

Tax Alerts!

■ A KFMR publication created to alert businesses and individuals of important tax changes.

■ January 2012

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Early Planning Can Make 2012 Filing Season Easier

The new year brings a new tax filing season. Mid-April may seem like a long time away in January but it is important to start preparing now for filing your 2011 federal income tax return. The IRS expects to receive and process more than 140 million returns during the 2012 filing season. Early planning can help avoid any delays in the filing and processing of your return.

Records

Initially, you will need to gather your records for 2011. A helpful jumping-off point is to review your 2010 return. Your personal situation may be unchanged from when you filed your 2010 return or it may have changed significantly. Either way, your 2010 return is a good vantage point for assembling the materials you will need to prepare your 2011 return.

If you need a copy of your previous year(s) return information, you have several options. You can order a copy of your prior-year return. Alternatively, you may order a tax return transcript or a tax account transcript. A tax return transcript shows most line items from your return as it was originally filed, including any accompanying forms and schedules. However, a tax return transcript does not reflect any changes you or the IRS made after the return was filed. A tax account transcript shows any later adjustments you or the IRS made after the tax return was filed.

If you changed your name as a result of marriage or divorce since you filed your 2010 return, you must advise the IRS. Your name as it appears on your return needs to match the name registered with the Social Security Administration. A mismatch will likely delay the processing of your return.

Forms W-2

Many taxpayers cannot begin preparing their 2011 income tax returns until they have their Forms W-2, Wage and Tax Statement. Employers have until January 31, 2012 to send you a 2011 Form W-2 earnings statement. If you do not receive your W-2 by the deadline, contact your employer. If you do not receive your W-2 by mid-February, contact the IRS. You still must file your return or request an extension to file even if you do not receive your Form W-2. In certain cases, you may be able to file Form 4852, Substitute for Form W-2, Wage and Tax Statement.

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Filing Deadline

April 15, 2012 is a Sunday. Returns would normally be due the next day, April 16, 2012. However, April 16 is a holiday in the District of Columbia (Emancipation Day). As a result, the due date for 2011 returns is April 17, 2012. If the mid-April tax deadline clock runs out, you can get an automatic six-month extension of time to file through October 17. However, this extension of time to file does not give you more time to pay any taxes due. To obtain an extension, you need to file Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.

Casualty Losses

Many taxpayers experienced family, business and personal losses from hurricanes, tropical storms, wild fires, floods, and other natural disasters in 2011. For federal tax purposes, a casualty loss can result from the damage, destruction or loss of your property from any sudden, unexpected, or unusual event such as a hurricane, tornado, fire, or other disaster.

Casualty losses are generally deductible in the year the casualty occurred. However, if you have a casualty loss from a federally-declared disaster, you can choose to treat the loss as having occurred in the year immediately preceding the tax year in which the disaster happened. This means you can deduct a 2011 loss on your 2011 return or amended return for that preceding tax year (2010). If you have any questions about a casualty loss, please contact our office.

Retirement Savings

Just because the calendar moved from 2011 to 2012 doesn't necessarily mean you missed out on contributing to a retirement savings plan. You can contribute up to \$5,000 to a traditional IRA for 2011 and you can make the contribution as late as April 17, 2012. However, if you or your spouse is covered by an employer retirement plan, this will affect how much, if any, of your contribution is tax deductible. Individuals age 50 and older may qualify for a catch-up contribution of \$1,000 on top of the \$5,000 maximum. Different rules apply to other types of retirement savings plans. Our office can review these rules in detail with you.

IRS Fresh Start Initiative

In 2011, the IRS announced a new program, called the Fresh Start Initiative, to help distressed taxpayers. The IRS adjusted its lien policies, increased the dollar threshold when liens are generally issued, made it easier for taxpayers to obtain lien withdrawals, and

extended the streamlined offer-in-compromise program. Previously, the IRS had given its employees greater authority to suspend collection actions in certain hardship cases where taxpayers are unable to pay. This includes instances where a taxpayer has recently lost a job, is relying solely on Social Security, or is paying significant medical bills.

