

# **Carmody Meach & Choo LLP**

Certified Public Accountants

2 North Lake Avenue Suite 830  
Pasadena, CA 91101  
(626) 440-1077  
<http://www.cmccpa.net>

Roger Carmody CPA  
[roger@cmccpa.net](mailto:roger@cmccpa.net), ext 104

Lee Meach CPA  
[lee@cmccpa.net](mailto:lee@cmccpa.net), ext 103

Wayne Choo CPA  
[waynec@cmccpa.net](mailto:waynec@cmccpa.net), ext 105

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## **Important 2011 Third Quarter Federal Tax Developments**

**Dear Client:**

During the third 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 unveiled a number of tax proposals and revenue raisers in September as part of his proposed American Jobs Act and in recommendations to Congress' Joint Select Committee on Deficit Reduction. In his American Jobs Act, President Obama proposed, among other measures, to extend and enhance the 2011 employee-side payroll tax cut, expand tax credits for hiring military veterans, and extend 100 percent bonus depreciation. President Obama also urged the joint committee to take a balanced approach to deficit reduction. Among other revenue raisers in his recommendations to the joint committee, President Obama proposed not to extend the Bush-era tax cuts for higher income taxpayers. *CCH Federal Tax Weekly No. 37, September 15, 2011; CCH Federal Tax Weekly No. 38, September 22, 2011.*

### **Foreign accounts**

The IRS touted the success of its offshore voluntary disclosure initiative (OVDI) in September. The IRS reported that 12,000 new applications came in from the 2011 OVDI. The OVDI offered taxpayers a reduced penalty framework in exchange for full disclosure of unreported foreign accounts. *CCH Federal Tax Weekly No. 38, September 22, 2011.* Previously, because of Hurricane Irene on the east coast, the IRS had extended the deadline to request participation in the OVDI to September 9, 2011. *CCH Federal Tax Weekly No. 35, September 1, 2011.*

In related news, the IRS announced in July that it will provide for a phased implementation timeline of certain provisions in the *Foreign Account Tax Compliance*

*Act (FATCA)*. The phased implementation generally applies to requirements imposed by *FACTA* on foreign financial institutions. *CCH Federal Tax Weekly No. 29, July 21, 2011*.

In August, the Court of Appeals for the Ninth Circuit found that a taxpayer had to produce records of his foreign bank accounts (In re Grand Jury Investigation M.H., CA-9, August 19, 2011). The court held that the Fifth Amendment right against self-incrimination did not protect the taxpayer from having to provide the records. *CCH Federal Tax Weekly No. 35, September 1, 2011*.

## **Worker classification**

The IRS unveiled the Voluntary Classification Settlement Program (VCSP) in September. The VCSP is open to employers that currently treat their workers as independent contractors and that want to prospectively treat the workers as employees. The VCSP provides a reduced penalty framework and audit protection to qualified employers. *CCH Federal Tax Weekly No. 39, September 29, 2011*.

The IRS and the U.S. Department of Labor (DOL) signed a memorandum of understanding in September. The two agencies pledged to cooperate and share resources to curb worker misclassification. *CCH Federal Tax Weekly No. 38, September 22, 2011*.

In related news, the Tax Court held that an adjunct professor of economics who taught online courses was an employee and not an independent contractor. *CCH Federal Tax Weekly No. 36, September 8, 2011*.

## **Hurricane Irene**

The IRS announced relief from certain tax filing and payment deadlines for taxpayers recovering from Hurricane Irene. The late summer hurricane caused damage along the east coast. Affected taxpayers have additional time to file returns and make certain payments. *CCH Federal Tax Weekly No. 36, September 8, 2011; CCH Federal Tax Weekly No. 37, September 15, 2011; CCH Federal Tax Weekly No. 38, September 22, 2011*.

## **FUTA surtax**

In 1976, Congress enacted a 0.2 percent Federal Unemployment Tax Act (FUTA) surtax. The surtax was regularly extended in subsequent years; the most recent extension expired after June 30, 2011. As a result of the expiration of the surtax, the FUTA tax rate falls from 6.2 percent to 6.0 percent for periods after June 30, 2011 before any state unemployment tax credits are taken into account. The IRS has indicated it intends to issue guidance on the mid-year expiration of the FUTA surtax. *CCH Federal Tax Weekly No. 28, July 14, 2011*.

