

ANSWERS: PROBLEMS WITH THE “2-YEAR SPREAD” (Continued)

c. Albert got caught “a little short” during 2011, and needed to take \$3,000 from his Roth Account. Any problems?

We’ll see the “acceleration” rule here. The original “plan” for the 2-year spread:

2011 Declare \$20,000 of income.

2012 Declare \$20,000 of income.

But now we see Albert took a distribution from the Roth before 2012 began. The \$3,000 is “accelerated”, and we now will see:

2011 Declare \$23,000 of income.

2012 Declare \$17,000 of income.

In addition, if Albert would have had a 10% penalty in 2010 when he originally did the conversion, he will now have a 10% penalty on the \$3,000 withdrawal.

d. Albert appears as a new client for his 2011 return. How will you spot the conversion?

We must have a copy of Albert’s 2010 return. We can then simply look at Page 2 of the Form 8606.

e. Albert appears as a new client for his 2012 return. How will you spot the conversion from 2010?

As previously discussed, we’re not yet completely certain whether the 2011 return will show clearly that the \$20,000 declared in 2011 is only the first half of his 2-year spread. Hopefully the Form 8606 will make this clear. If in doubt, ask Albert to bring in his 2010 return. Form 8606, page 2, will supply the answer.

2. Bertha has an IRA account, but wants to convert some of it into a Roth IRA this year. Can she do this? What factors would make this impossible?

Of course she can! Conversions have been possible for years. Now that we no longer have income limitations, we know she can do this.

The only problems are the age-old issues dealing with tax planning - - -

Can she afford to pay the tax?

Is she in one of the lower tax brackets?

Do her age and future plans make this wise?

Do special considerations for her estate suggest this move?

Discussion

ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (EGTRRA) included a phased-in reduction in estate tax from 2001 through 2009. This estate tax reduction was to end in 2010 with the estate tax being eliminated for 2010 and then reinstated at 2001 levels for 2011 and on.

THE 2010 TAX RELIEF ACT has established new estate and gift tax rules for 2010, 2011 and 2012. However, at the end of 2012 these new rules will expire and the EGTRRA provisions will again prevail.

ESTATE TAX (Form 706) (Page 1 of 2)		
Estate Tax Item	Prior Law	2010 Tax Relief Act
Retroactive Reinstatement (See also IR-2011-83, Notice 2011-66, Notice 2011-76 & Rev Proc 2011-41)	EGTRRA provision repealed estate tax for deaths in 2010.	Estate tax retroactively reinstated for deaths in 2010 as if EGTRRA provision was never enacted. Executor can make election to use EGTRRA provision.
Exclusion Amount	Started at \$1 million in 2001 and increased gradually to \$3.5 million by 2009.	For 2010, 2011 & 2012: Amount is \$5 million.
State Death Taxes Paid	For 2001 thru 2004: Amounts paid for state death taxes were allowed as a tax credit. For 2005 thru 2009: Amounts paid for state death taxes were allowed as a deduction.	For 2010, 2011 & 2012: Amounts paid for state death taxes are allowed as a deduction.
Tax Rates	Before 2010: Rate had gradually been reduced from 55% to 45%.	For 2010, 2011 & 2012: Maximum rate is 35%.
Executor Election To Opt Out Of Estate Tax (See also IR-2011-83, Notice 2011-66, Notice 2011-76 & Rev Proc 2011-41)	Not Applicable.	For 2010 only: Executor can elect to use rules enacted under EGTRRA. If election under Section 301(c) of the Tax Relief Act of 2010 is made, estate is not subject to estate tax and "modified carryover" basis rules apply. Election is irrevocable without IRS consent. Section 301(c) election must be made by January 17, 2012 on Form 8939 (see Publication 4895).

