



# 2012/2013 FALL FEDERAL AND CALIFORNIA TAX UPDATE SEMINAR FOLLOW-UP LETTER

## PowerPoint slides

The final version of the PowerPoint slides is available at:

 **Web site**

[www.caltax.com/spidellweb/public/editorial/slides/12fedcalslideshow.pdf](http://www.caltax.com/spidellweb/public/editorial/slides/12fedcalslideshow.pdf)

In addition, we are providing below a list of links for you to access Spidell's checklists and customizable versions of the client letters that are in the seminar materials.

- [Form 1040 engagement letter](#)
- [Form 1120 engagement letter](#)
- [Form 1120S engagement letter](#)
- [Form 1065 engagement letter](#)
- [Lender letter](#)
- [Client organizer letter](#)
- [Spidell's Refund Grabber Checklist](#)
- [Spidell's Checklist for a Trouble-Free Return](#)
- [Items clients should bring to an interview](#)
- [Walking Away from a Corporation Qualifier](#)

## NEW INFORMATION

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### AMERICAN TAXPAYER RELIEF ACT OF 2012

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There is a complete discussion of the American Taxpayer Relief Act of 2012, located before Chapter 1: Individuals. This information also appears throughout the manual in the applicable chapters.

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### INDIVIDUALS

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#### MAJOR PROVISIONS EXTENDED (OR MADE PERMANENT) UNDER ATRA '12

Provision	Federal	California Conformity	Discussed at Page
\$250 deduction for educator expenses	Extended through 2013	No	1-13
Tuition deduction	Extended through 2013	No	1-14
Sales tax deduction	Extended through 2013	No	1-18

<b>Provision</b>	<b>Federal</b>	<b>California Conformity</b>	<b>Discussed at Page</b>
Deduction of mortgage insurance	Extended through 2013	No	1-24
AMT exemption	Made permanent and indexed for inflation	Yes (different amounts)	1-29
Nonrefundable credits offset AMT	Made permanent	No	1-29
Nonbusiness energy credit	Extended through 2013	No	1-37
IRA-to-charity exclusion	Extended through 2013 with special provisions for late transfers	Yes	8-2
EGTTRA tax rates	Made permanent beginning in 2013 except for higher top rates	N/A	1 (ATRA chapter)
Exemption phaseout	Reinstated for 2013 with higher thresholds	California has its own	1-1
Qualified dividends	Made permanent	N/A	1-6
Capital gains rates	15% rate continued except for 20% rate for higher income beginning in 2013	N/A	1-6
Itemized deduction phaseout	Reinstated for 2013 with higher thresholds	California has its own	1-17
Adoption Credit	EGTTRA provisions made permanent. Nonrefundable. Maximum \$10,000 (projected to be \$12,770 for 2013)	California has its own	1-30
Enhanced Child Credit	Extended through 2017	N/A	1-32
American Opportunity Tax Credit	Extended through 2017	N/A	1-33
Enhanced EITC	Extended through 2017	N/A	1-38
2% payroll tax cut	Not extended	N/A	1-41
COD exclusion for principal residence	Extended through 2013	No	7-16
Enhanced student loan interest	Made permanent	Yes	1-13
Refundable credit for unused AMT	Made permanent	No	1-30
Enhanced Dependent Care Credit	Made permanent	Yes	1 (ATRA chapter)
Enhanced Coverdell Education Savings Accounts	Made permanent	Yes	1 (ATRA chapter)
Changes to estate tax	Made permanent with a higher top rate. Exemption amount set at \$5 million with adjustment for inflation. Portability election made permanent	N/A	1-43

## Payroll tax holiday *not* extended

The 2% cut in the Social Security tax for all earners will not be extended into 2013. For wages paid on or after January 1, 2013, the Social Security tax will return to 6.2% (along with the Medicare tax, the total employee share of the tax will be 7.65%).

## Estate tax provisions

The Act permanently provides for a maximum estate tax rate of 40% with an inflation adjusted exclusion of \$5 million. (Act §101(a)(2))

In addition, the Act continues, and makes permanent, the portability election between spouses.