If you are experiencing hardship, the most important thing you can do is to remain in compliance with your tax obligations. If you owe back taxes, now is the time to pay them, if possible, or enter into an installment agreement, if you qualify, with the IRS. The IRS wants to see you making a good faith effort to pay your taxes.

Tax Law Changes

Along with assembling records and reviewing activities in 2011, it's a good idea to review some of the tax law changes in 2011 that may affect your return. In some cases, popular tax incentives that were available in 2010 were extended into 2011. You don't want to miss out on any available tax breaks.

IRS Reminds Dual Citizenship Taxpayers to Report Foreign Accounts

The IRS recently reminded dual citizenship taxpayers and U.S. citizens residing abroad to file U.S. income tax returns and, if appropriate, Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). The reminder, posted on the IRS website, is part of the agency's ongoing campaign to heighten awareness about reporting foreign accounts.

Who is Required to File an FBAR?

A U.S. citizen or resident, as well as other U.S. persons, must file an FBAR if:

- The U.S. person had a financial interest in or signature authority over at least one financial account located outside of the U.S.; and
- The aggregate value of all foreign financial accounts exceeded \$10,000 at any time during the calendar year to be reported.

A foreign financial account includes a bank account, brokerage account, mutual fund, trust, or other type of account. The filing deadline is June 30 of the succeeding year.

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Payroll Tax Cut Extended Two-months; Other Temporary Incentives Expire

As 2012 gets underway, Congress has extended the employee-side payroll tax cut but a laundry list of tax incentives have expired and their renewal is in doubt. The fate of these incentives, along with the Bush-era tax cuts, will dominate debate in Washington D.C. in 2012. At the same time, tax planning in a time of uncertainty appears to have become the new normal.

Payroll Tax Cut

The Temporary Payroll Tax Cut Continuation Act of 2011, approved by Congress on December 23 and signed by President Obama the same day, extends the 2011 payroll tax holiday through the end of February 2012. The employee-share of OASDI taxes is 4.2 percent for the period January 1, 2012 through February 29, 2012 (10.4 percent for self-employment income). The new law also includes a recapture provision for certain individuals. However, the House Ways and Means Committee reported that the recapture provision will only apply if the payroll tax reduction is not extended for the remainder of 2012. Lawmakers are expected to extend the employee-side payroll tax cut through the end of 2012, although not before difficult negotiations.

One speed bump to extending the payroll tax cut through the end of 2012 is its cost. The two-month extension is paid for by increasing certain fees charged to mortgage lenders. A full-year extension will require additional offsets (unless Congress decides not to offset an extension). Lawmakers are reportedly discussing additional revenue raisers, such as unspecified changes to the S corporation rules and the closing of a loophole for corporate jets. Other revenue raisers reportedly under consideration are repeal of certain oil and gas preferences and repeal of the last-in, first-out (LIFO) method of accounting. A variety of spending cuts are also on the table.

Extenders

After December 31, 2011, many popular but temporary tax breaks expire. The incentives, which are known as “extenders,” impact individuals and businesses. Some of the more popular individual extenders are the state and local sales tax deduction, the higher education tuition deduction, and the teachers’ classroom expense deduction. For businesses, the research tax credit is one of the most important extenders.

One immediate change that many taxpayers will notice is a drop in transit benefits. In 2011, commuters benefitted from more generous transit benefits. The 2011 monthly limit on the tax benefit for transit and vanpools of \$230 per month reverts to \$125 per month in 2012. However, the monthly limit for qualified parking provided by an employer to its employees for 2012 will increase to \$240, up \$10 from the limit in 2011.

Several bills have been introduced in Congress to extend the expiring incentives. However, the bills have languished in committee. One reason for the lack of movement is that Congress can extend the incentives in 2012 and make them retroactive to January 1, 2012. The extenders are also separate from the temporary Bush-era tax cuts, which are scheduled to expire after December 31, 2012. Many lawmakers do not want to link the extenders to the more-controversial Bush-era tax cuts.

