Recent Tax Developments

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The following is a summary of the most important tax developments that have occurred in the past three months that may affect you, your family, your investments, and your livelihood. Please call us for more information about any of these developments and what steps you should implement to take advantage of favorable developments and to minimize the impact of those that are unfavorable.

New IRS offshore voluntary disclosure initiative. On January 9, 2012 the Internal Revenue Service reopened the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes and announced the collection of more than $4.4 billion so far from the two previous international programs.

The IRS reopened the Offshore Voluntary Disclosure Program (OVDP) following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. The third offshore program comes as the IRS continues working on a wide range of international tax issues and follows ongoing efforts with the Justice Department to pursue criminal prosecution of international tax evasion. This program will be open for an indefinite period until otherwise announced. The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS may increase penalties in the program for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any point.

The third offshore effort came as the IRS also announced it has collected $3.4 billion so far from people who participated in the 2009 offshore program, reflecting closures of about 95 percent of the cases from the 2009 program. On top of that, the IRS has collected an additional $1 billion from up front payments required under the 2011 program. That number will grow as the IRS processes the 2011 cases.

In all, the IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives. Since the 2011 program closed last September, hundreds of taxpayers have come forward to make voluntary disclosures. Those who have come in since the 2011 program closed last year will be able to be treated under the provisions of the new OVDP program.

The overall penalty structure for the new program is the same for 2011, except for taxpayers in the highest penalty category. For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. That is up from 25 percent in the 2011 program. Some taxpayers will be eligible for 5 or 12.5 percent penalties; these remain the same in the new program as in 2011.

Before choosing to join the program a taxpayer should first consult an attorney who is experienced in the nuances of international voluntary disclosure rules. Arnstein & Lehr LLP has a team of tax lawyers who have advised over 150 taxpayers on offshore account issues over the last 3 years.

Payroll tax cut temporarily extended. The Temporary Payroll Tax Cut Continuation Act of 2011 was enacted late last year. It temporarily extends the two percentage point payroll tax cut for employees, continuing the reduction of their Social Security tax withholding rate from 6.2% to 4.2% of wages paid through Feb. 29, 2012. Shortly after its passage, the IRS instructed employers to implement the new payroll tax rate as soon as possible in 2012 but not later than Jan. 31, 2012. The law also includes a "recapture" provision, which applies only to those employees who receive more than $18,350 in wages during the two-month period (i.e., two-twelfths of the 2012 wage base of $110,100). This provision imposes an additional income tax on these higher-income employees in an amount equal to 2% of the amount of wages they receive during the two-month period in excess of $18,350 (and not greater than $110,100). In addition, under the new law, the social security tax rate for a self-employed individual remains at 10.4%, for self-employment income of up to $18,350 (reduced by wages subject to the lower rate for 2012). Congress is going to try to negotiate a deal to extend the payroll tax cut for all of 2012. If a deal is struck to extend it for the full year, the recapture provision for employees would not apply.

Credit for hiring veterans extended and enhanced. A law enacted last November extended and enhanced a credit for hiring qualified veterans. Before the law was passed, the credit would have been available only if the qualified veteran were hired before Jan. 1, 2012, and only certain veterans were considered qualified veterans. The new law extends the credit for hiring qualified veterans, adds two new classes of veterans who are considered qualified veterans, increases the credit for hiring certain qualified veterans, "fast-tracks" the process for certifying that an individual is a qualified veteran, and provides tax-exempt employers with a credit against payroll tax for hiring qualified veterans. The credit amount varies depending on a number of factors. It can be as high as $9,600 for hiring a qualified disabled veteran. For an employer to qualify for the credit, the qualified veteran must begin work for the employer before Jan. 1, 2013 and other requirements must be met.

New rules for deducting or capitalizing tangible property costs. The IRS has issued new regulations for determining whether amounts paid to acquire, produce, or improve tangible property may be currently deducted as business expenses or must be capitalized. The regulations will affect virtually all taxpayers that acquire, produce, or improve tangible property. They are

comprehensive, voluminous and virtually rewrite the rules in this area. For example, they provide detailed definitions of "materials and supplies" and "rotable and temporary spare parts" and prescribe new rules and elective *de minimis* and optional methods for handling their cost. They also have rules for differentiating between deductible repairs and capitalizable improvements, among many other items. The regulations generally are effective in tax years beginning after Dec. 31, 2011. However, to add to their complexity, some of the new rules in the regulations do not supersede prior IRS guidance.

New foreign asset reporting guidance and form. The IRS issued detailed guidance on the new law requiring individuals with an interest in a "specified foreign financial asset" during the tax year to attach a disclosure statement to their income tax return for any year in which the aggregate value of all such assets is greater than $50,000 (or a dollar amount higher than $50,000 as the IRS may prescribe). In addition, the IRS issued Form 8938 (Statement of Specified Foreign Financial Assets), which individual taxpayers will use starting in the 2012 tax filing season to report specified foreign financial assets for tax year 2011. The guidance consists of detailed temporary regulations. They define terms that apply for purposes of the reporting requirement; provide rules to determine if a specified individual must file a Form 8938 with their annual return; define what are specified foreign financial assets; detail what information needs to be reported; provide guidelines for valuing specified foreign financial assets; list exceptions to the reporting requirements; and describe the penalties that apply for failure to comply with the reporting requirements.

Standard mileage rates flat or lower. The optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) is 55.5¢ per each business mile traveled after 2011. For 2011, it was 55.5¢ for miles driven after June 30 and 51¢ per mile for miles driven before July 1. Further, the 2012 rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction is 23¢ per mile. For 2011, it was 23.5¢ for miles driven after June 30 and 19¢ per mile for miles driven before July 1.

New Form 8949 replaces Form 1040, Schedule D-1. Many transactions that, in previous years, would have been reported on Form 1040, Schedule D or D-1 must be reported on Form 8949 if they occurred in 2011. Specifically, a taxpayer uses Form 8949 to report:

- The sale or exchange of a capital asset not reported on another form or schedule,
- Gains from involuntary conversions (other than from casualty or theft) of capital assets not held for business or profit, and
- Nonbusiness bad debts.

The taxpayer uses Schedule D to figure the overall gain or loss from transactions reported on Form 8949 and to report capital gain distributions not reported directly on Form 1040, line 13, a capital loss carryover from 2010 to 2011, and certain specialized items.

Withholding requirement for government contractors repealed. A law enacted in 2005 was to have required the Federal government and the government of every state, political subdivision of

a state, and instrumentality of a state or state subdivision (including multi-state agencies) making certain payments to a person providing any property or services (e.g., payments to a government contractor) to deduct and withhold 3% from that payment. Although the withholding requirement was originally set to apply to payments made after 2010, it was subsequently deferred to apply to payments made after 2012. A law enacted in November 2011 repealed the government contractor withholding requirement.