## CHARITABLE CONTRIBUTION LIMITED TO BASIS WHERE PROPERTY HELD LESS THAN ONE YEAR

A charitable contribution deduction for art was limited to basis rather than FMV under IRC §170(e) where a taxpayer held the property for less than one year before donating it. (*Williams III v. Comm.* (December 4, 2012) U.S. Court of Appeals for the Fourth Circuit, Case No. 11-1804)

The taxpayer argued that he met the one-year requirement because he had an option to buy the artwork that he had acquired more than one year before his purchase. However, the court rejected that argument, noting that the clock starts ticking at the time of actual purchase. Moreover, the taxpayer had no obligation under the option to follow through with the purchase.

## ESTATES GRANTED EXTRA TIME TO MAKE BASIS ALLOCATION ELECTION

In three separate private letter rulings with similar fact patterns, the IRS granted 120-day extensions to file Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent. (PLRs 201238011, 201238012, 201238016) Taxpayers met the requirements for reasonable cause under Treas. Regs. §301.9100-3. Although not stated in the PLRs, it appears that the taxpayers reasonably relied on tax professionals who failed to advise them of the need to timely file the Forms 8939.

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## BUSINESS

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### MAJOR PROVISIONS EXTENDED (OR MADE PERMANENT) UNDER ATRA '12

Provision	Federal	California Conformity	Discussed at Page
\$500,000 IRC §179	2012 and 2013	No	4-1
IRC §179 for certain real estate	Extended through 2013	No	4-2
Revoke IRC §179 election	Extended through 2013	No	4-1
IRC §179 for computer software	Extended through 2013	No	4-2
15-year depreciation for certain real estate	Extended through 2013	No	4-5
100% bonus depreciation	Drops to 50% in 2012; 50% extended through 2013	No	4-1

Provision	Federal	California Conformity	Discussed at Page
Enhanced transportation fringe benefits	Extended through 2013	Different amounts	4-23
Reduced built-in gains holding period	Extended through 2013	No	4-28
Research Credit	Extended through 2013	Permanent	4-30
Enhanced charitable deductions for computer software and for food and book inventory	Extended through 2013	No	7 (ATRA chapter)
S corporation basis adjustment for charitable contributions	Extended through 2013	No, expired December 31, 2011	7 (ATRA chapter)
Work Opportunity Credit for non-veterans	Extended through 2013	No	7 (ATRA chapter)
100% exclusion for small business stock	Extended through 2013	No, provision found unconstitutional	4-24
IRC §181 expensing of film and TV productions	Extended through 2013	No	7 (ATRA chapter)
Seven-year motorsports depreciation	Extended through 2013	No	7 (ATRA chapter)

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## REAL ESTATE

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### IRS GIVES OK TO USE OF SAME INTERMEDIARY BY RELATED PARTIES — IRC §1031

The IRS has given its blessing to the unique situation of two related parties each trying to acquire the same property using a reverse like-kind exchange. The IRS ruled that, if all requirements of IRC §1031 are met, the taxpayer that ends up acquiring the desired property can defer tax as a like-kind exchange. (PLR 201242003)

#### Facts of taxpayer's case

Entity 1 and Entity 2 (related entities; i.e., under common ownership), each owned multifamily residential properties and were each interested in acquiring a certain property ("New Property") in a like-kind exchange. New Property's seller required the purchase of property by a certain date and neither entity had disposed of their properties by that date. Therefore, the entities each initiated a reverse like-kind exchange, with each entering into a "qualified exchange accommodation agreement" (QEAA) with the same "exchange accommodation titleholder" (EAT). (Rev. Proc. 2000-37)

Both entities advanced funds to the EAT to acquire New Property. The QEAA stated that if either entity first gave notice, in writing, of its intention to acquire New Property, the other entity's rights under the agreement would be terminated and the entity giving notice would have the right to complete the exchange.

## IRS rules

The PLR concludes that an EAT may enter into QEAs with more than one entity, including related entities, each of which has the intent to acquire the same property. The fact that the related entity's (let's say, Entity 2) QEA failed because Entity 1 acquired New Property does not invalidate the QEA for either entity under the terms of Rev. Proc. 2000-37. The entities' QEAs are separate and distinct even though they are related entities.

### *Comment*

A "reverse like-kind exchange" is one in which the new property is acquired before the old property is disposed of.