IRS Budget

One bill that did pass Congress at year-end 2011 was a fiscal year 2012 budget for the IRS. Congress voted to cut \$305 million from the IRS’s FY 2012 budget. How this cut will impact IRS operations is unknown. In November 2011, the IRS offered buyouts and early outs to back-office employees to reduce its greatest expense: employee payroll. The IRS could also delay some business systems modernizations to save money. The IRS will likely keep customer service as close as possible to full funding, especially during the busy 2012 filing season.

Tax Planning

One of the most significant challenges to long-term tax planning is the on-again, off-again nature of many tax incentives. Temporary incentives, such as the research tax credit and the state and local sales tax deduction, have become de facto permanent incentives because they are regularly extended. Nonetheless, they are temporary. Because of their temporary nature, taxpayers must have two tax plans: one that takes into account an extension of the incentives, and a second plan that does not.

Looking Back: Top 10 Federal Tax Developments of 2011

Looking back over 2011, the IRS, Congress and the courts made many tax decisions impacting taxpayers of all types. Some tax developments were taxpayer-friendly; others imposed new requirements on taxpayers. Here is a brief rundown of the top 10 federal tax developments of 2011.

1. Bush-era Tax Cuts Unresolved

Reduced individual income tax rates, marriage penalty relief, an enhanced child tax credit, and much more are part of a package of tax breaks known as the “Bush-era tax cuts.” All of these incentives were renewed in 2010 and are scheduled to expire after 2012. President Obama wants to allow the Bush-era tax cuts to expire for higher income individuals, which the White House broadly defines as single persons with incomes over \$200,000 and families with incomes over \$250,000. In the summer of 2011, the White House and the GOP reportedly came close to an agreement but nothing materialized. The fate of the Bush-era tax cuts will likely be one of the major issues in the 2012 presidential election.

2. Foreign Account Reporting Oversight Increases

Since passage of the Foreign Account Tax Compliance Act (FATCA) in 2010, the Treasury Department and the IRS have ratcheted-up their oversight of foreign accounts. In December 2011, the IRS issued final Form 8938, Statement of Specified Foreign Assets, which taxpayers will file to report foreign accounts (if they meet certain requirements). The IRS also issued guidance in 2011 for foreign financial institutions about their reporting obligations under FATCA. In related news, the Treasury Department issued final rules on Form TD-F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) in February 2011. Lastly, the IRS launched a new campaign in 2011 to encourage taxpayers to voluntarily disclose unreported offshore accounts. The 2011 Offshore Voluntary Disclosure Initiative (OVDI) rewarded taxpayers who came forward voluntarily with a reduced penalty framework (although not as generous as a similar program in 2009).

3. Payroll Tax Cut Extended Two Months

President Obama signed the Temporary Payroll Tax Cut Continuation Act of 2011 in December 2011. The new law extends the employee-side payroll tax cut through the end of February 2012. The two-month extension is

intended to give Congress additional time to negotiate a longer-term extension of the payroll tax cut to cover all of calendar year 2012.

4. Cell Phones Removed from Listed Property Category

The Small Business Jobs Act of 2010 removed cell phones from the definition of “listed property.” That category generally requires additional recordkeeping by taxpayers. In September 2011, the IRS issued guidance on the treatment of employer-provided cell phones as an excludible fringe benefit. When an employer provides an employee with a cell phone primarily for noncompensatory business reasons, the business and personal use of the cell phone is generally nontaxable to the employee and the IRS will not require recordkeeping of business use to receive this tax-free treatment.

5. IRS Launches Voluntary Classification Settlement Program

In September 2011, the IRS launched a new program to enable employers to voluntarily reclassify their workers for federal employment tax purposes and take advantage of a reduced penalty framework. The Voluntary Classification Settlement Program (VCSP) is open to employers currently treating their workers as independent contractors and who want to prospectively treat the workers as employees. The employer must not be under audit and satisfy other requirements. The IRS has not announced an end-date to the VCSP.

