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2017 TAX UPDATE CLASS NOTES
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I. WHAT MIGHT WE EXPECT UNDER A DONALD TRUMP ADMINISTRATION? HERE ARE SOME EDUCATED GUESSES BASED ON HIS CAMPAIGN PROPOSALS.

A. CORPORATE TAXES

1. Lower the basic corporate tax rate from 35% to 15%. Question: Does this mean that there will no longer be a special 35% rate for personal service corporations such as physicians, dentists, attorneys, accountants, and engineers?

2. Allow U.S. corporations to repatriate foreign profits held offshore to their U.S. holding company at a 10% corporate tax.

3. Eliminate most corporate tax credits except for research and development.

4. Allow firms engaged in manufacturing to elect to expense plant and equipment expenditures in exchange for losing the deductibility of corporate interest expense.

5. Businesses that pay a portion of an employee’s childcare expenses can exclude those contributions from income. Employees who are recipients of direct employer subsidies would not be able to exclude those costs from the individual income tax and the costs of direct subsidies to employees could not be used as a cost eligible for the childcare credit.
B. INDIVIDUAL TAXES

1. Collapse the seven tax brackets into three brackets
   a. Low-income Americans will have an effective tax rate of 0%
   b. For married joint filers, less than $75,000 taxable income will be taxed at 12%
   c. More than $75,000, but less than $225,000 taxable income will be taxed at 25%
   d. More than $225,000 will be taxed at 33%
   e. Single filers will have tax brackets at half the above amounts

2. Retain the existing 20% maximum capital gains maximum rate

3. Eliminate the 3.8% Obamacare tax on investment income

4. Increase the standard deduction from $12,600 to $30,000 for married joint filers and to $15,000 for single filers

5. Cap total itemized deductions at $200,000 for married joint filers and to $100,000 for single filers

6. Repeal the estate death tax

7. Americans will be able to take an above-the-line childcare deduction for children under age 13 that will be capped at the state average for age of child, and for eldercare for a dependent. The exclusion will not be available to taxpayers with a total income over $500,000 married joint or $250,000 single, and because of the cap on the size of the benefit, working and middle class families will see the largest percentage reduction in their taxable income.

   The childcare exclusion would be provided to families who use stay-at-home parents or grandparents as well as those who use paid caregivers, and would be limited to four children per taxpayer. The eldercare exclusion would be capped at $5,000 per year. The cap would increase each year at the rate of inflation.

8. There would be spending rebates for childcare expenses to certain low-income taxpayers through the earned income tax credit (EITC). The rebate would be equal to 7.65% of remaining eligible childcare expenses, subject to a cap of half of the payroll taxes paid by the taxpayer (based on the lower earning parent in a two-earner household).

   This rebate would be available to married joint filers earning $62,400 ($31,200 for single taxpayers) or less. Limitations on costs eligible for exclusion and the number of beneficiaries would be the same as for the basic exclusion. The ceiling would increase with inflation each year.

   All taxpayers would be able to establish Dependent Care Savings Accounts (DCSAs) for the benefit of specific individuals, including unborn children. Total annual contributions to a DCSA are limited to $2,000 per year from all sources, which include the account owner (parent in the case of a minor or the person establishing eldercare account), immediate family members of the account owner, and the employer of the account owner. When established for
children, the funds remaining in the account when the child reaches 18 can be used for education expenses, but additional contributions cannot be made.

To encourage lower-income families to establish DCSAs for their children, the government will provide a 50% match on parental contributions of up to $1,000 per year for these households. When parents fill out their taxes, they can check a box to directly deposit a portion of their EITC into their Dependent Care Savings Account. All deposits and earnings thereon will be free from taxation, and unused balances can rollover from year to year.

C. AFFORDABLE CARE ACT—CHANGES TO BROADEN HEALTHCARE ACCESS MAKE HEALTHCARE MORE AFFORDABLE AND IMPROVE THE QUALITY OF THE CARE AVAILABLE TO ALL AMERICANS.

1. Eliminate the individual mandate. No person should be required to buy insurance unless she wants to.

2. Modify existing law that inhibits the sale of health insurance across state lines.

3. Allow individuals to fully deduct health insurance premium payments from their tax returns under the current tax system. Note: This appears to mean an insurance premium deduction to adjusted gross income.

4. Allow individuals to use health savings accounts (HSAs). Contributions into HSAs should be tax free and should be allowed to accumulate. These accounts would become part of the estate of the individual and could be passed on to heirs without fear of a death penalty. These plans should be particularly attractive to young people who are healthy and can afford high-deductible insurance plans. These funds can be used by a member of a family without penalty.

5. Require price transparency from all healthcare providers, especially doctors and healthcare organizations like clinics and hospitals. Individuals should be able to shop to find the best prices for procedures, exams, or a medical-related procedure.

6. Block grant Medicaid to the states. Nearly every state already offers benefits beyond what is required in the current Medicaid structure. The state will have the incentives to seek out and eliminate fraud, waste, and abuse to preserve resources.

7. Remove barriers to entry into free markets for drug providers that offer safe, reliable, and cheaper products.

8. Eliminate the employer mandate for employers of more than 50 full time equivalent (FTE) employees. Also eliminate the 30 hours of service per week for FTE determination.

9. Continue to provide coverage for employee dependents up to age 26.

10. Continue to provide coverage for preexisting conditions.

D. EDUCATION—THESE EDUCATIONAL ITEMS INCLUDE THE FOLLOWING.

1. School choice. Provide a state mechanism of $12,000 for school choice in school choice funds for every child who lives in poverty today.
2. University costs. Ensure universities are making a good faith effort to reduce the cost of college and student debt in exchange for the federal tax breaks and tax dollars.

3. Ensure that the opportunity to attend a two or four-year college, or to pursue a trade or a skill set through vocational and technical education, will be easier to access, pay for, and finish.

**E. DEFENSE—THESE DEFENSE PROGRAMS ITEMS INCLUDE THE FOLLOWING PROGRAMS WHICH WILL ALSO INCREASE DEFENSE CONTRACTS TO BUSINESSES.**

1. Work with Congress to fully repeal the defense sequester and submit a new budget to rebuild our depleted military.

2. Increase the size of the U.S. Army to 540,000 active duty soldiers, which the Army chief of staff says he needs to execute current missions.

3. Rebuild the U.S. Navy toward a goal of 350 ships, as the bipartisan National Defense Panel has recommended.

4. Provide the U.S. Air Force with the 1,200 fighter aircraft they need.

5. Grow the U.S. Marine Corps to 36 battalions.

6. Invest in a serious missile defense system to meet growing threats by modernizing our Navy’s cruisers and procuring additional, modern destroyers to counter the ballistic missile threat from Iran and North Korea.

7. Emphasize cyber warfare and require a comprehensive review from the joint chiefs of staff and all relevant federal agencies to identify our cyber vulnerabilities and to protect all vital infrastructure and to create a state-of-the-art cyber defense and offense.

8. Pay for this necessary rebuilding of our national defense by conducting a full audit of the Pentagon, eliminating incorrect payments, reducing duplicative bureaucracy, collecting unpaid taxes, and ending unwanted and unauthorized federal programs.
I. TAX GAP ESTIMATES FOR TAX YEARS 2008–2010

A. IRS STATEMENT ON THE TAX GAP UPDATE
The IRS periodically estimates the tax gap, which gives a broad view of the nation’s compliance with federal tax laws. The new study covers tax years 2008–2010. The report finds that there has been no significant change in the amount of the tax gap or the rate of compliance since the last report was issued for tax year 2006.