## Conclusion

Although not stated in the PLR, it's obvious what happened here. Entities 1 and 2 were under common ownership. The ultimate Owner wanted New Property. Entities 1 and 2 each owned properties and Owner was willing to give up properties owned by either Entity 1 or Entity 2 to get New Property. He was also under time constraints (45 days and 180 days) after acquiring New Property to unload one or more properties in exchange. By making the properties held by both entities available, he increased the probability that he could find a buyer and meet those time constraints.

Accordingly, he made both entities parties to the exchange. As part of the exchange agreement, the entity that did not exchange its property was contractually obligated to withdraw from the agreement. The IRS agreed that this arrangement met the requirements of IRC §1031, generally, and Rev. Proc. 2000-37, specifically.

## IRS GRANTS DEEMED IRC §1033 ELECTION

A taxpayer was deemed to have made an election to defer gain on an involuntary conversion when he did not recognize gain on his tax return. (PLR 201240006) The taxpayer's principal residence was destroyed in a disaster and the insurance proceeds exceeded the basis in his property. He used the insurance proceeds to purchase a new residence but did not notify the IRS of his election to defer gain as required under Treas. Regs. §1.1033(a)-2(c)(2).

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## RETIREMENT

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### NO WAIVER ON 60-DAY ROLLOVER RULE FOR ASSISTED LIVING

The IRS declined to waive the 60-day rollover requirement where a taxpayer used funds distributed from an IRA to secure assisted living accommodations. (PLR 201243019)

The funds couldn't be returned to the IRA because the sale of the taxpayer's home took longer than 60 days. The IRS stated that taxpayer assumed the risk of what was, in essence, a short-term loan.

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## CALIFORNIA INDIVIDUALS

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### NEW FORM FOR SPLITTING RDP INCOME

The IRS has released a new form to compute the community property split for RDP or same-sex married couples' income on the single federal tax returns. Form 8958, Allocation of Tax Amounts Between Certain Individuals in Community Property States, is now available on the IRS website at:

 Website

[www.irs.gov/pub/irs-pdf/f8958.pdf](http://www.irs.gov/pub/irs-pdf/f8958.pdf)

## CORRECTIONS AND ADDITIONS

### Chapter 2: Health Care Act

- Pages 2-8 through 2-14: Updated discussion of 3.8% Medicare NIIT

### Chapter 4: Business

- Page 4-8: Update on effective date of regulations
- Page 4-10: 2013 mileage rates added
- Page 4-28: Added resource for tax package support

### Chapter 5: Foreign reporting

- Page 5-2: No 2012 Form 8938 for domestic entities

### Chapter 6: Practice and procedures

- Page 6-17: Updated information on VCSP and temporary relief

### Chapter 7: Real estate

- Page 7-8: California nonconformity to real estate professional test
- Page 7-16: Updated text regarding extended COD exclusion
- Page 7-18: Correction to example of excess COD income

### Chapter 8: Retirement

- Pages 8-2 through 8-3: Updated text on IRA-to-charity transfers
- Page 8-4: Correction to Practice Pointer
- Page 8-26: Correction to the Maximum Contributions to Retirement Plans chart
- Page 8-29: 2013 Medicare Part D numbers updated

## Chapter 10: Practitioner aids

- Page 10-4: Correction to client letter – amount of use tax on \$75,000 of AGI

## Chapter 11: Conformity and nonconformity

- Pages 11-3 through 11-4: Update regarding ATRA '12 automatic conformity
- Page 11-11: Update regarding extended qualified residence debt provision
- Page 11-13: Update to Quick Guide to California Nonconformity, bond premium interest

## Chapter 12: California individuals

- Page 12-4: Updated information on penalty exception
- Page 12-25: Treasury Regulations citation correction
- Page 12-30: California conformity to child care expense extension
- Page 12-31: Update to Repealed and Expired California Credits chart

## Chapter 14: California business

- Page 14-3: Updated information on the *Cutler* case
- Page 14-5: Update to bulleted list of problems for LLCs failing to register in California
- Pages 14-12 through 14-13: Update on review of *Gillette* decision

## Chapter 15: California miscellaneous

- Page 15-1: Clarification on MyFTB Account – client permission to view account information