## **Cell phones**

The IRS announced that employer-provided cell phones, provided primarily for noncompensatory business reasons, will not be treated as taxable compensation to employees and that personal use is nontaxable. Likewise, employer reimbursements to employees who use their personal cell phones for business will not be taxable. *CCH Federal Tax Weekly No. 38, September 22, 2011.*

## **Employee reimbursements**

The IRS issued its annual update of the simplified per diem rates that taxpayers can use to reimburse employees for expenses incurred during business travel after September 30, 2011. The simplified high-low per diems have increased for 2012 to \$242 for high-cost localities and to \$163 for all other localities, an increase from \$233 and \$160, respectively, for 2011. At the same time, the IRS reported that it abandoned plans to discontinue the high-low method. *CCH Federal Tax Weekly No. 40, October 6, 2011.*

## **6707A penalty**

The IRS issued final regulations on the reportable transaction penalty under Code Sec. 6707A. The final regulations reflect changes made to the penalty by the *Small Business Jobs Act of 2010*. The IRS also identified various factors it will consider in deciding whether to rescind a penalty. *CCH Federal Tax Weekly No. 36, September 8, 2011.*

## **Innocent spouse relief**

In July, the IRS announced it was abandoning its controversial regulation imposing a two-year limitations period on taxpayers requesting equitable innocent spouse relief. The announcement came after a number of court decisions, some of which upheld the IRS's regulations; others which did not. The IRS also provided transition rules pending modification of the equitable innocent spouse regulations. *CCH Federal Tax Weekly No. 30 July 28, 2011; CCH Federal Tax Weekly No. 31, August 4, 2011.*

## **Fringe benefits**

The IRS revoked a prior letter ruling that had allowed certain employer-provided clothing and accessories to be excluded from employees' gross incomes as de minimis fringe benefits. The IRS explained that additional information, received after its initial taxpayer-friendly decision, caused it to revoke its prior ruling. *CCH Federal Tax Weekly No. 37, September 15, 2011.*

## **Gift tax examinations**

The IRS announced in July that it will not pursue gift tax examinations of contributions to [Code Sec. 501\(c\)\(4\)](#) organizations while the agency reviews the need for additional guidance or legislation. In recent months, some members of Congress have questioned the applicability of the federal gift tax to contributions to [Code Sec. 501\(c\)\(4\)](#) organizations. *CCH Federal Tax Weekly No. 28, July 14, 2011.*

## **Economic substance doctrine**

The IRS gave its examiners new instructions about how to apply the codified economic substance doctrine in July. The *Health Care and Education Reconciliation Act of 2010 (HCERA)* codified the economic substance doctrine. The IRS described various factors examiners should consider when reviewing cases where the economic substance doctrine may be applied. *CCH Federal Tax Weekly No. 29, July 21, 2011.*

## **Advance pricing agreements**

In August, the IRS realigned its Advance Pricing Agreement (APA) and Mutual Agreement Program (MAP) initiatives. The APA program allows taxpayers to obtain an agreement covering prospective determination and application of transfer pricing methods. A new office will be created in the IRS Large and International Business Division to consolidate the two initiatives. *CCH Federal Tax Weekly No. 31, August 4, 2011.*

## **Annuity contracts**

The IRS issued guidance in July intending to ease the requirements for treating a direct transfer of a portion of an existing annuity contract for a second annuity contract as a tax-free exchange under Code Sec. 1035. Under the new guidance, the portion of the existing contract representing the contract's cash surrender value may be converted tax free into another annuity. *CCH Federal Tax Weekly, No. 27, July 7, 2011.*

## **Exempt organizations**

The IRS issued final regulations to implement redesigned Form 990, Return of Organization Exempt From Income Tax. The final regulations reflect proposed regulations and provide for the elimination of the advance ruling process for new [Code Sec. 501\(c\)\(3\)](#) organizations. *CCH Federal Tax Weekly No. 37, September 15, 2011.*

## Health care reform

The Sixth Circuit Court of Appeals upheld the constitutionality of the individual coverage mandate in the *Patient Protection and Affordable Care Act (PPACA)*. In *Thomas More Law Center v. Obama*, CA-6, June 29, 2011, the Sixth Circuit found the health care reform law was a reasonable exercise of Congress' authority to regulate commerce. *CCH Federal Tax Weekly No. 27, July 7, 2011*. However, the Eleventh Circuit Court of Appeals struck down the individual mandate in the *PPACA* in August. The Eleventh Circuit found that Congress cannot require individuals to enter into contracts with insurance providers. *CCH Federal Tax Weekly No. 33, August 18, 2011*.

## Tax collection

The IRS increased its enforcement revenue in fiscal year (FY) 2010, the Treasury Inspector General for Tax Administration (TIGTA) reported in August. FY 2010 gross collections included approximately \$1.2 trillion from individual taxes, \$800 billion from employment taxes and \$300 billion from corporate taxes. *CCH Federal Tax Weekly No. 34, August 25, 2011*.

If you have any questions about these or any federal tax developments, please contact our office.

Sincerely yours,

*Carmody Meach & Choo LLP*  
*Certified Public Accountants*