The average annual tax gap for 2008–2010 is estimated to be $458 billion, compared to $450 billion for tax year 2006. IRS enforcement activities and late payments resulted in an additional $52 billion in tax paid, reducing the net tax gap for the 2008–2010 period to $406 billion per year. The voluntary compliance rate is now estimated at 81.7% compared to the prior estimated rate of 83.1%. After accounting for enforcement and late payments, the net compliance rate is 83.7%.

The small increase in the estimated size of the tax gap and small decrease in the voluntary compliance rate are largely attributable to improvements in the tax gap estimation methodology, and do not represent a significant change in underlying taxpayer behavior. The changes also reflect the overall decline in the nation's tax revenues due to the severe recession during the time period covered by this study, as well as changes in the mix of income sources that have different compliance rates.

A high level of voluntary tax compliance remains critical to help ensure taxpayer faith and fairness in the tax system. Those who don’t pay what they owe ultimately shift the tax burden to those who properly meet their tax obligations. The new tax gap estimate updates long-standing research findings that information reporting and withholding are strongly associated with higher levels of voluntary compliance.
The IRS continues to look for ways to keep the voluntary compliance rate high, including educational efforts aimed at preparers and taxpayers, ongoing efforts to improve compliance in the international tax arena, and working with businesses on employment tax issues.

(I will show you a chart from the IRS that reflects exactly where they think this tax gap comes from.)
I. FOR SMALL BUSINESSES: IRS RAISES TANGIBLE PROPERTY EXPENSING THRESHOLD TO $2,500; SIMPLIFIES FILING AND RECORDKEEPING

IR-2015-133, November 24, 2015

WASHINGTON — The Internal Revenue Service today simplified the paperwork and recordkeeping requirements for small businesses by raising from $500 to $2,500 the safe harbor threshold for deducting certain capital items.

The change affects businesses that do not maintain an applicable financial statement (audited financial statement). It applies to amounts spent to acquire, produce, or improve tangible property that would normally qualify as a capital item.

The new $2,500 threshold applies to an item substantiated by an invoice. As a result, small businesses will be able to immediately deduct many expenditures that would otherwise need to be spread over many years through annual depreciation deductions.

“We received many thoughtful comments from taxpayers, their representatives, and the professional tax community”, said IRS Commissioner John Koskinen. “This important step simplifies
taxes for small businesses, easing the recordkeeping and paperwork burden on small business owners and their tax preparers.”

Responding to a February comment request, the IRS received more than 150 letters from businesses and their representatives suggesting an increase in the threshold. Commenters noted that the existing $500 threshold was too low to effectively reduce administrative burden on small business. Moreover, the cost of many commonly expensed items such as tablet-style personal computers, smart phones, and machinery and equipment parts typically surpass the $500 threshold.

As before, businesses can still claim otherwise deductible repair and maintenance costs, even if they exceed the $2,500 threshold.

The new $2,500 threshold takes effect starting with tax year 2016. In addition, the IRS will provide audit protection to eligible businesses by not challenging use of the new $2,500 threshold in tax years before 2016.

For taxpayers with an applicable financial statement, the de minimis or small-dollar threshold remains $5,000.

II. CHOICE OF BUSINESS ENTITY

A. DISTRIBUTION OF ENTITY CHOICES

- Sole Props 67%
- S corps 12%
- LLCs 6%
- Partnerships 9%
- C corps 5%
B. Of all the choices you make when starting a business, one of the most important is the type of legal organization you select for your company. This decision can affect how much you pay in taxes, the amount of paperwork your business must do, the personal liability you face, and your ability to borrow money. Business formation is controlled by the law of the state where your business is organized. This fact sheet provides a quick look at the differences between the most common forms of business entities.

The most common forms of businesses are known as the following:
- Sole proprietorships
- Partnerships
- Corporations
- Limited liability companies (LLC)

While state law controls the formation of your business, federal tax law controls how your business is taxed. Federal tax law recognizes an additional business form, the Subchapter S corporation. All businesses must file an annual return. The form you use depends on how your business is organized. Sole proprietorships and corporations file an income tax return. Partnerships and S corporations file an information return. For an LLC with at least two members, except for some businesses that are automatically classified as a corporation, it can choose to be classified for tax purposes as either a corporation or a partnership. A business with a single member can choose to be classified as either a corporation or disregarded as an entity separate from its owner, that is, a disregarded entity. As a disregarded entity, the LLC will not file a separate return. Instead, all the income or loss is reported by the single member/owner on its annual return.

What structure makes the most sense? The answer to that question depends on the individual circumstances of each business owner.

The type of business entity you choose will depend on the following:
- Liability
- Taxation
- Recordkeeping

C. SOLE PROPRIETORSHIP

A sole proprietorship is the most common form of business organization. It’s easy to form and offers complete control to the owner. It is an unincorporated business owned entirely by one individual. In general, the owner is also personally liable for all financial obligations and debts of the business. (State law may also govern this area depending on the state.) Sole proprietors can operate any kind of business. It must be a business, not an investment or hobby. It can be full-time or part-time work. This includes operating the following:
- Shop or retail trade business
- Large company with employees
- Home-based business
- One person consulting firm

Every sole proprietor must keep sufficient records to comply with federal tax requirements regarding business records.

Generally, sole proprietors file Schedule C or C-EZ, Profit or Loss from Business, with their Form 1040. Sole proprietor farmers file Schedule F, Profit or Loss from Farming. Your net business income or loss is combined with your other income and deductions and taxed at individual rates on your personal tax return.
Sole proprietors must also pay self-employment tax on the net income reported on Schedule C or Schedule F. You may also be able to deduct one-half of SE tax on your 1040. Use Schedule SE, Self-Employment Tax, to compute this tax.

Sole proprietors do not have taxes withheld from their business income so they will generally need to make quarterly estimated tax payments if you expect to make a profit. These estimated payments include both income tax and self-employment taxes for Social Security and Medicare.

D. SUBCHAPTER S CORPORATION

The Subchapter S corporation is a variation of the standard corporation. The S corporation allows income or losses to be passed through to individual tax returns, similar to a partnership. The rules for Subchapter S corporations are found in Subchapter S of Chapter 1 of the Internal Revenue Code.

An S corporation has the same corporate structure as a standard corporation. It is a legal entity, chartered under state law, and is separate from its shareholders and officers. There is generally limited liability for corporate shareholders. The difference is that the corporation files an election on Form 2553, Election by a Small Business Corporation, to be treated differently for federal tax purposes.

Generally, an S corporation is exempt from federal income tax other than tax on certain capital gains and passive income. It is treated in the same way as a partnership, in that generally taxes are not paid at the corporate level.

An S corporation files Form 1120S, U.S. Corporation Income Tax Return for an S corporation. The income flows through to be reported on the shareholders’ individual returns. Schedule K-1, Shareholder's Share of Income, and Credits and Deductions is completed with Form 1120S for each shareholder. The Schedule K-1 tells shareholders their allocable share of corporate income and deductions. Shareholders must pay tax on their share of corporate income, regardless of whether it is actually distributed.

E. WHY IS THE S CORPORATION THE ENTITY OF CHOICE BY SO MANY TAX PROFESSIONALS?

Here is an example of how an S corporation could save you in SE tax if you were a one person S corporation.