ESTATE TAX (Form 706) (Page 2 of 2)		
Estate Tax Item	Prior Law	2010 Tax Relief Act
<p>Basis Of Assets</p> <p>(See also IR-2011-83, Notice 2011-66, Notice 2011-76 & Rev Proc 2011-41)</p>	<p>Before 2010: “Fresh start” basis equal to FMV at date of death (or alternate valuation date).</p> <p>For 2010 only: Because of EGTRRA rules “modified carryover” basis applied (under Sect 1022). Executor could “step-up” basis to FMV for up to \$1.3 million of any property, or up to \$4.3 million of property passing to a surviving spouse.</p>	<p>For 2010 only: “Fresh start” basis equal to FMV at date of death (or alternate valuation date) UNLESS executor chooses the estate taxed under prior law (EGTRRA rules).</p> <p>For 2011 & 2012: “Fresh start” basis equal to FMV at date of death (or alternate valuation date).</p>
<p>Portability Of Exclusion Amount For Spouses</p> <p>“Deceased Spouse Unused Exclusion Amount”</p>	<p>Not Applicable.</p>	<p>For 2011 & 2012: In determining the maximum Unified Credit to be used on the Form 706, any exclusion amount that remains unused as of the death of the first spouse is available for use by the surviving spouse in addition to the surviving spouse’s exclusion amount. This unused exclusion amount is limited to the lesser of \$5 million (adjusted for inflation and rounded to the nearest \$10K after 2011) or the deceased spouse’s unused exclusion.</p> <p>An election must be made on a timely filed estate return (including extensions) even if an estate return would normally not be required to be filed. This election is irrevocable. It is outlined in Section 2010(c).</p>
<p>Extension Of Time To File 2010 Return</p>	<p>Not Applicable.</p>	<p>For 2010 deaths only: Due date for filing return, paying tax and making disclaimer is no earlier than March 19, 2012.</p>

GIFT TAX (Form 709)		
Gift Tax Item	Prior Law	2010 Tax Relief Act
Exclusion Amount	<p>Before 2004: Amount was identical to estate exclusion amount.</p> <p>For 2004 thru 2009: Amount was \$1 million.</p>	<p>For 2010 only: Amount is \$1 million.</p> <p>For 2011 & 2012: Amount is \$5 million.</p>
Tax Rates	Used identical rates as used for estate tax.	For 2010, 2011 & 2012: Maximum rate is 35%.
Unification With Estate Tax	<p>Before 2004: Estate and Gift taxes were unified, with a single rate schedule and a single exclusion amount.</p> <p>2004 thru 2010: Estate and Gift taxes were not unified.</p>	For 2011 & 2012: Estate and Gift taxes are again unified with a single rate schedule and a single exclusion amount.

GENERATION SKIPPING TRANSFER TAX (GSTT) (Form 706)		
GSTT Item	Prior Law	2010 Tax Relief Act
Retroactive Reinstatement	<p>Before 2010: GSTT rules were similar to Estate tax rules.</p> <p>For 2010 only: EGTRRA provision repealed GSTT for deaths in 2010.</p>	GSTT retroactively reinstated for deaths in 2010 as if EGTRRA provision was never enacted. However, tax rate of 0% for 2010 (see below) essentially repeals GSTT for deaths in 2010.
Exclusion Amount	Started at \$1 million in 2001 and increased gradually to \$3.5 million by 2009.	For 2010, 2011 & 2012: Amount is \$5 million.
Tax Rates	Used identical rates as used for estate tax.	<p>For 2010 only: Maximum rate is 0%.</p> <p>For 2011 & 2012: Maximum rate is 35%.</p>
Extension Of Time To File 2010 Return	Not Applicable.	For 2010 deaths only: Due date for filing return, paying tax and making disclaimer is no earlier than March 19, 2012.

Specific Rules For Income

OVERVIEW. The rules shown below are arranged in a table format to show you the Federal community rules specifically for income. The “Usual MFS” column outlines the Federal rules to be used if an opposite-sex married couple is considering filing separately. The “California RDP or SSMC” column indicates how these Federal rules apply to California RDPs or SSMCs. For California purposes, these taxpayers are considered married and will file MFJ or MFS. However, for Federal purposes they are considered unmarried and can only file Single or Head of Household.