6. IRS Makes Mid-year 2011 Adjustment to Business Standard Mileage Rate

For the third time in six years, the IRS announced a mid-year adjustment to the business standard mileage rate because of rising gasoline prices. The business standard mileage rate increased from 51 cents-per-mile to 55.5 cents-per-mile for the second half of 2011. The medical/moving standard mileage rate increased from 19 cents-per-mile to 23.5 cents-per-mile for the second half of 2011. Congress did not make a mid-year adjustment to the charitable standard mileage rate, which remained at 14 cents-per-mile for the second half of 2011. For 2012, the business standard mileage rate is 55.5 cents-per-mile and the medical/moving standard mileage rate is 23 cents-per-mile. The statutorily-determined charitable standard mileage rate remains at 14 cents-per-mile for 2012.

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7. FUTA Surtax Expires

In 1976, Congress enacted the 0.2 percent FUTA surtax to help repay federal revenues paid in unemployment benefits. The Worker, Homeownership and Business Assistance Act of 2009 extended the surtax through 2010 and the first six months of 2011. The 0.2-percent FUTA surtax expired after June 30, 2011. In December 2011, the IRS released Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and accompanying schedules, for 2011. Form 940 for 2011 reflects the mid-year expiration of the FUTA surtax.

8. IRS Continues Fresh Start Initiative

During 2011, the IRS continued its Fresh Start Initiative, which the agency explains is its response to the economic slowdown. The Fresh Start Initiative allows lien withdrawals for taxpayers entering into direct debit installment agreements (and for taxpayers who convert from a regular installment agreement to a direct debit agreement). The IRS also announced it would make streamlined installment agreements available to more small businesses. Qualified small businesses with \$25,000 or less in unpaid taxes can participate in the streamlined installment agreement program.

9. Basis Overstatement Regs

The Supreme Court agreed in September 2011 to resolve a split among the federal courts of appeal over IRS regulations that impose a six-year limitations period on assessments due to overstated basis. The IRS asked the Supreme Court to decide, among other questions, whether an understatement of gross income attributable to an overstatement of basis in sold property is an omission from income that can trigger the six-year assessment period.

10. Congress Bans Tax Strategy Patents

In September 2011, President Obama signed the America Invents Act. The new law is a comprehensive overhaul of the nation's patent laws. The new law treats any strategy for reducing, avoiding or deferring tax liability as prior art under patent law and therefore not patentable.

IRS Revises Regulations for Capitalization of Tangible Assets

Just before year-end 2011, the IRS issued much-anticipated revised regulations on the capitalization of tangible assets. The IRS withdrew proposed regulations issued in 2008 and issued temporary and proposed regulations. The text of the temporary regulations serves as the text of the proposed regulations.

The IRS and taxpayers have often disagreed over how to characterize certain expenditures for tax purposes. The IRS explained that there has been uncertainty over how to determine when expenses may be deducted immediately and when expenses must be capitalized and depreciated over a certain number of years.

The IRS issued regulations in 2006 and then re-proposed the regulations in 2008. Since 2008, the IRS has worked to refine the regulations in light of taxpayer concerns. In late December 2011, the IRS withdrew the 2008 proposed regulations and issued new guidance in the form of temporary and proposed regulations.

The new guidance, the IRS explained, is intended to clarify existing standards and provide certain bright-line tests for applying the standards. In the preamble to new regulations, the IRS acknowledged the highly factual nature of determining whether expenditures are for capital improvements or for ordinary repairs and the difficulty in applying the standards in practice.

The 2011 regulations provide a general framework for capitalization, the IRS explained. The 2011 regulations also provide general rules for capital expenditures, rules for amounts paid for the acquisition or production of tangible property, rules for amounts paid for the improvement of tangible property, and more. Additionally, the 2011 regulations address the definition and treatment of materials and supplies, a de minimis rule for the acquisition and production of property and the safe harbor for routine maintenance.

How Do I – Claim a Charitable Contribution of Property?

Included among the many important individual and business incentives extended and enhanced by the massive tax bill passed in late December is a 100-percent exclusion of gain from the sale of qualified small business stock. Under the Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) individuals and other noncorporate taxpayers should not overlook the benefit of investing in qualified small business stock considering the ability for qualifying taxpayers to exclude 100-percent of gain from the sale or exchange of the stock. There are certain limitations, however, regarding who qualifies for the tax break, holding periods, and what qualifies as qualified small business stock.