Example: The taxable income generated by your S corporation business is estimated to be $100,000 for 2017 before you pay yourself. You take a $50,000 salary. Only that amount is hit with the 15.3% federal Social Security and Medicare tax, which amounts to $7,650. You can withdraw the remaining corporate cash flow in the form of distributions to yourself that will not be subject to SE taxes (this will be added to your personal income on which you will pay tax at your current tax bracket).

If you operate the same business as an LLC or sole proprietorship (assuming one owner) where each member is subject to SE taxes, you owe SE tax on your entire $100,000 profit, for a total of $14,130 ($100,000 × .9235 = $92,350 × 15.3%). Operating as an S corporation could save you thousands ($14,130 − $7,650 = $6,480).

Remember: You must be able to show that a $50,000 salary is reasonable. If the IRS thinks it’s too low, it may try to reclassify all or part of your purported cash distributions as disguised wages. Future tax bills look to possibly remove this tax break.

F. LIMITED LIABILITY COMPANY

A limited liability company (LLC) is a relatively new business structure allowed by state statute. LLCs are popular because, similar to a corporation, owners generally have limited personal liability for the debts and actions of the LLC. Other features of LLCs are more like a partnership, providing management flexibility and the benefit of pass-through taxation.
Owners of an LLC are called members. Since most states do not restrict ownership, members may include individuals, corporations, other LLCs, and foreign entities. Most states also permit single member LLCs, those having only one owner.

A few types of businesses generally cannot be LLCs, such as banks and insurance companies. Check your state’s requirements and the federal tax regulations for further information. There are special rules for foreign LLCs.

For additional information on the kinds of tax returns to file, how to handle employment taxes and possible pitfalls, refer to Publication 3402, Tax Issues for Limited Liability Companies.

Which structure best suits your business?

One form is not necessarily better than another. Each business owner must assess her own needs. It may be important to seek advice from business experts and professionals when considering the advantages and disadvantages of a business entity.

G. VEHICLE EXPENSES

You have a choice of either deducting the actual operating costs of your car when used for business or using a flat IRS allowance based on the business mileage traveled during the year. The allowance is in lieu of deducting your actual expenses; however, you may add business parking fees, tolls, and the business interest expense on the car loan to the mileage allowance. _Should you choose to deduct actual expenses the first year you own the car, then you may not use the auto allowance in later years for that car._

For tax purposes, the miles you drive your car are classified in one of three categories:

- Personal
- Commuting
- Business

Recordkeeping to appropriately classify the miles driven in a given tax year is the responsibility of the taxpayer. Now the IRS wants contemporaneous records. The simplest way to keep accurate records is to record your odometer reading at the beginning and end of each business day. It may be presumed that those miles driven before the start or after the end of each day are personal miles. It is also important to record the odometer reading at the beginning and end of each year. This will enable the taxpayer to determine the total miles driven in a year. Your daily record will allow you to determine the business miles driven.

The following is an excerpt from IRS Publication 463 regarding the use of sampling for keeping records on the use of the vehicle for business. Note that this sampling only applies to the use of a business vehicle, and not to other business recordkeeping requirements.

**Sampling**

_You can keep an adequate record for parts of a tax year and use that record to prove the amount of business or investment use for the entire year. You must demonstrate by other evidence that the periods for which an adequate record is kept are representative of the use throughout the tax year._

**Example.** You use your car to visit the offices of clients, meet with suppliers and other subcontractors, and pick up and deliver items to clients. There is no other business use of the car, but you and your family use the car for personal purposes. You keep adequate records during the first week of each month that show that 75% of the use of the car is for business. Invoices and bills show that your business use continues at the same rate during the later weeks of each month. Your weekly records are representative of the use of the car each month and are sufficient evidence to support the percentage of business use for the year.

When you leave home, you are commuting to your office or to your first business stop. However, when you go from one business activity to another you are incurring business mileage.

In 1990, the Internal Revenue Service issued Revenue Ruling 90-23 which states that if your first stop is for an appointment, then your mileage from your residence to the first stop and afterwards is considered business mileage. Ditto for the trip home, assuming you make a genuine business stop. However, in the case...
of a qualified office in home, Revenue Ruling 90-23 is not needed, as the minute you leave your qualified office in home; you are on the business clock, even if going directly to another office. You are now traveling between offices and it is totally deductible. Also keep in mind that to claim a qualified home office, strict requirements must be met. These requirements are covered later in this material.

**Business vs. Personal**

Once we have determined how many miles we have driven in a year and how many of those miles are either commuting or personal, we know that the balance must have been business. Now we are able to select one of two methods to determine our business expense deduction on Schedule C or other business tax return.

**IRS Optional Mileage Rates**

In 2016, the standard mileage rate was 54 cents per mile. In 2017, the CPM will be -----. In addition to the standard cents per mile allowance, you can deduct the business parking, tolls, AND the business percentage of the vehicle interest expense on the loan, if applicable.

**Actual Costs**

As an optional approach to using the mileage rates, a taxpayer may keep a record of all expenses associated with the operation of the car. Then the taxpayer may deduct that percentage of expenses which is for business. The business percentage is established by dividing the total business miles driven in the tax year by the total miles driven.

For example:
- Business miles driven: 18,000
- Total miles driven: 24,000
- Business percentage: 75%

Examples of actual expenses are licenses, taxes, car washes, repairs, insurance, interest, oil and lube, fuel costs, depreciation et cetera.

**Cost Recovery or Depreciation**

In addition to those actual expenses incurred in operating your business car, you may add to your expenses a deduction for cost recovery or depreciation. If you use your car more than 50% for business usage, then you are allowed to use the MACRS (Modified Accelerated Cost Recovery System). This system is accelerated in a fashion, in that it allows you to deduct larger amounts in the first three years of owning the car. However, after the third year the taxpayer’s deduction is limited until the car is fully depreciated. Should you use the business car less than 50%, then you are limited to a straight line cost recovery. The useful life of a car is five years.

**The 2016/2017 Luxury Vehicle Depreciation Limits**

Luxury autos (Note: the definition of “luxury” is not by vehicle, but by the cost of the vehicle.)

The new law also raises the Code Sec. 280F limitations on luxury auto depreciation. Ordinarily, the first-year limit on depreciation for passenger automobiles cannot exceed $3,160 (inflation adjusted). The new law raises the cap once again, this time to $8,000 if bonus depreciation is claimed for a qualifying vehicle (for a maximum first-year depreciation of no more than $11,160; $11,360 for vans or trucks). If the vehicle is not predominantly used for business in a subsequent year, then bonus depreciation must be recaptured. The depreciation cap was enacted because Congress did not want the Code subsidizing the use of luxury vehicles by businesses.

To put all this in perspective, assume that you spend $60,000 today on a 100% business-use vehicle and you want to deduct as much as possible this year. Your first-year deduction for both depreciation and expensing is the following:

- $60,000 on a new or used qualifying pickup truck
- $46,000 on a new qualifying SUV
H. HOME OFFICE

A home office deduction may include real estate taxes, insurance, mortgage interest, utility costs, et cetera. In addition, depreciation may be included. To figure depreciation, the basis of the home is the lower of the fair market value of the entire house at the time you started to use a part of it for business, or its adjusted basis. Only that part of the cost basis allocated to the office is depreciable.

To calculate that portion of the above mentioned expenses which would be for business, a business percentage must be determined. This is figured by dividing the area used for the home office by the total area of the home. If the rooms of the home are about the same size, then the number of rooms may be used to determine a percentage.