SPECIFIC RULES FOR INCOME		
Item	Usual MFS	California RDP or SSMC
Wages, Earnings & Profits	<p>Wages, earnings and net income from a sole proprietorship from filer and spouse are community income and must be split evenly.</p> <p>This rule also applies to active duty military pay earned during a marriage where the couple is domiciled in a community property state.</p>	Same as for MFS.
Dividends, Interest & Rents	<p>Dividends, interest and rents from community property are community income and must be split evenly.</p> <p>Dividends, interest and rents from separate property are characterized as discussed under the Item “Income From Separate Property” shown further down in this table.</p>	Same as for MFS.
Alimony Received	<p>Alimony or separate maintenance payments are taxable to the spouse receiving the payments.</p> <p>Exception: Alimony or separate maintenance payments made <u>prior</u> to a divorce are taxable to the spouse receiving the payments only to the extent the payments exceed 50% of</p>	Same as for MFS.

	the community income. This is because the receiving spouse is already required to report 50% of the community income. See also “Alimony Paid” under “Specific Rules For Exemptions And Deductions” later.	
Gains & Losses	Gains and losses are classified as separate or community depending on how the underlying property is held.	Same as for MFS.
IRA & ESA Withdrawals	An IRA or ESA is deemed to be separate property by law. Taxable draws from an IRA or ESA are separate property even if the funds in these accounts would otherwise be community property. The owner of the account is liable for all tax and/or penalty due to the withdrawal. For purposes of this rule, IRA includes any traditional IRA, Roth IRA, Simple IRA or SEP IRA.	Same as for MFS.
Pensions		
Pensions In General	Community laws apply to pension income. The pension is either separate or community income based on the marital status and domicile of the employee when the original wages were earned. The classification of separate or community is not tied to where the recipient resides when receiving the pension, but rather to where the recipient was domiciled when earning the monies leading to the pension. It is possible that the pension can be a mixture of separate and community income and must be allocated based upon time in community and separate property domiciles.	Same as for MFS.
Lump-Sum Distributions	For the 10-year tax option available on lump-sum distributions for persons born before 01-02-1936, community property laws are disregarded.	Same as for MFS.

<p>Civil Service Retirement</p>	<p>State community property laws apply to an annuity payable under Civil Service Retirement (CSRS) or Federal Employee Retirement (FERS). The annuity is either separate or community income based on the marital status and domicile of the employee when the original wages were earned. See discussion under "Pensions In General".</p>	<p>Same as for MFS.</p>
<p>Military Retirement Pay</p>	<p>State community property laws apply to military retirement pay. The retirement pay is either separate or community income based on the marital status and domicile of the employee while in the Armed Forces on active military status. See discussion under "Pensions In General."</p>	<p>Same as for MFS.</p>
<p>Social Security Benefits</p>	<p>Social Security benefits are separate income for the person receiving the benefits.</p>	<p>Same as for MFS.</p>
<p>Partnership Income</p>	<p>If an interest is held in a partnership and partnership income is attributed to the efforts of either spouse, the partnership income is community income.</p> <p>If an interest held in a partnership is merely a passive investment in a separate property investment, the partnership income is characterized as discussed under the Item "Income From Separate Property" directly below.</p>	<p>Same as for MFS.</p>
<p>Tax-Exempt Income</p>	<p>Community income that is tax-exempt income keeps its exempt status for both spouses.</p>	<p>Same as for MFS.</p>
<p>Income From Separate Property</p>	<p>Income from separate property is deemed separate income in Arizona, California, New Mexico and Washington, but is deemed community income in Idaho, Louisiana, Texas and Wisconsin.</p>	<p>Same as for MFS.</p>

