

***CALIFORNIA CPA EDUCATION FOUNDATION***

**2011 Federal & California Tax Update  
for  
Individuals**

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**January 2012 Supplement**

## 2012 Busy Season Look-Out List

- **Foreign Asset Reporting:** New Form 8938 required for individuals with specified foreign financial asset holdings over threshold amounts.
- **Cost Basis Reporting:** New Form 8949 requires segregation and identification of capital gain transactions. (*Sch. D Instructions*)
- **Cost Basis Elections:** New cost basis rules require election of default methods for determining basis of stock and mutual funds.
- **Capitalization Regs:** Regulations effective 1/1/2012 provide new rules and safe harbors for distinguishing capital expenditures from repairs. (*Reg §1.263(a)-2T & 3T*)
- **Revised Schedule E:** Disclosure of property type required.
- **Form 1099-MISC Questions:** Business tax returns and 1040 Schedules C, E, and F require inquiry regarding client filing of Form 1009s.
- **Passive Activity Grouping Disclosure:** New passive activity grouping disclosure rules kick in for activities acquired in 2011. (*Rev. Proc. 2010-13*)
- **Late Aggregation Elections for Real Professionals:** Retroactive rental property aggregation election allowed for real estate professionals under the new relief provision. (*Rev. Proc. 2011-34*).
- **Mortgage Assistance Payments:** Safe harbor method for reporting mortgage interest and property tax payments for recipients of federal mortgage assistance payments. (*Notice 2011-14*)
- **Adult Child Insurance Coverage:** California retroactive conformity to 2010 federal law change creates potential refund opportunity for clients who reported a 2010 fed-Cal difference for health insurance on an adult child. (*AB 36*)
- **Self-Employed Health Insurance:** Health insurance premiums no longer deductible in computing SE Tax; however, IRS now allows Medicare premiums to count as SE health insurance.
- **Earned Income Tax Credit Due Diligence Requirements:** Submission of Form 8867 required to avoid \$500 preparer penalty.
- **Energy Credits:** New dollar limits and eligibility requirements apply in 2011 for residential energy credits and green vehicle credits. (*Secs. 25C, , 30, 30B, 30C*)
- **California Use Tax Table:** New standard use tax table for safe-harbor reporting of small internet purchases. (*SB 86*)

- **New Hire Credit:** Federal credit of \$1,000 for qualified employees hired in 2010 and retained for 52 weeks. (*Form 5884-B*)
- **Credit for Hiring Veterans.** Expanded work opportunity tax credit for hiring qualified veterans after 11/21/2011.
- **California Multi-State Apportionment Changes:** Single sales factor apportionment option (with market-based sourcing for services and intangibles) may be elected in 2011. “Finnigan Rule” applies for determining throwback sales of combined groups.
- **Bonus Depreciation Component Election:** Written election required to claim 100% bonus depreciation on components of building placed in service in 2011, where construction began prior to 9/9/2010. (*Rev. Proc. 2011-26*)
- **Accounting Method Changes:** New *Rev. Proc. 2011-14* replaced *Rev. Proc. 2008-52* as operative guidance for automatic accounting method changes. Includes a new automatic change for accrual of California franchise tax deduction.
- **IRS Voluntary Classification Settlement Program:** Low-cost settlement program offered by IRS to employers who have misclassified employees as independent contractors.
- **New California Penalties for Misclassifying Employees:** SB 459 gives the California Department of Industrial Relations authority to impose penalties on employers who misclassify employees as independent contractors. The penalty can also be imposed on CPAs who give incorrect advice on employee classification.
- **Innocent Spouse Relief:** IRS drops 2-year limit on filing claims for “equitable relief” under the innocent spouse rules. (*Notice 2011-70*)
- **Estate Tax \$5 Million Exclusion Portability:** For deaths of a first spouse in 2011, consideration must be given to filing a Form 706 in order to elect to carry over the unused exclusion amount to the estate of the surviving spouse.
- **Estate Tax Deductions for Unpaid Claims:** The IRS has established new procedures for filing protective claims for refund of estate tax based upon deductions for claims of against the estate that remain unpaid as of the filing date of the Form 706. (*Rev. Proc. 2011-48*)
- **Modified Carryover Basis Calculations:** IRS has established safe harbor rules for calculating the basis of assets inherited from the estate of a 2010 decedent that elects out of federal estate tax. (*Rev. Proc 2011-41*)
- **Reinstatement of Exempt Status:** IRS establishes procedures for charities to reinstate exempt status lost due to failure to file 990s. (*Notices 2011-43 & 44*)

## January 2012 Supplement

### Chapter 1:

#### **Page 1-1: Deficit Reduction Committee Fails to Produce Recommendations**

As everyone knows, the 12-member “Super-Committee” failed to agree upon a package for reducing the federal deficit over the next 10 years. Therefore, no new tax legislation emerged from their deliberations. Absent further action, the automatic sequestration process goes into effect to automatically cut federal program budgets at the end of this year.