The expenses which would be deductible under the home office rules would be shown on the appropriate lines of Schedule C.

You may operate your business from your home; however, to deduct your expenses associated with your home office you must be able to prove that you use the home area designated as your home office exclusively for business and on a regular basis. In addition, the tax law change of 1998 removed the “principal place of business” test and replaced that test with a more relaxed requirement that the office in home be used on a substantial basis for the management and administrative tasks of running the business. This new substantial requirement also means that there is no other space where the self-employed person performs substantial management and administrative tasks of running the business. The compliance with the above tests must be strictly adhered to. If your office is not where you perform the substantial management or administrative tasks of running the business and you do not use it exclusively, then your deduction will be lost. Note: Many accountants tell their clients that if they have an office to go to, for example, the brokers office, that the home office deduction is not allowable. That is not what the law says, and careful adherence to the rules would allow the deduction. Also note that the new regulations dated 12/23/02 do not require the allocation of the gain between the office and residence when the home is sold. This is truly a win-win situation for the self-employed, inasmuch as the only amount of gain on the sale of the residence that will probably be taxable is due to a depreciation claimed on the home office after 5/6/97. And that amount is generally a very small number.

Because the burden of proof is on the taxpayer, you must be able to prove that your home office qualifies. The IRS suggests that you keep a daily planner noting the hours you spend on the business each day, especially if you have another office that you can use. Furthermore, the taxpayer's total deduction may not create a business loss. In other words, your home office expenses are limited to the amount of income produced. However, unused home office expenses may be carried forward to a tax year in which they can be used.


I. THE HOME OFFICE DEDUCTION 2.0

Most practitioners have regarded the home office deduction as a red flag for an IRS audit. In fact, this deduction seems to make every top 10 list of issues that the IRS targets. In early January 2013, the IRS issued Revenue Procedure 2013-13, announcing a safe harbor home office deduction. The reasoning behind the issuance of this revenue procedure is to reduce the administrative, recordkeeping, and compliance burdens of determining the allowable deduction for certain business use of a residence under §280A.

This material covers this revenue procedure and provides a comparison of the new versus the old rules.
**Rev. Proc. 2013-13**

This revenue procedure provides an optional safe harbor method that individual taxpayers may use to determine the amount of deductible expenses attributable to certain business use of a residence during the taxable year. This safe harbor method is an alternative to the calculation, allocation, and substantiation of actual expenses for purposes of satisfying the requirements of §280A of the Internal Revenue Code. The basic premise of this revenue procedure provides a deduction based on $5 per square foot, with a maximum of 300 square feet limitation. Therefore, the maximum deduction that can be claimed under this safe harbor is $1,500. This revenue procedure is effective for taxable years beginning on or after January 1, 2013.

**J. INCREASE IN RETIREMENT PLAN CONTRIBUTION LIMITS—PUT MORE OF YOUR HARD-EARNED MONEY AWAY FOR LATER**

<table>
<thead>
<tr>
<th>Retirement Plan Contribution Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td>2017</td>
</tr>
</tbody>
</table>

1. Catch-up contributions for individuals 50 years or older for certain plans
   - IRA or Roth IRA $1,000
   - Simple Plans $3,000
   - 401(k) $6,000
   
   Note: The SEP IRA does not allow catch-up contributions

**K. THE 401(K) SERIES**

1. A good way to increase retirement plan contribution on lower levels of profit (or S corporation salaries).

2. Must be started by the end of the first year. You can’t wait until the following year to set up like a SEP IRA.

3. Only problem is that if a self-employed person is not maximizing contributions to his current retirement plan, he won’t do it to the 401(k) either.

**The 401(k) Series**

<table>
<thead>
<tr>
<th>Profit</th>
<th>Solo (k) or Safe Harbor 401(k)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contribution</strong></td>
<td><strong>$50,000</strong></td>
</tr>
<tr>
<td><strong>Plus 25%</strong></td>
<td><strong>$18,000</strong></td>
</tr>
<tr>
<td><strong>= 401(k)</strong></td>
<td><strong>$30,500</strong></td>
</tr>
<tr>
<td><strong>If 50+</strong></td>
<td><strong>$36,500</strong></td>
</tr>
<tr>
<td><strong>vs. SEP</strong></td>
<td><strong>$10–$12,000</strong></td>
</tr>
</tbody>
</table>
L. **ROTH 401(K)**

1. Not subject to Roth IRA income limits
2. Not tax deductible, but distributions are generally tax free
3. $401(k) loans are available
4. Maximum annual contribution is $18,000 or $24,000 for age 50+
5. Maximum contribution from employer is 25% of employee’s compensation
6. Combined contributions between employer and employee cannot exceed $54,000 per year

M. **WHO CLAIMS ITEMIZED TAX DEDUCTIONS?**

N. **WHAT IS THE VALUE OF AN ITEMIZED TAX DEDUCTION?**

O. **ANALYSIS OF SELECTED DEDUCTIONS**

P. **WHICH ITEMIZED DEDUCTIONS CONTRIBUTE MOST TO REVENUE LOSS?**
Consider Purchasing Investment Real Estate

I. THE IDEAL FORMULA
   I  Income from cash flows
   D  Depreciation deductions
   E  Equity buildup
   A  Appreciation
   L  Leverage

II. APP—PROPERTY EVALUATOR (IPHONE ONLY)

III. CONSIDER THE REAL ESTATE IRA

A. INTRODUCTION
   This opportunity is legal although few professionals really understand the details. This opportunity is very complex, although after you have done it once, the process does not seem that difficult. This opportunity is like a ladder, at the first rung, everyone can quickly grasp the details, but as you climb the ladder, the higher rungs become much more difficult to both understand and to implement. I have used the phrase, “Many are called, but few are chosen,” to emphasize that while many real estate agents get very excited about the possibilities of this investment, if 10% of them actually follow up and make the investment, I would be surprised.
B. TERMINOLOGY

1. The ability to purchase real estate in a retirement plan includes ALL retirement plans. This means that the following retirement plans can own real estate properties.

   a. IRA
   b. Roth IRA
   c. SEP (simplified employee pension)
   d. 401(k)
   e. Profit sharing plan
   f. Money purchase plan
   g. Defined benefit plan

Custodian or Trustee—A custodian or trustee is required for all individual account arrangements. These two terms are synonymous. A custodian or trustee must be a bank, federally insured credit union, savings and loan institution, or other entity approved by the IRS to act as trustee or custodian. An individual cannot qualify as trustee or custodian. The trustee or custodian is the entity which is responsible for receiving and holding contributions and plan assets; maintaining accurate records of contributions, earnings, distributions, and other relevant records; making distributions to beneficiaries, and providing annual statements to account holders. The most commonly used name for these custodians or trustees is Special Asset Trustee, and the five better known SATs are known as the following:

   a. Equity Trust, Elyria, OH
   b. Fiserv, Denver, CO
   c. Pensco Trust Company, Denver, CO
   d. Sterling Trust, Waco, TX
   e. Chicago Trust Administration, Chicago, IL

C. ADVANTAGES

Among the most obvious advantages of investing retirement plan assets in real estate properties are the following:

1. Income tax (federal and state) deferral. Keeping the money that would otherwise be paid in taxes in the investment.

2. Investing in what you know as opposed to conventional investment vehicles such as stocks, bonds, and mutual funds that you may not understand as well.
3. Investing in what you can control.

4. If a Roth IRA is used to own the real estate properties, the opportunity for tax-free profits, as opposed to tax-deferred profits is available.