What is Qualified Small Business Stock?

Claiming a charitable deduction for a cash contribution is straightforward. The taxpayer claims the amount paid, whether by cash, check, credit card or some other method. Taxpayers need only a bank record or a written acknowledgment from the charity. For contributions of property, the rules can be more complex.

Contributions of Property

A taxpayer that contributes property can deduct the property's fair market value at the time of the contribution. For example, contributions of clothing and household items are not deductible unless the items are in good used condition or better. An exception to this rule allows a deduction for items that are not in at least good used condition, if the taxpayer claims a deduction of more than \$500 and includes an appraisal with the taxpayer's income tax return.

Household items include furniture and furnishings, electronics, appliances, linens, and similar items. Household items do not include food, antiques and art, jewelry, and collections (such as coins).

To value used clothing, the IRS suggests using the price that buyers of used items pay in second-hand shops. However, there is no fixed formula or method for determining the value of clothing. Similarly, the value of used household items is usually much lower than the price paid for a new item, the IRS instructs. Formulas (such as a percentage of cost) are not accepted by the IRS.

Vehicles

The rules are different for "qualified vehicles," which are cars, boats and airplanes. If the taxpayer claims a deduction of more than \$500, the taxpayer is allowed to deduct the smaller of the vehicle's fair market value on the date of the contribution, or the proceeds from the sale of the vehicle by the organization.

There are two exceptions to this rule. If the organization uses or improves the vehicle before transferring it, the taxpayer can deduct the vehicle's fair market value when the contribution was made. If the organization gives the vehicle away, or sells it far well below fair market value, to a needy individual to further the organization's purpose, the taxpayer can claim a fair market value deduction. This latter exception does not apply to a vehicle sold at auction.

To determine the value of a car, the IRS instructs that "blue book" prices may be used as "clues" for comparison with current sales and offerings. Taxpayers should use the price listed in a used car guide for a private party sale, not the dealer retail value. To use the listed price, the taxpayer's vehicle must be the same make, model and year and be in the same condition.

Most items of property that a person owns and uses for personal purposes or investment are capital assets. If the value of a capital asset is greater than the basis of the item, the taxpayer generally can deduct the fair market value of the item. The taxpayer must have held the property for longer than one year.

IRS Relief for IRA Owners Entering into Broker Indemnification Agreements

The IRS is providing temporary relief for owners of individual retirement accounts (IRAs) who have entered into indemnification agreements with brokers that may result in prohibited loan transactions. The relief is in response to a recent decision by the U.S. Department of Labor (DOL).

DOL Opinion

In October 2011, the DOL issued an advisory opinion addressing a scenario where an individual IRA owner entered into an agreement to indemnify a broker against

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January 2012 Tax Compliance Calendar

As an individual or business, it is your responsibility to be aware of and to meet your tax filing/reporting deadlines. This calendar summarizes important tax reporting and filing data for individuals, businesses and other taxpayers for the month of January 2012.

January 6

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates December 31-January 3.

January 10

Employees Who Work for Tips: Employees who received \$20 or more in tips during November must report them to their employer using Form 4070.

January 11

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 4-6.

January 13

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 7-10.

January 17

Monthly Depositors: Monthly depositors must deposit employment taxes for payments in December.

January 19

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 11-13.

January 20

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 14-17.

January 25

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 18-20.

January 27

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 21-24.

January 31

Employers: Employers give employees copies of Form W-2 for 2011.

Employers: Employers file Form 945 to report income tax withheld for 2011 on all nonpayroll items. Deposit any undeposited tax (if more than \$2,500).

Employers: Employers file Form 941 for the fourth quarter of 2011. Deposit any undeposited tax (if more than \$2,500).

Employers: Employers file Form 940 to report federal unemployment tax for 2011. Deposit any undeposited tax (if more than \$500).

Small Employers: Certain small employers file Form 944 to report Social Security, Medicare, and withheld income tax for 2011. Deposit any undeposited tax (if more than \$2,500).

February 1

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 25-27.

February 3

Employers: Semi-weekly depositors must deposit employment taxes for payroll dates January 28-31.

