Dear Client:

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 settlement offer for misclassified workers. The IRS has launched a new Voluntary Classification Settlement Program (VCSP) for employees that have been misclassified as independent contractors (or as other nonemployees). The VCSP is available to taxpayers who are currently treating their workers (or a class or group of workers) as independent contractors or other nonemployees and want to prospectively treat the workers as employees. To be eligible, a taxpayer: (a) must have consistently treated the workers as nonemployees; (b) must have filed all required Forms 1099 for the workers for the previous three years; and (c) cannot currently be under audit by the IRS, or currently under audit concerning the classification of the workers by the Department of Labor or by a state government agency. A taxpayer who applies for and is accepted into the VCSP will agree to prospectively treat the class of workers as employees for future tax periods and in exchange:

A. Will pay 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under reduced rates;
B. Will not be liable for any interest and penalties on the liability;
C. Will not be subject to an employment tax audit for the worker classification of the workers for prior years; and
D. Will agree to extend the period of limitations on assessment of employment taxes for three years for the first, second and third calendar years beginning after the date on which the taxpayer has agreed under the VCSP closing agreement to begin treating the workers as employees.

Personal use of employer-provided cell phones generally nontaxable under new guidance. Close to one year after cell phones were removed from the "listed property" category of Code Sec. 280F, the IRS has explained the practical consequences of the change. In sum, where an employer provides employees with cell phones primarily for noncompensatory business reasons, neither the business nor personal use of the phone results in income to the employee, and no recordkeeping of usage is required. And, in most instances, an employer's reimbursement to employees for their providing a cell phone for bona fide employment-related business use won't be taxable. The guidance applies for all tax years after Dec. 31, 2009.

Simplified per-diem rates increase slightly for post-Sept. 30 business travel. An employer may pay a per-diem amount to an employee on business-travel status instead of reimbursing actual substantiated expenses for away-from-home lodging, meal and incidental expenses (M&IE). If the rate paid doesn't exceed IRS-approved maximums, and the employee provides simplified substantiation, the reimbursement isn't subject to income- or payroll-tax withholding and isn't reported on the employee's Form W-2. In general, the IRS-approved per-diem maximum is the GSA per-diem rate paid by the federal government to its workers on travel status. This rate varies from locality to locality. Instead of using actual per-diems, employers may use a simplified "high-low" per-diem, under which there is one uniform per-diem rate for all "high-cost" areas within the continental U.S. (CONUS), and another per-diem rate for all other areas within CONUS. The IRS has issued a new notice carrying the “high-low” simplified per-diem rates for post-Sept. 30, 2011 travel. The high-cost area per-diem increases by $9 to $242, and the low-cost area per-diem increases by $3 to $163. The IRS also has issued a revenue procedure providing rules for using per diem rates to substantiate the amount of ordinary and necessary business expenses paid or incurred while traveling away from home.

Guidance on electing zero estate tax for 2010 decedents. Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, estates of decedents who died in 2010 can choose zero estate tax, but at the price of beneficiaries being limited to the decedents' basis plus certain increases under Code Sec. 1022. In early August, the IRS issued detailed guidance on how this election is made. The guidance revealed that the election is made by filing a Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent. Specifically, Form 8939 is an information return used by the executor of a decedent who died in 2010: (1) to make the Section 1022 Election; (2) to report information about property acquired from a decedent; and (3) to allocate Basis Increase to certain property acquired from a decedent. In general, Form 8939 is due by Jan. 17, 2012.

Time for executors to make portability election for 2011 decedents. In a new notice and accompanying news release, the IRS reminded executors of the estates of married decedents dying after 2010 that they must file an estate tax return in order to pass along the unused estate and gift tax exclusion amount, available for the first time this year, to their surviving spouse. The first estate tax returns for estates eligible to make the portability election started becoming due on Oct. 3, 2011 (i.e., nine months after a post-2010 date of death). Because the IRS believes that most married couples will want the surviving spouse to be able to take advantage of the unused exclusion amount of the first spouse to die, the election is deemed made if a Form 706 (estate tax return) is properly and timely filed. No affirmative statement or other indication is necessary. Even if the estate isn't required to file a Form 706 (e.g., because the value of the gross estate is less than the exclusion amount), the Form 706 must be filed in ordered to make the election. For estates that choose not to make a portability election, if that estate is otherwise required to file a Form 706, the executor must follow the instructions for Form 706 describing the necessary steps to avoid making the election. For estates that aren't required to file a Form 706, simply not filing the form will effectively prevent the making of the election.

Foreign financial assets disclosure. For tax years beginning after Mar. 18, 2010, the Hiring Incentives to Restore Employment Act of 2010 provides that individuals with an interest in a “specified foreign financial asset” during the tax year must 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). “Specified foreign financial assets” are: (1) depository or custodial accounts at foreign financial institutions, and (2) to the extent not held in an account at a financial institution, (a) stocks or securities issued by foreign persons, (b) any other financial instrument or contract held for investment that is issued by or has a counterparty that is not a U.S. person, and (c) any interest in a foreign entity. Disclosure is made by filing Form 8938 (Statement of Specified Foreign Financial Assets) with the taxpayer's appropriate return (e.g., with Form 1040 in the case of an individual). In September, the IRS released a draft version of the 2011 Instructions to Form 8938. The instructions indicate that under a transitional rule, most taxpayers won't have to file the form until 2012.

Equitable innocent spouse relief eased. Married joint return filers are jointly and severally liable for the tax arising from their returns. Innocent spouses may request relief from this liability in certain circumstances. Previously, the IRS took the position that a request for equitable innocent spouse relief had to be made no later than two years from the first collection activity against the spouse. After being pressured by legislators and the National Taxpayer Advocate, the IRS has now eliminated the two-year period for equitable relief. Elimination of the two-year period is reflected on Form 8857, which is used to request innocent spouse relief.

Supreme Court to decide whether basis overstatements can trigger six-year limitations period. Late last year, the IRS issued final regulations under which an understated amount of gross income reported on a return resulting from an overstatement of unrecovered cost or other basis is an omission of gross income for purposes of the six-year period for assessing tax and the minimum period for assessment of tax attributable to partnership items. The six-year limitations period applies when a taxpayer omits from gross income an amount that's greater than 25% of the amount of gross income stated in the return. Several courts had held that a basis overstatement is not an omission of gross income for this purpose. In response to these decisions, the IRS issued the new regulations to clarify that an omission can arise in that fashion. However, some courts have upheld the regulations and others have rejected them. As a result, the Supreme Court has now decided to resolve the dispute.

Sincerely,

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