D. DISADVANTAGES

Not all is a bed of roses with this investment alternative. The following list provides reasons why you should not consider the real estate IRA.

1. The federal income tax rates, both marginal and capital gains rates, have never been lower. So paying your taxes now, (owning the property outside of your retirement plan) may be a wise decision.

2. Tax write-offs attributable to the rental property owned by the retirement plan are not deductible.

3. Complexity, complexity, complexity!

4. Find professional advisors that know what they are doing.

5. Avoid prohibited transactions! These are known as the following:
   
   a. Personally borrowing money from your retirement plan
   
   b. Selling property to your retirement plan
   
   c. Receiving unreasonable compensation for managing the property
   
   d. Using the retirement plan as a security for a loan
   
   e. Purchasing property for personal use with your retirement plan funds
Pressing Tax Issues That Matter in 2017

I. TARGETING OF IDENTITY THIEVES

II. NEW TAX DEADLINES FOR INFORMATION RETURNS AND FORMS 1065

III. THE AFFORDABLE CARE ACT ISSUES GIVEN THE ELECTIONS

IV. IRS INTEREST/ENFORCEMENT IN PURSUING INTERNATIONAL MONEY

V. TAX PREPARER REGULATION EFFORT CONTINUES

VI. CROWDFUNDING AND FANTASY SPORTS INCOME
VII. PERSISTENT TAX SCAMS

VIII. WHO PAYS TAXES CHART—LATEST IRS STATISTICS?

<table>
<thead>
<tr>
<th>Tax Year 2014</th>
<th>Percentages Ranked by AGI</th>
<th>AGI Threshold on Percentiles</th>
<th>Adjusted Gross Income Share (Percentage)</th>
<th>Percentage of Federal Personal Income Tax Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 1%</td>
<td>$465,626</td>
<td>20.58</td>
<td>39.48</td>
<td></td>
</tr>
<tr>
<td>Top 5%</td>
<td>$188,996</td>
<td>35.96</td>
<td>59.97</td>
<td></td>
</tr>
<tr>
<td>Top 10%</td>
<td>$133,445</td>
<td>47.21</td>
<td>70.88</td>
<td></td>
</tr>
<tr>
<td>Top 25%</td>
<td>$77,714</td>
<td>68.91</td>
<td>86.78</td>
<td></td>
</tr>
<tr>
<td>Top 50%</td>
<td>$38,173</td>
<td>88.73</td>
<td>97.25</td>
<td></td>
</tr>
<tr>
<td>Bottom 50%</td>
<td>&lt;$38,173</td>
<td>11.27</td>
<td>2.75</td>
<td></td>
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</tbody>
</table>
I. PHASEOUT OF ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

A. THE BIG SURPRISE IN THE NEW LAW IN THE RE-INTRODUCTION IS REFERRED TO AS THE PEP AND PEASE PHASEOUTS. THE TWO RULES BASICALLY PHASE OUT EXEMPTIONS AND MUCH OF THE ITEMIZED DEDUCTION OF AN INDIVIDUAL TAXPAYER FOR ADJUSTED GROSS INCOMES OVER CERTAIN THRESHOLD AMOUNTS. THESE RULES HAVE NO IMPACT ON TAX RETURNS OTHER THAN FORM 1040. THE PHASE-OUT INCOME LEVELS ARE DIFFERENT THAN THE TAXABLE INCOME LEVELS FOR THE NEW 39.6% HIGHEST INDIVIDUAL MARGINAL TAX RATE, WHICH WILL RESULT IN A STEALTH TAX OF BETWEEN 4–6% OVER AND ABOVE THE MARGINAL TAX RATES.

B. THE ADJUSTED GROSS INCOME THRESHOLDS FOR 2014 ARE THE FOLLOWING:

1. $250,000 for single taxpayers
2. $275,000 for heads of household
3. $300,000 for married taxpayers filing jointly
C. EXEMPTION PHASEOUT

1. This rule reduces the exemption deduction by 2% for each $2,500 of adjusted gross income over the threshold amount, and can result in total elimination of the exemption deduction.

D. ITEMIZED DEDUCTION PHASEOUT

1. This rule reduces the itemized deduction by 3% of adjusted gross income over the threshold amount, and can ultimately reduce itemized deductions by as much as 80%. Most itemized deductions are affected by this phaseout, except for medical and dental expenses, investment interest expense, casualty losses, and gambling losses.

II. ESTATE TAXES

A. A LOT OF THOUGHT WAS GIVEN TO GIFT TAX PLANNING IN BOTH 2011 AND 2012 DUE TO THE HIGHER LIFETIME GIFT TAX EXCLUSION AVAILABLE IN THOSE TWO YEARS. IN ADDITION, THE THOUGHT THAT THE GIFT TAX EXEMPTION COULD DROP TO $1 MILLION IN 2013 AND LATER, YEARS REINFORCED THE PLAN TO GIVE AWAY HIGH VALUE, LOW BASIS ASSETS BEFORE THE START OF 2013. ANOTHER CONSIDERATION THAT WAS JOKED ABOUT, AND WHICH I HOPE FEW TOOK SERIOUSLY, WAS THAT DEATH IN 2012 WAS PREFERABLE VERSUS 2013 FOR A HIGH NET WORTH INDIVIDUAL. ALL OF THIS FOR NAUGHT, AS CONGRESS KICKED THE CAN DOWN THE ROAD AND BASICALLY LEFT THE ESTATE AND GIFT TAX RULES IN PLACE, WITH SLIGHT UPWARD ADJUSTMENTS TO AMOUNTS.

B. FOR 2017, THE CHANGES IN THE VARIOUS ESTATE AND GIFT TAX NUMBERS ARE THE FOLLOWING.

1. Exemption for estate and gift tax rises to $5,490,000.
2. Tax rate is 40%.
3. The annual gift tax exclusion remains at $14,000.

C. THE PORTABILITY ELECTION REMAINS A HUGE ISSUE.

III. CAPITAL GAINS AND DIVIDENDS

A. THE REAL SURPRISE IN THE NEW TAX LAW WAS THE PERMANENT EXTENSION OF THE CAPITAL GAINS AND QUALIFIED DIVIDENDS TAX RATES FOR THE VAST MAJORITY OF INDIVIDUAL TAXPAYERS.
B. THE 0% CAPITAL GAINS AND DIVIDENDS TAX RATE IS NOW PERMANENT FOR THOSE INDIVIDUALS WHOSE CAPITAL GAIN AND DIVIDENDS FIND THE 10% AND 15% MARGINAL TAX RATES. THIS RULE SURPRISED A LOT OF INDIVIDUALS IN THE TAX BUSINESS.

C. IN ADDITION, THE 15% TOP CAPITAL GAINS AND QUALIFIED DIVIDENDS TAX RATE FOR INDIVIDUALS IS NOW PERMANENT, AND THIS WILL APPLY TO THE BULK OF TAXPAYERS WITH THESE TYPES OF INCOME.

D. THE CHANGE IN 2013 AND LATER YEARS FOR THE HIGHEST INCOMES WAS EXPECTED, AND THE LAW IS AT LEAST CONSISTENT WITH OTHER PROVISIONS IN ATRA 2012. FOR CAPITAL GAINS AND QUALIFIED DIVIDENDS OF THE HIGHER-INCOME INDIVIDUALS, THE NEW 20% TAX RATE APPLIES TO CAPITAL GAINS AND QUALIFIED DIVIDENDS INCOME THAT FIND THE INCOME THRESHOLDS THAT ARE SUBJECT TO THE NEW 39.6% MARGINAL TAX RATES.