#### **Page 1-2: No Sunset for SB 401**

Because there have been no lawsuits filed challenging the constitutionality of SB 401, the conformity changes made by that legislation will remain in effect for 2011 tax returns.

#### **Page 1-6: 2% Payroll Tax Cut Extended for 2 Months**

On 12/23/2011, President Obama signed into law **P.L. 112-78**, extending the 2% cut in the employee FICA and self-employment tax rates through the end of February 2012. If the cut is not further extended for the remainder of 2012, there is a recapture mechanism which imposes additional income tax equal to the amount of the 2% payroll tax savings on earnings in the first two months of 2012 in excess of \$18,350—i.e., 2/12 of the social security wage base for 2012.

#### **Page 1-9: Correction**

The second to last paragraph should read “For *2011* we are back to . . .”

#### **Page 1-10: Correction of 2012 Sec. 179 Expense Amounts**

For tax years beginning in 2012, the correct sec. 179 expense limit is **\$139,000**, with the phase-out of the limit for sec. 179 asset acquisitions in excess of **\$560,000**.

#### **Page 1-13: FTB Publishes Standard Use Tax Table**

California individuals who report use tax on out-of-state purchases can elect to pay the tax by reporting it on their Form 540. This year, the form includes a table with standard use tax amounts that be reported (based upon AGI) for non-business purchases of items costing under \$1,000 individually. The table and instructions are shown on the following two pages.

## Use Tax

### Line 95 – Use Tax. This is not a total line.

California use tax applies to purchases of “tangible personal property” from out-of-state sellers (for example, purchases made by telephone, over the Internet, by mail, or in person). If you have questions about whether a purchase is taxable, go to the State Board of Equalization’s website at [boe.ca.gov](http://boe.ca.gov), or call their Taxpayer Information Section at 800.400.7115 or California Relay Service (CRS) 711 (for hearing and speech disabilities.)

The following taxpayers are required to report purchases subject to use tax directly to the State Board of Equalization and may not report use tax on their income tax return:

- Individuals or businesses that have a California seller’s permit.
- Businesses that are not required to hold a California seller’s permit, but receive at least \$100,000 in gross receipts.
- Individuals or businesses that have a California consumer use tax account.

If you are not required to report purchases subject to use tax directly to the State Board of Equalization, you may report use tax on your income tax return. The Use Tax Worksheet and Use Tax Table below will help you determine how much use tax to report. If you owe use tax but you do not report it on your income tax return, you must report and pay the tax to the State Board of Equalization. For information on how to report use tax directly to the State Board of Equalization, go to their website at [boe.ca.gov](http://boe.ca.gov) and type “use tax” into the Search box.

Failure to report and timely pay may result in the assessment of interest, penalties and fees.

See page 20 for a general explanation of California use tax.

### Use Tax Worksheet

You must use the Use Tax Worksheet below to calculate your use tax liability if any of the following apply:

- You prefer to calculate the amount of use tax due based upon your actual purchases subject to use tax.
- You owe use tax on non-business purchases of individual items of property with a sales price of \$1,000 or more.
- You owe use tax on any item purchased for use in a trade or business not registered with the Board of Equalization.

If you have a combination of individual items purchased for \$1,000 or more and individual, non-business items purchased for less than \$1,000, you may either:

- Use the Use Tax Worksheet to compute use tax due on all purchases, or
- Use the Use Tax Worksheet to compute use tax due on all individual items purchased for \$1,000 or more, and use the Estimated Use Tax Table to estimate the use tax due on individual, non-business items purchased for less than \$1,000.

| Use Tax Worksheet<br>Use whole dollars only.   |              |
|--|--------------|
| 1. Enter purchases from out-of-state sellers made without payment of California sales/use tax. See worksheet instructions below.           | \$ _____ .00 |
| 2. Enter the applicable sales and use tax rate.  | _____        |
| 3. Multiply line 1 by the tax rate on line 2. Enter result here  | \$ _____ .00 |
| 4. Enter any sales or use tax you paid to another state for purchases included on line 1. See worksheet instructions below.                | \$ _____ .00 |
| 5. Subtract line 4 from line 3. This is the total use tax due. Enter the amount due on line 95. If the amount is less than zero, enter -0- | \$ _____ .00 |