IRS Releases Business Standard Mileage Rate for 2012

The business standard mileage rate, which many employers use to reimburse employees for business miles driven, is 55.5 cents-per-mile for 2012, the IRS has announced. This reflects no change from the second half of 2011.

Deduction

Under Code Sec. 162(a), taxpayers are allowed a deduction for the ordinary and necessary expenses a taxpayer incurs while operating an automobile for trade or business purposes. Depending on their automobile usage, taxpayers may have several options for calculating the deduction. They may use the actual expense method, which requires them to determine the actual costs to operate the car for business uses. (Actual expenses include gas, oil, repairs, tires, insurance, registration fees, licenses, and other qualified expenditures.)

In the alternative, taxpayers may use the business standard mileage rate set by the IRS. (Although, in order to use the business standard mileage rate, the taxpayer must not operate five or more vehicles at the same time – as for example in a fleet vehicle operation.)

Business Standard Mileage Rate

In June 2011, the IRS announced a mid-year increase in the business standard mileage rate. The business standard mileage rate increased from 51 cents-per-mile to 55.5 cents-per mile for the second half of 2011.

For 2012, the business standard mileage rate will be 55.5 cents-per-mile, which reflects no change from the second half of 2011.

Other Rates

For 2012, the standard mileage rate for medical and moving expenses will be 23 cents-per-mile, reflecting a 0.5 cents-per-mile reduction from 2011. The statutorily-determined rate for the charitable deduction remains unchanged at 14 cents-per-mile for 2012.

IRS Updates Form 940 for Mid-year Expiration of FUTA Surtax

The IRS has updated Form 940 to reflect the mid-year 2011 expiration of the 0.2 percent FUTA surtax. FUTA taxes for 2011 will be calculated using two rates, the IRS explained.

Mid-year Expiration

FUTA authorizes the IRS to collect a tax used to fund state workforce agencies. FUTA covers the costs of administering the unemployment insurance and job service programs in all states. In addition, FUTA pays one-half of the cost of extended unemployment benefits (during periods of high unemployment) and provides for a fund from which states may borrow, if necessary, to pay benefits.

Employers pay FUTA on the first \$7,000 of each employee's annual wages.

Since the 0.2% FUTA surtax expired mid-year 2011, FUTA taxes for calendar year 2011 are calculated using two rates: 6.2% of taxable wages paid through June

30, 2011; and 6.0% of taxable wages paid after June 30, 2011.

Employers file Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and accompanying schedules, to pay their FUTA liability. The IRS has released an updated version of Form 940 to reflect the mid-year expiration of the FUTA surtax.

Form 940 for 2011 must be filed by January 31, 2012. The due date is extended to February 10, 2012 for employers that timely deposited all of their FUTA taxes.

Credit Reduction States

Employers that pay their state unemployment tax timely and in full receive a 5.4 percent credit. However, the credit is reduced when a state has outstanding federal loans for two consecutive Januarys. The reduction is 0.3 percent for the first year and an additional 0.3 percent for each succeeding year until the loan is repaid. A state that has not repaid money it has borrowed from the federal government is called a credit reduction state.

Form 940 for 2011 identifies the 0.3 percent credit reduction states, which are Arkansas, California, Connecticut, Florida, Georgia, Illinois, Kentucky, Minnesota, Missouri, North Carolina, New Jersey, Nevada, New York, Ohio, Pennsylvania, Rhode Island, Virginia, and Wisconsin (the U.S. Virgin Islands is also a 0.3 percent credit reduction jurisdiction). Indiana is a 0.6 percent credit reduction state and Michigan is a 0.9 credit reduction state.

FAQ – When Do I Need to File IRS Form 8938, Statement of Specified Foreign Financial Assets?

The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, requires certain U.S. taxpayers to report their interests in specified foreign financial assets. The reporting requirement may apply if the assets have an aggregate value exceeding certain thresholds. The IRS has released Form 8938, Statement of Specified Foreign Financial Assets, for this reporting requirement under FATCA.