E. NOTE THE 3.8% MEDICARE TAX ON UNEARNED INCOME CAN ONLY HURT MORE HERE!

IV. GIFTING STRATEGIES

V. CONVERSION OF IRAS TO ROTH IRAS

A. WITH THE ELIMINATION OF THE $100,000 AGI LIMITATION ON ROTH CONVERSIONS IN 2010 AND LATER YEARS, THE POTENTIAL TO GROW TAX-FREE DOLLARS HAS BEEN OPENED TO MANY INDIVIDUALS WITH BOTH HIGH INCOMES AND HIGH NET WORTH.

B. THE PROBLEM REMAINS HOWEVER, AS IS EVIDENCED IN THE POCKET TABLE, THAT HIGHER-INCOME INDIVIDUALS ARE PROHIBITED FROM CONTRIBUTING TO A ROTH IRA. THIS TOO CAN BE OVERCOME BY FIRST CONTRIBUTING TO A NONDEDUCTIBLE IRA, AND THEN MAKING THE CONVERSION TO A ROTH IRA. WHILE YOUR INSTRUCTOR HAS HEARD RUMBLINGS THAT THE IRS WOULD LIKE TO STEP ON THIS PRACTICE, I CAN FIND NOTHING IN WRITING TO CONCERN ME.

C. REMEMBER THAT THE TIME TO RECHARACTERIZE AN IRA CONVERSION TO A ROTH IRA IS OCTOBER 15 OF THE FOLLOWING YEAR, WHICH PROVIDES A NICE CHANCE TO TAKE A LOOK AT HOW THE ROTH IRA HAS DONE SINCE THE CONVERSION AND USE THE HINDSIGHT OF 20/20 TO DETERMINE IF THE CONVERSION WAS THE BEST THING TO DO. IN THIS VAIN, AND FOLLOWING THE INSIGHT OF THE FAMOUS ED SLOTT, CONSIDER IRA CONVERSIONS TO ROTH IRAS NOT ON AN ALL OR NOTHING BASIS, BUT INSTEAD ON AN ASSET SECTOR-BY-SECTOR BASIS, SO THAT IF ONE SECTOR OF THE PORTFOLIO PERFORMS POORLY AFTER THE CONVERSION, THAT ROTH IRA CAN BE RECHARACTERIZED WITHOUT HAVING TO RECHARACTERIZE THE ROTH IRAS THAT HAVE DONE WELL.
D. A DOWNSIDE TO AN IRA CONVERSION TO A ROTH IRA IS THE POTENTIAL IMPACT ON MEDICARE B AND D PREMIUMS TWO YEARS LATER FOR THE CLIENT. THIS IS DUE TO THE FACT THAT THESE PREMIUMS ARE INCOME INDEXED AND THE PREMIUMS INCREASE AT CERTAIN AS CERTAIN INCOME LEVELS ARE REACHED. THIS IS NOT A MAJOR OBSTACLE TO A CONVERSION, BUT A POINT THAT THE FA NEEDS TO DISCUSS WITH THE MEDICARE CLIENT TO AVOID A BITTER SURPRISE TWO YEARS LATER. (WHY DID YOU NOT TELL ME THAT?) THE CHART BELOW PROVIDES THE INDEXED INCOME LEVELS BASED ON THE TWO YEARS PRIOR 1040 ADJUSTED GROSS INCOME.

<table>
<thead>
<tr>
<th>If Your Yearly Income in 2015 (for What You Pay in 2017) Was</th>
<th>You Pay Each Month</th>
</tr>
</thead>
<tbody>
<tr>
<td>$85,000 or less</td>
<td>$170,000 or less</td>
</tr>
<tr>
<td>above $85,000 up to $107,000</td>
<td>above $170,000 up to $214,000</td>
</tr>
<tr>
<td>above $107,000 up to $160,000</td>
<td>above $214,000 up to $320,000</td>
</tr>
<tr>
<td>above $160,000 up to $214,000</td>
<td>above $320,000 up to $428,000</td>
</tr>
<tr>
<td>above $214,000</td>
<td>above $428,000</td>
</tr>
</tbody>
</table>

Source: Medicare.gov

E. ONE MAJOR CONSIDERATION FOR NOT CONVERTING AN IRA TO A ROTH IRA IS THE IMPACT THAT THE ADDITIONAL INCOME WILL HAVE ON SO MANY OTHER FACETS OF THE INCOME TAX CODE. THIS REFERS BACK TO THE POLE OF HIGHER TAXES THAT YOUR INSTRUCTOR HAS ILLUSTRATED ON THE WHITEBOARD. IN ESSENCE, THE HIGHER THE ADJUSTED GROSS INCOME REPORTED ON A 1040, THE FOLLOWING TAX ISSUES MIGHT BE IMPACTED.

1. Exposure to the 39.6% marginal tax rate

2. Loss of some amount of itemized deductions, a stealth tax of 4-6%

3. Loss of some amount, if not all, of the exemption deduction, a stealth tax of 4–6%

4. Increase of the capital gains and qualified dividends tax rate from 15% to 20%, a 33% increase, and with #6 below, a new rate of 23.8%

5. Possible application of the new .09% Medicare tax on earned income

6. Possible application of the new 3.8% tax on net investment income
VI. HARVESTING LOSSES

A. A CONSISTENT YEAR-END STRATEGY IS TO MEET WITH YOUR TAX ADVISOR TO DETERMINE HOW THE TAX PICTURE IS GOING TO LOOK FOR THE YEAR AND TAKE YEAR-END ACTIONS TO EITHER REDUCE OR POSSIBLY INCREASE THE TAX LIABILITY FOR THE YEAR.

B. AS AN EXAMPLE, IN 2015, AN UNCLE OF MINE CALLED ME AND INDICATED THAT HE WAS GOING TO SELL A SINGLE FAMILY RENTAL PROPERTY. THIS SALE WOULD RESULT IN BOTH LONG TERM CAPITAL GAINS IN THE AMOUNT OF APPROXIMATELY $30,000 AND UNRECAPTURED IRC 1250 DEPRECIATION OF ANOTHER $20,000. TO OFFSET THIS, HE SOLD CERTAIN UNDERPERFORMING STOCKS AND MUTUAL FUNDS IN HIS PORTFOLIO TO CREATE A LOSS IN THE AMOUNT OF ROUGHLY $50,000.


VII. TRANSFERRING IRAS TO THE CHARITY OF CHOICE INSTEAD OF LEAVING THE IRA TO YOUR GREEDY 55-YEAR-OLD CHILD

A. FIRST, REMEMBER THAT THIS PROVISION IS NOW PERMANENT IN THE TAX LAW, WHATEVER THAT MEANS.

B. BEFORE WE DISCUSS THIS PROVISION IN MORE DETAIL, LET’S LOOK AT THE TAX LAW BEFORE THIS PROVISION WAS ENACTED YEARS AGO. UNDER THE OLD RULES, THE ONLY WAY THAT AN IRA OWNER COULD REALLY LEAVE AN IRA TO A CHARITY WAS AT DEATH. THE RESULT OF THIS WAS THAT GENERALLY THE IRA VALUE WAS INCLUDED IN THE DECEDENT’S ESTATE, BUT THEN ELIMINATED FROM THE ESTATE THROUGH THE CHARITABLE DEDUCTION. RESULT, NO TAXABLE INCOME TO THE IRA OWNER, AND THE CHARITY RECEIVED THE IRA WITH NO INCOME TAX CONSEQUENCE TO THE ORGANIZATION. THE KICKER WAS THAT THE IRA OWNER HAD TO DIE TO ACCOMPLISH THIS.
C. THE NEW LAW, WHICH HAS BEEN IN EXISTENCE FOR A NUMBER OF YEARS, HAS ALLOWED IRA OWNERS TO TRANSFER CERTAIN AMOUNTS DIRECTLY TO THE CHARITY OF THEIR CHOICE WHILE THEY ARE STILL ALIVE. THE REQUIREMENTS HAVE BEEN THE FOLLOWING.