### Worksheet, Line 1, Purchases Subject to Use Tax

- Report purchases of items that would have been taxable if purchased in a California store. For example, you would include purchases of clothing, but not purchases of prescription medicine.
- Include handling charges.
- Do not include any other state’s sales or use tax paid on the purchases.
- Enter only purchases made during the year that correspond with the tax return you are filing.
- If you traveled to a foreign country and carried items back to California, generally the use tax is due on the purchase price of the goods you listed

on your U.S. Customs Declaration less the \$800 per-person exemption. This \$800 exemption does not apply to goods sent or shipped to California by mail or other common carrier.

- If your filing status is “married/RDP filing separately,” you may elect to report one-half of the use tax due or the entire amount on your income tax return. If you elect to report one-half, your spouse/RDP may report the remaining half on his or her income tax return or on the individual use tax return available from the State Board of Equalization.

**Note:** Report and pay any use tax you owe on the following purchases directly to the State Board of Equalization, not on your income tax return:

- Vehicles, vessels, and trailers that must be registered with the Department of Motor Vehicles.
- Mobile homes or commercial coaches that must be registered annually as required by the Health and Safety Code.
- Vessels documented with the U.S. Coast Guard.
- Aircraft.
- Leases of machinery, equipment, vehicles, and other tangible personal property.
- Cigarettes and tobacco products when the purchaser is registered with the State Board of Equalization as a cigarette and/or tobacco products consumer.

### Worksheet, Line 2, Sales and Use Tax Rate

- Enter the sales and use tax rate applicable to the place in California where the property is used, stored, or otherwise consumed. If you do not know the applicable city or county sales and use tax rate, using your computer or mobile device please go to the State Board of Equalization’s website at [boe.ca.gov](http://boe.ca.gov) and click on City and County Tax Rates or call their Taxpayer Information Section at 800.400.7115 or California Relay Service (CRS) 711 (for hearing and speech disabilities.)
- The statewide sales and use tax rate decreased by 1% effective July 1, 2011. If you made purchases prior to July 1, 2011, please use the rates in effect at that time.

### Worksheet, Line 4, Credit for Tax Paid to Another State

- This is a credit for tax paid to other states on purchases reported on Line 1. You can claim a credit up to the amount of tax that would have been due if the purchase had been made in California. For example, if you paid \$8.00 sales tax to another state for a purchase, and would have paid \$6.00 in California, you can claim a credit of only \$6.00 for that purchase.

### Estimated Use Tax Table

You may use the Estimated Use Tax Table to estimate and report the use tax due on individual non-business items you purchased for less than \$1,000 each, instead of reporting your use tax liability determined using the Use Tax Worksheet. This option is only available if you are permitted to report use tax on your income tax return and you are not required to use the Use Tax Worksheet to calculate the use tax owed on the purchases of such items. Simply include the use tax liability, that corresponds to your California Adjusted Gross Income, on line 95 and you will not be assessed additional use tax on the individual non-business items you purchased for less than \$1,000 each.

You may not use the Estimated Use Tax Table to estimate and report the use tax due on purchases of items for use in your business or on purchases of individual non-business items you purchased for \$1000 or more each. See the instructions for the Use Tax Worksheet if you have a combination of purchases of individual non-business items for less than \$1,000 each and purchases of individual non-business items for more than \$1,000.

| California Adjusted Gross Income (AGI) Range         | Use Tax Liability |
|--|-------------------|
| Less Than \$20,000                                   | \$ 7              |
| \$20,000 to \$39,999                                 | \$ 21             |
| \$40,000 to \$59,999                                 | \$ 35             |
| \$60,000 to \$79,999                                 | \$ 49             |
| \$80,000 to \$99,999                                 | \$ 63             |
| \$100,000 to \$149,999                               | \$ 88             |
| \$150,000 to \$199,999                               | \$123             |
| More than \$199,999 – Multiply AGI by 0.070% (.0007) |                   |

## **Chapter 2:**

### **Page 2-9: Form 8938 Finalized and Required for 2011 Tax Returns**

The IRS has issued the final version of form 8938 and instructions, in conjunction with the publication of temporary regulations under sec. 6038D outlining the new reporting requirements. These new reporting rules are covered in the second day of this course.

