

TAX LETTER

Key Tax Provisions for 2011 and 2012 Tax Years

Dear Clients and Friends

Last time in our October Taxletter, we reminded our readers about the expiring key business tax credits and deductions. The purpose of this Taxletter is to highlight certain extended and/or new tax provisions, some of them effective only for 2011, some of them effective for the first time in 2011 and some of them will continue to be effective in 2012 and, perhaps, beyond.

- 1) W2 reporting of cost paid by employer to provide health insurance was scheduled to begin for year 2011. However, according to the IRS Notice 2010-69 reporting 2011 employer provided health insurance cost will be optional. For year 2012, the reporting will be mandatory for large employers with at least 250 employees. (IRS Notice 2011-28). At the time of this letter, there was no specific instruction setting a definite timeline for smaller employers to report their employee health coverage costs. Our observation is: for smaller employers the reporting requirement continue to be optional.
- 2) Over-the-counter medications can no longer be allowed as qualified expenses for HSA, MSA, FSA type medical saving accounts beginning 2011. Further, penalty for excess withdrawal or distribution from these types of medical saving accounts is increased from 15% to 20%.
- 3) Small Employer Cafeteria Plan. First time in 2011, small employers with less than 100 employees will be allowed to set-up Simplified Cafeteria Health Plans. However, there is a catch. Although it is “referred to” as a simplified plan, it is a qualified plan, however. Therefore, many rules, limitations, restrictions, and specific reports will be there to haunt and to obstruct the setting up of any “simplified” Cafeteria Health Plan by smaller employers.
- 4) 2011 is the first year that Foreign Financial Assets (FFA) in aggregate value \$50,000 or more must be reported to the IRS. First report will be for 2011 and will be due in 2012. A new Form 8938 has been designed by the IRS for this special FFA reporting. On the other hand, any Foreign Bank and /or investment Foreign Brokerage accounts with \$10,000 or more aggregate value will continue to be required to file a report on Form TDF 90-22.1 directly to the US Treasury. In many occasions, both Form 8938 and Form TDF90-22.1 must be prepared and filed separately to the IRS and to the US Treasury.
- 5) Built-in Gain for “S” Corporation. Normally, “S” Corporation does not pay income tax directly. It passes the tax liability to its shareholder(s). However, “built-in” gain is quite different. Generally, it happened when a “C” Corporation changed to be an “S” Corporation with assets having appreciated value. The amount of such appreciation in value is referred to as “built-in” gain. If any of those assets were sold within 10 years from the date of change from “C” Corporation to “S” Corporation, the “built-in” appreciation would be released and taxed at the maximum Corporate rate of 35%. This 10 year recognizing period was reduced to 7 years for taxable years 2009 and 2010. The small business Jobs Act of 2010 further reduced this recognizing period to 5 years for taxable year 2011. Absent any Congressional action, the recognizing period will return to 10 years by 1/1/2012.

- 6) Capital gain from the sales of Qualified Small Business Stock (QSBS) by an individual investor could be excluded up to 50% of the gain provided the holding period is longer than 5 years. This 50% exclusion of gain is increased to 75% if the QSBS were acquired between 2/17/2009 to 9/28/2010. It further increased to 100% for QSBS acquired between 9/29/2010 to 12/31/2011. Beginning 1/1/2012, the exclusion percentage will return to the original 50%. Finally, amount of excludable gain from selling of QSBS acquired between 2/17/2009 to 12/31/2011 (75% or 100%) will not be subject to any Alternative Minimum Tax (AMT) adjustment. For requirement to be a QSBS, please refer to IRC Sec. 1202(c).
- 7) Self Employ Health Insurance Premium. Generally, self employed individuals can deduct their Health Insurance premium as an “above-the-line” deduction against income for income tax purposes. Beginning 2011, the Health Insurance premium paid by self employed individuals can also be subtracted from their total self employment income for purposes of calculating the self employment taxes. This could result in significant tax saving for self employed individuals whose total earned income (employment and self employment income) are within the Social Security Tax limit. For 2012, this limit will be \$ 110,100.
- 8) Itemized Deduction and Personal Exemption. High income reduction (also known as phase-out) for both “itemized deduction” and “personal exemption” will be eliminated in 2010 for 2010 only. The high income reduction will automatically be resumed for 2011 and thereafter. Under the Tax Relief Act of 2010 both “itemized deduction” and “personal exemption” will not be “reduced” and/or “phase-out” for two more years, 2011 and 2012.
- 9) Mortgage Insurance Premium paid by home owners may be deductible as part of qualified residence interest in their individual tax returns was scheduled to end by 12/31/2010. The 2010 Tax Relief Act extended the deductibility for one more year to include 2011.

Certainly, the above 9 items of tax provisions do not include all changes and/or newly effective tax provisions for 2011 or beyond. They represent items, in our opinion, with broader/general applicability.

Any questions or further discussion, please give us a call at 415-381-0681 or 415-381-0683.

Sincerely

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