1. IRA owner must have reached age 70½
2. Yearly limit on the transfer, per person, $100,000
3. Married couple, both 70½ or older, $200,000
4. Direct transfer from IRA to charity required
5. No charitable deduction allowed for the contribution
6. The IRA distribution to the charity is NOT INCLUDED in the AGI of the owner

D. THE RESULTING TAX AND FINANCIAL PLANNING BENEFITS OF THIS TAX PROVISION ARE NUMEROUS, AND INCLUDE THE FOLLOWING. (REMEMBER THAT THE IRA IS NOT INCLUDED IN THE AGI OF THE OWNER, NOR IS THERE A CHARITABLE CONTRIBUTION ALLOWED, WHICH MIGHT BE SUBJECT TO LIMITATIONS.)

1. Reduction of taxable income by including annual RMD amounts in the donation
2. Reduction of federal and state estate taxes (potentially)
3. Possible reduction in the amount of Social Security benefits included in income
4. Possible higher itemized deductions due to AGI remaining lower
5. And others, including giving more of the client’s net worth to worthy causes versus the 55-year-old child who failed to launch. (Instructor sick humor, but true.)

VIII. BE WARY OF THE IMPACT ON MEDICARE B AND D PREMIUMS TWO YEARS AFTER A SIGNIFICANT INCOME EVENT

A. AS I DISCUSSED EARLIER IN THIS MATERIAL UNDER THE SUBJECT OF IRA CONVERSIONS TO ROTH IRAS, ATTENTION MUST BE PAID TO THE CLIENT WHO FIRST, IS OR WILL SOON BE ON MEDICARE AND SECOND, WHO IS CONSIDERING A SIGNIFICANT ECONOMIC EVENT THAT WILL RAISE AGI CONSIDERABLY IN THE CURRENT YEAR. SOME OF THESE EVENTS COULD INCLUDE THE FOLLOWING.

1. Conversion of an IRA to a Roth IRA
2. Sale of stock or mutual funds resulting in large gain
3. Sale of a second home resulting in a large gain

4. Continuing to work at a very successful income level after age 65

5. Being married to a much younger spouse who has a very high income

6. Winning the Powerball

7. Many other reasons

B. I INCLUDED THE INCOME CHART EARLIER IN THIS MATERIAL FOR REFERENCE, AND THE ONLY POINT I AM TRYING TO MAKE IS THAT THE FA NEEDS TO MAKE THE CLIENT TOTALLY AWARE OF THE COLLATERAL IMPLICATIONS OF FINANCIAL DECISIONS MADE IN THE CURRENT YEAR. PERSONALLY, I HAVE ALWAYS, AND TO THIS DAY, AM CONCERNED THAT A FINANCIAL OR TAX RECOMMENDATION THAT I MAKE TO A CLIENT TODAY COULD COME BACK TO BE AN UNWISE DECISION BASED ON THINGS THAT I AM NOT EVEN AWARE OF.

IX. ADDITIONAL HOSPITAL INSURANCE TAX ON HIGH INCOME TAXPAYERS

A. CALCULATION OF ADDITIONAL TAX

The employee portion of the HI tax is increased by an additional tax of 0.9% on wages received in excess of the threshold amount. However, unlike the general 1.45% HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in another case.

B. LIABILITY FOR THE ADDITIONAL HI TAX ON WAGES

As under present law, the employer must withhold the additional HI tax on wages but is liable for the tax if the employer fails to withhold the amount of the tax from wages, or collect the tax from the employee if the employer fails to withhold. However, in determining the employer's requirement to withhold and liability for the tax, only wages that the employee receives from the employer in excess of $200,000 for a year are taken into account and the employer must disregard the amount of wages received by the employee's spouse. Thus, the employer is only required to withhold on wages in excess of $200,000 for the year, even though the tax may apply to a portion of the employee's wages at or below $200,000, if the employee's spouse also has wages for the year, they are filing a joint return, and their total combined wages for the year exceed $250,000.

C. FOR EXAMPLE, IF A TAXPAYER'S SPOUSE HAS WAGES IN EXCESS OF $250,000 AND THE TAXPAYER HAS WAGES OF $100,000, THE EMPLOYER OF THE TAXPAYER IS NOT REQUIRED TO WITHHOLD A PORTION OF THE ADDITIONAL TAX, EVEN THOUGH THE COMBINED WAGES OF THE TAXPAYER AND THE TAXPAYER'S SPOUSE ARE OVER THE $250,000 THRESHOLD. IN THIS INSTANCE, THE EMPLOYER OF THE TAXPAYER'S SPOUSE IS OBLIGATED TO WITHHOLD THE ADDITIONAL 0.9% HI TAX WITH RESPECT TO THE $50,000 ABOVE THE THRESHOLD WITH RESPECT TO THE WAGES OF $250,000 FOR THE TAXPAYER'S SPOUSE.
D. IN CONTRAST TO THE EMPLOYEE PORTION OF THE GENERAL HI TAX OF 1.45% OF WAGES FOR WHICH THE EMPLOYEE GENERALLY HAS NO DIRECT LIABILITY TO THE IRS TO PAY THE TAX, THE EMPLOYEE IS ALSO LIABLE FOR THIS ADDITIONAL 0.9% HI TAX TO THE EXTENT THE TAX IS NOT WITHHELD BY THE EMPLOYER. THE AMOUNT OF THIS TAX NOT WITHHELD BY AN EMPLOYER MUST ALSO BE TAKEN INTO ACCOUNT IN DETERMINING A TAXPAYER’S LIABILITY FOR ESTIMATED TAX.

E. ADDITIONAL HI FOR SELF-EMPLOYED INDIVIDUALS

1. This same additional HI tax applies to the HI portion of SECA tax on self-employment income in excess of the threshold amount. Thus, an additional tax of 0.9% is imposed on every self-employed individual on self-employment income in excess of the threshold amount.

2. As in the case of the additional HI tax on wages, the threshold amount for the additional SECA HI tax is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in another case. The threshold amount is reduced (but not below zero) by the amount of wages taken into account in determining the FICA tax with respect to the taxpayer. No deduction is allowed under section 164(f) for the additional SECA tax, and the deduction under 1402(a)(12) is determined without regard to the additional SECA tax rate.

X. UNEARNED INCOME MEDICARE CONTRIBUTION

A. IN THE CASE OF AN INDIVIDUAL, ESTATE, OR TRUST AN UNEARNED INCOME MEDICARE CONTRIBUTION TAX IS IMPOSED.

B. IN THE CASE OF AN INDIVIDUAL, THE TAX IS THE 3.8% OF THE LESSER OF NET INVESTMENT INCOME OR THE EXCESS OF MODIFIED ADJUSTED GROSS INCOME OVER THE THRESHOLD AMOUNT. THE THRESHOLD AMOUNT IS $250,000 IN THE CASE OF A JOINT RETURN OR SURVIVING SPOUSE, $125,000 IN THE CASE OF A MARRIED INDIVIDUAL FILING A SEPARATE RETURN, AND $200,000 IN ANOTHER CASE.