<p>Alimony Paid</p>	<p>Alimony or separate maintenance payments are deductible to the spouse making the payments. Exception: Alimony or separate maintenance payments made <u>prior</u> to a divorce are deductible to the spouse making the payments only to the extent the payments exceed 50% of the community income. This is because the receiving spouse is already required to report 50% of the community income. See also “Alimony Received” under “Specific Rules For Income” earlier.</p>	<p>Same as for MFS.</p>
<p>IRA Deduction</p>	<p>The IRA deduction for each spouse is figured separately and without regard to community property laws. It is placed on the return of the person who owns the IRA. The total deduction for IRA contributions cannot be split between spouses.</p>	<p>Same as for MFS.</p>
<p>Personal Expenses</p>	<p>Expenses paid out of community funds are deducted equally between spouses.</p> <p>Expenses paid out of separate funds are deductible by the person who paid the expense.</p>	<p>Same as for MFS.</p>

The adjustments needed to prepare the joint California return are shown below.

**CALIFORNIA RDP ADJUSTMENTS WORKSHEET
(Used To File A Joint California Return)**

ITEM	SAM	CHRIS	ADJUSTMENTS	ADJUSTED FEDERAL AMOUNTS
Wages	\$130,000	\$50,000		\$180,000
Interest	\$ 2,000	\$ 1,500		\$ 3,500
Dividends	\$ 12,000	\$ 4,500		\$ 16,500
LTCL	(\$ 2,000)	(\$ 3,000)	+ \$ 2,000	(\$ 3,000)
Rental Loss	(\$10,000)		+ \$10,000	\$ 0

**2. TAX RELIEF ACT OF 2010
BUSINESS TAXPAYER
PROVISIONS**

Item	Effective	2010 Legislation
Bonus Depreciation	NEW thru 2012	Boosts 50% bonus depreciation to 100% for qualified investments made after 09-08-2010 and before 01-01-2013. An election is available to use 50% bonus instead of 100% bonus.
	For 2012 Only	Extends 50% bonus depreciation for qualified property.
Section 179 Expensing Provision	Thru 2011	Increases max annual Section 179 deduction to \$500,000 with phase-out beginning at \$2 million.
	For 2012 Only	Sets max annual Section 179 deduction to \$125,000 with phase-out beginning at \$500,000. Both limits are indexed for inflation.
	Thru 2012	Extends the election to elect or revoke Section 179 expensing.
	Thru 2012	Extends the election to treat “off the shelf” computer software as qualifying Section 179 property.
	Thru 2011	Extends rules for qualified film & TV productions.
	After 2011	Did <u>not</u> extend the definition of “qualifying” Section 179 property to include qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property that applied for 2010 and 2011.
Passenger Auto Depreciation Caps	Thru 2011	Extends the \$8,000 bonus increase to the normal 1 st year depreciation limit (therefore, total 1 st year depreciation is approximately \$11,000).
Qualifying Leasehold Improvement, Retail Improvement And Restaurant Property	Thru 2011	Extends 15 year MACRS depreciation and 39 year alternative depreciation.
	After 2011	Reverts back to 39 year MACRS depreciation and 40 year alternative depreciation.

Item	Effective	2010 Legislation
Employee Benefits	Thru 2011	Extends parity between exclusion for employer provided parking and employer provided transit passes/vanpooling benefits. Exclusion is \$230 for 2010. Exclusion is TBD for 2011.
	Thru 2012	Extends enhanced adoption assistance exclusion.
Tax Credits	Thru 2011	Extends research tax credit.
	For 2011	Extends work opportunity tax credit.
	Thru 2011	Extends differential wage payment credit (for employees who are active duty members of the uniformed services).
	Thru 2011	Extends and modifies energy efficient appliance credit.
	Thru 2011	Extends tax credits for biodiesel & renewable diesel fuel, alcohol fuel & alcohol fuel mixtures and alternative fuel & alternative fuel mixtures.
	Thru 2012	Extends employer provided child care credit.

**3. 2011 MID-YEAR INCREASE
IN OPTIONAL STANDARD
MILEAGE RATES**

OPTIONAL STANDARD MILEAGE ALLOWANCES. IRS normally publishes these annually. However, in late June 2011, IRS Announcement 2011-40 increased the standard mileage rates for the second half of 2011 as shown.