## **Chapter 3:**

### **Page 3-3: Form 1098-MA Issued for Reporting Mortgage Assistance Payments**

The IRS has issued a new form to be used by state housing authorities to report mortgage assistance payments made to lenders on behalf of homeowners participating in HFA Hardest Hit Fund and Emergency Homeowners' Loan Program. The **Form 1098-MA** informs the homeowner how much the agency paid to the mortgage lender, split between the amount paid by agency and the amount paid by the homeowner.

## **Chapter 4:**

### **Page 4-2: Correction**

The first line of page 4-2 should read “The IRS has changed both the 1099-B and the Form 1040 Schedule *D* . . .”

### **Page 4-6: IRS Issues final Schedule D Instructions with Form 8949 Adjustment Codes**

The IRS issued the final version of the instructions for completing the Form 8949, including a table with 10 “Column b” codes, as shown on the following page. This represents a significant change from the initial version of the instructions, which had 21 different codes to be used in reporting a wide variety of different gains and losses. Our initial speculation was that these codes were sought for IRS “data mining” purposes, in seeking to gather additional information on asset sales. For whatever reason, the Service backed off on this in the final version of the form.

### **Page 4-14: Form 8937 Issued for Reporting Organizational Actions Affecting Stock Basis**

The IRS has issued **Form 8937**, the form to be used by corporations to report organizational actions (such as mergers) that affect the basis of their securities held by investors. It is unlikely that many corporations will ever use this form, given the alternative they have of simply reporting the organizational action on their website.

**Cal CPA Education Foundation: McBride/Daley 2011 Tax Update for Individuals**  
**How To Complete Form 8949, Columns (b) and (g)**

For most transactions, you do not need to complete columns (b) and (g) and can leave them blank. You may need to complete columns (b) and (g) if you got a Form 1099-B or 1099-S that is incorrect, if you are excluding or postponing a capital gain, if you have a disallowed loss, or in certain other situations. Details are in the table below.

| IF . . .  | THEN enter this code in column (b) . . . | AND. . .  |
|---|--|---|
| You received a Form 1099-B (or substitute statement) and the basis shown in box 3 is incorrect. . . .   | B  | Enter the basis shown on Form 1099-B (or substitute statement) in column (f).<br><br>If the correct basis is higher than the basis shown on Form 1099-B (or substitute statement), enter the difference between the two amounts as a negative number (in parentheses) in column (g).<br><br>If the correct basis is lower than the basis shown on Form 1099-B (or substitute statement), enter the difference between the two amounts as a positive number in column (g). |
| You received a Form 1099-B (or substitute statement) and the type of gain or loss (short term or long term) shown in box 8 is incorrect . . . .   | T  | Enter -0- in column (g) unless an adjustment is required because of another code. Report the gain or loss in the correct Part of Form 8949.   |
| You received a Form 1099-B or 1099-S as a nominee for the actual owner of the property. . . .   | N  | Report the transaction on Form 8949 as you would if you were the actual owner, but enter any resulting gain as a negative adjustment (in parentheses) in column (g) or any resulting loss as a positive adjustment in column (g). However, if you received capital gain distributions as a nominee, report them instead as described under <i>Capital Gain Distributions</i> , earlier.   |
| You sold or exchanged your main home at a gain, must report the sale or exchange on Form 8949, and can exclude some or all of the gain. . . .   | H  | Report the sale or exchange on Form 8949 as you would if you were not taking the exclusion. Then enter the amount of excluded (nontaxable) gain as a negative number (in parentheses) in column (g). See the example in the instructions for Form 8949, column (g).   |
| You sold or exchanged qualified small business stock and can exclude part of the gain. . . .  | S  | Report the sale or exchange on Form 8949 as you would if you were not taking the exclusion. Then enter the amount of the exclusion as a negative number (in parentheses) in column (g).   |
| You can exclude all or part of your gain under the rules explained earlier in these instructions for DC Zone assets or qualified community assets. . . .  | X  | Report the sale or exchange on Form 8949 as you would if you were not taking the exclusion. Then enter the amount of the exclusion as a negative number (in parentheses) in column (g).   |
| You are electing to postpone all or part of your gain under the rules explained earlier in these instructions for rollover of gain from QSB stock, empowerment zone assets, publicly traded securities, or stock sold to ESOPs or certain cooperatives. . . . | R  | Report the sale or exchange on Form 8949 as you would if you were not making the election. Then enter the amount of postponed gain as a negative number (in parentheses) in column (g).   |
| You have a nondeductible loss from a wash sale. . . .   | W  | Enter the amount of the nondeductible loss as a positive number in column (g). See <i>Wash Sales</i> , earlier, for details.  |
| You have a nondeductible loss other than a loss indicated by code W. . . .  | L  | Enter the amount of the nondeductible loss as a positive number in column (g). See the example under <i>Nondeductible Losses</i> , earlier.   |
| You include any expense of sale or certain option premiums in column (g) or you have an adjustment not explained above in this column. . . .  | O  | Enter your expenses of sale or the appropriate adjustment amount in column (g). Enter any expenses of sale as a negative number (in parentheses). See the instructions for Form 8949, column (g). If you sold a call option and it was exercised, see <i>Gain or Loss From Options</i> , earlier, for information about reporting certain option premiums.  |
| None of the other statements in this column apply. . .  | Leave columns (b) and (g) blank.         |   |

