer and pay at least half of the premiums for employee health insurance for your workers you may be eligible for the small business health care tax credit. The credit can enable small businesses and small tax-exempt organizations to offer health insurance coverage for the first time. It also helps those already offering health insurance coverage to maintain the coverage they already have. The credit is specifically targeted to help small businesses and tax-exempt organizations that employ 25 or fewer workers with average incomes of $50,000 or less.

Small businesses that were eligible for the credit in 2010 but did not claim it on your return, can still claim the credit. I will be glad to discuss how we can amend your return.

Businesses that could not use the credit in 2010 may be eligible to claim it in future years. If you changed your health insurance plan structures and contributions in 2011, you may be eligible to claim the credit on the 2011 return or in years beyond.

The credit can be claimed 2010 through 2013 and for two additional years beginning in 2014.

For tax years 2010 through 2013, the maximum credit is 35 percent of premiums paid. For eligible tax exempt employers the maximum credit is 25 percent. Beginning in 2014 the maximum tax credit will go up to 50 percent for small business and 35 for tax exempt organizations.

## Client Advisory

### Taxpayers' e-mails not subject to IRS summons

In a victory for taxpayers, the IRS Chief Counsel has decided that a revenue officer's summons to an internet service provider requesting a taxpayer's e-mails was invalid and should be withdrawn. The revenue officer was trying to collect more than a quarter million dollars form a taxpayer who received large refunds from credits claimed through a "shell" entity.

### Your Right to E-Mail Privacy

Because the revenue officer was seeking the records in a civil tax case, rather than a criminal case, the IRS could *not* force the internet provider to turn over the records. However, the IRS can force disclosure of other customer information, such as the name, address, length and type of service, and means of payment. This type of information must be turned over to the IRS, but the content of e-mails may not without a *criminal* warrant.

## Thank you for your Business

I can assure you that I will be keeping a watchful eye on Congress and on IRS actions which may affect you business and your tax filings in the New Year. I will be happy to address any concerns and answer question you have about any of the issues covered in this newsletter. Thank you for the opportunity and privilege of allowing me to serve as your tax professional. Best Regards,

Earl E. Glenn, E.A

# Qualified Medical Expense Checklist

- Abortion
- Acupuncture
- Alcoholism– Inpatient treatment at a therapeutic center for alcohol addiction (includes meals and lodging provided by the center)
- Ambulance
- Artificial Limbs and Artificial Teeth
- Birth Control Pills
- Braille Books and Magazines to the extent the cost exceeds a regular printed edition
- Breast reconstruction after a mastectomy (Rev. Rul. 2003-57)
- Car– special hand controls, etc. for disabled individuals
- Chiropractor
- Christian Science Practitioner
- Contact Lens– Including equipment and materials such as saline and enzyme cleaner
- Crutches (Rev. Rul. 2003-58)
- Dentists & Dental Treatment
- Drug addiction– inpatient treatment at a therapeutic center (includes meals and lodging)
- Drugs-Prescription
- Elastic hosiery
- Equipment, supplies and diagnostic devices even if not prescribed (Rev. Rul. 2003-58)
- Eyeglasses– includes examination fees
- Fertility enhancement - in vitro and surgery (PLR 200318017)
- Guide dog or other animal– includes care expenses of the animal
- Health club—if treatment is prescribed and the physician issued a statement that the treatment is necessary to alleviate a physical or mental defect or illness of the individual receiving the treatment.
- Hearing aids (including batteries)
- Home care
- Hospital services
- Insurance premiums– hospitalization, surgical fees, x-rays, etc. including prescription drugs, replacement of lost or damaged contact lenses membership in "free choice" medical services, Medicare or qualified long-term care.
- Laboratory fees
- Laser eye surgery
- Lead-Based Paint Removal—to prevent a child who has or who has had lead poisoning from eating the paint
- Learning Disability—tuition fees for a special school for a child with sever learning disabilities caused by mental or physical impairments, including nervous systems disorders. Doctors must recommend child attend.
- Legal Fees– necessary to authorize treatment for mental illness.
- Lodging while away from home - $50 per night for each person. Includes a person accompanying an ill person– both parties will be allowed to deduct up to $50 per night. Lodging not provided in a hospital or similar institution must meet all of the following:

- Lodging is primarily and essentially for medical care and not lavish or extravagant;
    - Medical Care is provided by a doctor in a licensed hospital or equivalent; and
    - No significant element of personal pleasure, recreation or vacation in the travel.
- Meals—only for inpatient care
- Medical Conferences — admission to or transportation to a medical conference if it concerns the chronic illness of you, spouse, or dependent. Must spend a majority of your time at the conference attending sessions. Does not include meals or lodging.
- Medicines — prescribed medicines and drugs )requires a prescription) and insulin
- Medical Services—for legal medical services provided by physicians, surgeons, specialists, or other medical practitioners
- Mentally Retarded—the cost of keeping a mentally retarded person in a special home, not the home of a relative, on the recommendation of a psychiatrist to help the person adjust
- Nursing Home—cost of medical care in a nursing home, including the cost of meals and lodging in the home if the main reason for being there is to get medical care. If the reason for being there is personal, deduct only the portion for nursing and medical care
- Nursing Services need not be performed by a nurse as long as the services are of a kind generally performed by a nurse ( giving medications, changing dressings, bathing, etc.)
- Operations—legal operation that are necessary (not cosmetic surgery)
- Optometrist
- Oxygen—for oxygen and oxygen equipment to relieve breathing problems caused by a medical condition
- Psychiatric Care—includes the cost of supporting a mentally ill dependent at a specially equipped medical center; does not include psychoanalysis you must get as part of your training to be a psychoanalyst
- Schools and Education, Special—payments to a special impaired or physically disable person I f the main reason for using the school is its resources for relieving the disability. Includes the cost of teaching Braille to the visually impaired, teaching lip reading to the hearing impaired and giving remedial language training to correct a condition caused by a birth defect. You cannot include the cost of sending a problem child to a special school for benefits the child may get from the course study and the disciplinary methods.
- Sterilization—costs of a legal sterilization
- Stop-smoking Program—You cannot include drugs that do not require a prescription such as nicotine patch or gum (Rev. Rul. 99-28)
- Telephone—the cost and repair of special telephone equipment that lets a hearing-impaired person communicate over a regular telephone.
- Television—the cost of equipment that displays the audio part of a television program for the hearing-impaired.
- Therapy
- Transplants—surgical, laboratory, and transportation expenses for a donor or possible donor of an organ
- Transportation Costs—primarily for and essential to medical care, includes bus, taxi, train, plane, ambulance, parking fees, tolls, and automobile expenses at the greater of out-of-pocket expenses for gas and oil or mileage rate for the current tax year.
- Trips—transportation to another city if the trip is primarily for and essential to receiving medical services. Does not include vacations even if recommended by a doctor.
- Weight-Loss Programs—undertaken at a physician's direction to treat an existing disease ( such as heart disease or obesity). Not deductible if it is to improve your general health and well-being (Rev. Rul. 2002-19 and rev. Rul. 79-151)
- Wheelchair—used mainly for the relief of sickness or disability and not just to provide transportation to and from work.
- X-Rays