Reporting

For now, only specified individuals are required to file Form 8938, but specified U.S. entities will eventually also have to file the form. Taxpayers who do not file a federal income tax return for the year do not have to file Form 8938, even if the value of their foreign assets exceeds the normal reporting threshold.

Individuals who have to file Form 8938 include U.S. citizens, resident aliens for any part of the year, and nonresident aliens living in Puerto Rico or American Samoa.

Reporting applies to specified foreign financial assets. Specified foreign financial assets include:

- A financial account maintained by a foreign financial institution;
- Other foreign financial assets, such as stock or securities issued by a non-U.S. person, or an interest in a foreign entity.

The aggregate value of the individual's specified foreign financial assets must exceed specified reporting thresholds, as follows:

- Unmarried U.S. taxpayers, and married U.S. taxpayers filing a separate return - more than \$50,000 on the last day of the year, or more than \$75,000 at any time during the year;
- U.S. married taxpayers filing a joint return - more than \$100,000 on the last day of the year, or more than \$150,000 at any time during the year; or
- Taxpayers living abroad: if filing a joint return, more than \$400,000 on the last day of the year, or more than \$600,000 during the year; other

taxpayers, more than \$200,000 on the last day of the year, or more than \$300,000 at any time during the year.

Taxpayers who report assets on other forms, such as Form 3520, do not have to report the asset on Form 8938, but must use Form 8938 to identify other forms on which they report.

Filing

Reporting applies for tax years beginning after March 18, 2010, the date that FATCA was enacted. Most taxpayers, such as those who report their taxes for the calendar year, must start filing Form 8938 with their 2011 income tax return.

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the indebtedness of, or arising from, the individual's IRA with the broker. The advisory opinion asked under what circumstances such an agreement would be an impermissible "extension of credit," under Code Sec. 4975(c)(1)(B) and whether, in such cases, any prohibited transaction would be covered by DOL class exemption PTE 80-26. The advisory opinion concluded that PTE 80-26 does not provide relief for such extensions of credit

In general, Code Sec. 4975(c)(1)(B) prohibits the direct or indirect lending of money or other extension of credit between a plan and a disqualified person. For purposes of the Tax Code, a plan includes an IRA and a disqualified person includes a fiduciary. Also, an IRA owner who self-directs investments attributable to his or her IRA is a fiduciary and subject to Code Sec. 4975.

IRS Relief

Pending further action or guidance from the DOL, the IRS announced that it will determine the tax consequences relating to an IRA without taking into account the consequences that might otherwise result from a prohibited transaction under § 4975 resulting from entering into any indemnification agreement or any cross-collateralization agreement similar to those described in DOL Advisory Opinions 2009-03A and 2011-09A. (That is, provided there has been no execution or other enforcement pursuant to the agreement against the assets of an IRA account owned by an individual granting the security interest.)



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What if There was Reasonable Cause Not to File?

The IRS goal is to increase compliance, and not to penalize or overly burden taxpayers. For example, individuals who fail to file a U.S. income tax return or to pay the taxes due may be subject to penalties under Code Sec. 6651. The penalty is a percentage of the taxes due; there is no penalty if no tax is due.

Additionally, taxpayers who do owe taxes will not have to pay a penalty if their failure to file or pay is due to reasonable cause and not willful neglect. Reasonable cause is satisfied if the taxpayer exercised ordinary business care and prudence in meeting his or her tax obligations. Reasonable cause may also be established where the taxpayer shows that he or she was not aware of specific obligations to file returns or pay taxes.

What are the Penalties for Failure to Comply?

In the absence of reasonable cause, however, a taxpayer who fails to file an FBAR may be subject to a willful or non-willful civil penalty. Penalties for a willful violation are the greater of \$100,000 or 50 percent of the total in the foreign account. Penalties for a non-willful violation can be as high as \$10,000. The IRS can issue a warning letter rather than assert a penalty.

Taxpayers who realize they should have filed FBARs for earlier years to file the delinquent FBARs should attach a statement explaining the late filing. The IRS will not assert penalties if the taxpayer had reasonable cause for filing late.

Tax Alerts

KFMR'S SERVICES

- Accounting, Assurance and Advisory Services
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