**Schedule D**

Complete all necessary pages of Form 8949 before you complete line 1, 2, 3, 8, 9, or 10 of Schedule D.

**Rounding Off to Whole Dollars**

You can round off cents to whole dollars on your Schedule D. If you do round to whole dollars, you must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the

next dollar. For example, \$1.39 becomes \$1 and \$2.50 becomes \$3.

If you have to add two or more amounts to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

**Lines 1, 2, 3, 8, 9, and 10, column (h)—Gain or Loss**

Figure gain or loss on each line. First, subtract cost or other basis (column (f)) from

sales price (column (e)). Then take into account any adjustments in column (g). Enter the gain or loss in column (h). Enter negative amounts in parentheses.

**Example 1.** Column (e) is \$6,000 and column (f) is (\$2,000). Enter \$4,000 in column (h).

**Example 2.** Column (e) is \$6,000 and column (f) is (\$8,000). Enter (\$2,000) in column (h).

## **Chapter 5:**

### **Page 5-13: Case Name Correction**

The name of the case at the top of the page should be *Viralam v. Comm'r.* (*Gundanna* is the taxpayer's middle name.)

## **Chapter 6:**

### **Page 6-7: IRS Extends Special Madoff Loss Safe Harbor to Dead Ponzis**

As noted on page 6-7, Rev. Proc. 2009-20 provides an optional safe harbor allowing certain investors to claim a theft loss deduction for qualified losses from certain fraudulent investment schemes. Use of this safe harbor requires that authorities have charged the lead figure by indictment, information, or criminal complaint with a crime that meets the definition of theft for purposes of sec. 165. What happens if the swindler dies before the required criminal charges can be filed?

*Rev. Proc. 2011-58* addresses this, by expanding the safe harbor to cover a situation where:

A lead figure, or an associated entity involved in the specified fraudulent arrangement, was the subject of one or more civil complaints or similar documents that a state or federal governmental entity filed with a court or in an administrative agency enforcement proceeding, and:

- (a) The civil complaint or similar documents together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement, conducted by the lead figure;
- (b) The death of the lead figure precludes a charge by indictment, information, or criminal complaint against that lead figure; and
- (c) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen.

### **Page 6-16: IRS Acquiesces in *Mayo* Decision**

In *AOD 2011-06*, the IRS announced its acquiescence in the Tax Court's decision in *Mayo v. Comm'r.*, ruling that a professional gambler's expenses (as distinguished from wagering losses) are not limited to gambling winnings (thereby allowing a professional gambler to generate a Schedule C loss).

## **Chapter 7:**

### **Page 7-14: Final Regs Issued on EITC Due Diligence Requirement for Tax Preparers**

The proposed regulations discussed on page 7-14 have been finalized. As a result, paid preparers who prepare a 2011 tax return claiming the earned income tax credit will have to submit Form 8867, the Earned Income Credit Checklist, with the return in order to satisfy the new due diligence requirements for the credit. Failure to do so will subject the preparer (and potentially also the preparer's firm) to a \$500 penalty.

## **Chapter 9:**

### **Page 9-2: Correction**

**Note 4** in the middle of the page should read as follows:

*Note 4:* If the deficiency is attributable to unreported community property income on a joint return, or improper community property deductions, *reg. sec. 1.6015-1(f)* provides that *community property laws are disregarded* in allocating income and deductions between spouses. If married couples in a community property state file *separate returns*, an innocent spouse can avoid liability of tax on unreported community property income of the guilty spouse under sec. *IRC 66(c)*, which applies the same principles that apply for traditional relief under sec. 6015(b).

## **Chapter 10:**

### **Page 10-15: Correction to Case Header**

The header to this case should read:

**Reliance on CPA Does Not Excuse Omission of \$3.4 Million from Tax Return**