Year	Business miles	Deemed Deprec.	Charitable	Medical or Moving	Source
2011 thru 6/30 7/01 – 12/31	51.0¢	22¢	14¢	19.0¢	Rev. Proc 2010-51 Ann 2011-40
	55.5¢	22¢	14¢	23.5¢	
2010	50¢	23¢	14¢	16.5¢	Rev. Proc 2009-54

JANUARY 1, 2011 – SB 931 – NO DEFICIENCY JUDGEMENT FOR 1ST. The law was passed in September 2010, signed by the Governor, and became effective January 1. It basically says the first lender, because of accepting the “short” sale price, is now barred from seeking a deficiency judgment. For us, in tax law, this means the loan is nonrecourse. When this is true:

SALE PRICE IS SAME AS LOAN, and

DEBT RELIEF INCOME IS IMPOSSIBLE. Effectively, lender has agreed to feel “satisfied”.

SECOND LOANS WERE NOT ADDRESSED in the law. Analysts disagree here as well. Some feel these loans are always recourse. Thus, if bank does not pursue, there is income from debt relief. Whether or not lender is forced to decide immediately is also subject to debate. Many believe the cancellation can occur in later years.

JULY 15, 2011 – SB 458 – NO DEFICIENCY JUDGEMENTS AT ALL! This was signed and took immediate effect on July 15. It bars both the first lender and any other lenders from pursuing a deficiency judgment when they agree to a short sale. Some feel this will make it even more difficult to convince lenders to accept short sales, but the outcome is:

SHORT SALE = NO DEBT RELIEF ON PRINCIPAL RESIDENCES!

SHORT SALES ONLY! PRINCIPAL RESIDENCE ONLY! Nothing has changed for foreclosures, abandonments, or a voluntary reconveyance. Only “short sales” for “principal personal residences” are affected.

RETURNING TO OUR QUESTIONS

ANSWERS: SHORT SALE OF RESIDENCE

1. Taxpayer recently completed a “short sale” of his home for \$250,000. Two loans existed:

First loan with outstanding balance of \$400,000.

Second loan with outstanding balance of \$50,000.

Consider the sale and potential debt relief if the short sale was:

a. Prior to 2011.

MOST ANALYSTS SAY:

SALE PRICE - \$250,000

POSSIBLE DEBT RELIEF – \$200,000. That’s \$150,000 from the first loan, and another \$50,000 from the second. Of course, we have the possible delay in resolving the disposition of the second loan.

PTINS FOR ALL. This was the first step. Deadline was 12/31/2010. Since the deadline has passed, IRS is in the “mop-up” phase. Yes, there are fees, and the process has glitches. As of late June, IRS recognizes they will need to oversee well over 1 million preparers! They also learned more than 100,000 of them did not acquire PTINs. They began sending letters to those who appear to be “preparers”, but do not have a PTIN registered with IRS.

RENEWAL TIME COMING – DEADLINE 12/31/2011! We now know PTINs will renew on a calendar-year cycle. Thus, we must renew our PTINs by 12/31/11. IRS expects to have the “renewal” process up and running by mid-October 2011.

TESTING. We all heard the original proposals – three levels of “preparation” and three levels of tests. At present, IRS has backed down to some extent. Until they have time for further study, there will be a single testing program for all preparation levels. We know you’ll be able to take and re-take the test until you pass. New details on the testing procedure are on the IRS website as of 09-06-2011. Earliest possible date you can be required to have passed the test is December 31, 2013.

CHARACTER “SCREENING”. Before anyone is an approved RTRP there will be a screening process, similar to what EAs, CPAs and attorneys were subjected to. It will involve fingerprinting, a tax compliance check, and background check.

CONTINUING EDUCATION. IRS continues to suggest RTRPs will have 15 hours of required CE each calendar year. Required will be:

3 hours of Federal update,
2 hours of ethics, and
10 hours of other Federal tax law.

2012 is the earliest possible year the continuing education will be required.