C. MODIFIED ADJUSTED GROSS INCOME IS ADJUSTED GROSS INCOME INCREASED BY THE AMOUNT EXCLUDED FROM INCOME AS FOREIGN EARNED INCOME UNDER SECTION 911(A)(1) (NET OF THE DEDUCTIONS AND EXCLUSIONS DISALLOWED WITH RESPECT TO THE FOREIGN EARNED INCOME).

D. IN THE CASE OF AN ESTATE OR TRUST, THE TAX IS 3.8% OF THE LESSER OF UNDISTRIBUTED NET INVESTMENT INCOME OR THE EXCESS OF ADJUSTED GROSS INCOME [AS DEFINED IN SECTION 67(E)] OVER THE DOLLAR AMOUNT AT WHICH THE HIGHEST INCOME TAX BRACKET APPLICABLE TO AN ESTATE OR TRUST BEGINS.
E. THE TAX DOES NOT APPLY TO A NON-RESIDENT ALIEN OR TO A TRUST ALL THE UNEXPIRED INTERESTS IN WHICH ARE DEVOTED TO CHARITABLE PURPOSES. THE TAX ALSO DOES NOT APPLY TO A TRUST THAT IS EXEMPT FROM TAX UNDER SECTION 501 OR A CHARITABLE REMAINDER TRUST EXEMPT FROM TAX UNDER SECTION 664.

F. THE TAX IS SUBJECT TO THE INDIVIDUAL ESTIMATED TAX PROVISIONS. THE TAX IS NOT DEDUCTIBLE IN COMPUTING A TAX IMPOSED BY SUBTITLE A OF THE INTERNAL REVENUE CODE (RELATING TO INCOME TAXES).

G. NET INVESTMENT INCOME

1. Net investment income is investment income reduced by the deductions properly allocable to such income.

2. Investment income is the sum of (1) gross income from interest, dividends, annuities, royalties, and rents (other than income derived from a trade or business to which the tax does not apply), (2) other gross income derived from a business to which the tax applies, and (3) net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in a trade or business to which the tax does not apply.

3. In the case of a trade or business, the tax applies if the trade or business is a passive activity with respect to the taxpayer or the trade or business consists of trading financial instruments or commodities [as defined in section 475(e)(2)]. The tax does not apply to other trades or businesses conducted by a sole proprietor, partnership, or S corporation.

4. In the case of the disposition of a partnership interest or stock in an S corporation, gain or loss is taken into account only to the extent gain or loss would be taken into account by the partner or shareholder if the entity had sold all its properties for fair market value immediately before the disposition. Thus, only net gain or loss attributable to property held by the entity which is not property attributable to an active trade or business is taken into account. Income, gain, or loss on working capital is not treated as derived from a trade or business. Investment income does not include distributions from a qualified retirement plan or amounts subject to SECA tax.

5. Ways/methods/considerations to mitigate the net investment income tax
   a. Muni bond investments
   b. Cash value life insurance
   c. Rents and capital gains of the real estate professional
   d. Distributions from S corporations in which the owner materially participates
   e. Installment sales, IRC 1031 exchanges, IRC 1033 involuntary conversions
   f. Death and stepped up basis
g. The Roth IRA and Roth 401(k)

h. Self-rental income

i. Self-charged interest income

j. Literally, anything that the taxpayer can keep out of income legally that will help to keep AGI below the thresholds that kick in the 3.8%
I. STREAMLINED FILING COMPLIANCE PROCEDURES

A. PURPOSE OF THE STREAMLINED PROCEDURES

The streamlined filing compliance procedures described below are available to taxpayers certifying that their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part. The streamlined procedures are designed to provide to taxpayers in such situations with the following:

- A streamlined procedure for filing amended or delinquent returns
- Terms for resolving their tax and penalty procedure for filing amended or delinquent returns
- Terms for resolving their tax and penalty obligations

As reflected below, the streamlined filing procedures that were first offered on September 1, 2012 have been expanded and modified to accommodate a broader group of U.S. taxpayers. Major changes to the streamlined procedures include the following:

- Extension of eligibility to U.S. taxpayers residing in the United States
- Elimination of the $1,500 tax threshold
- Elimination of the risk assessment process associated with the streamlined filing compliance procedure announced in 2012

B. ELIGIBILITY CRITERIA FOR THE STREAMLINED PROCEDURES

The modified streamlined filing compliance procedures are designed only for individual taxpayers, including estates of individual taxpayers. The streamlined procedures are available to both U.S. individual taxpayers residing outside the United States and U.S. individual taxpayers residing in the United States. Descriptions of the specific eligibility
requirements for the streamlined procedures for both non-U.S. residents (the “Streamlined Foreign Offshore Procedures”) and U.S. residents (“Streamlined Domestic Offshore Procedures”) are set forth below.

Taxpayers must certify that conduct was not willful. Taxpayers using either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures, will be required to certify, in accordance with the specific instructions set forth below, that the failure to report all income, pay all tax and submit all required information returns, including FBARs (FinCEN Form 114, previously Form TD F 90-22,1) was due to non-willful conduct.

IRS has initiated a civil examination of taxpayer’s returns for a taxable year. If the IRS has initiated a civil examination of taxpayer’s returns for a taxable year, regardless of whether the examination relates to undisclosed foreign financial assets, the taxpayer will not be eligible to use the streamlined procedures. Taxpayers under examination may consult with their agent. Similarly, a taxpayer under criminal investigation by IRS Criminal Investigation is also ineligible to use the streamlined procedures.

Taxpayers eligible to use streamlined procedures who have previously filed delinquent or amended returns must pay previous penalty assessments. Taxpayers eligible to use the streamlined procedures who have previously filed delinquent or amended returns in an attempt to address U.S. tax and information reporting obligations with respect to foreign financial assets [quiet disclosures made outside of the Offshore Voluntary Disclosure Program (OVDP) or its predecessor programs] may still use the streamlined procedures by following the instructions set forth below. However, penalty assessments previously made with respect to those filing will not be abated.

Taxpayers who want to participate in the streamlined procedures need a valid Taxpayer Identification Number (TIN). All returns submitted under the streamlined procedures must have a valid TIN. For U.S. citizens, resident aliens, and certain other individuals, the proper TIN is a valid Social Security Number (SSN). For individuals who are not eligible for an SSN or ITIN will not be processed under the streamlined procedures. However, for taxpayers who are ineligible for an SSN but do not have an ITIN, a submission may be made under the streamlined procedures if accompanied by a complete ITIN application. Additional information on getting an ITIN is available.

C. OVDP OR STREAMLINED PROCEDURES

Taxpayers who are concerned that their failure to report income, pay tax, and submit required information returns was due to willful conduct and who therefore seek assurance that they will not be subject to criminal liability, substantial monetary penalties, or both should consider participating the Offshore Voluntary Disclosure Program and should consult with their professional or legal advisors.

D. GENERAL TREATMENT UNDER THE STREAMLINED PROCEDURES

Tax returns submitted under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures will be processed like another return submitted to the IRS. Consequently, receipt of the returns will not be acknowledged by the IRS and the streamlined filing process will not culminate in the signing of a closing agreement with the IRS.

Returns submitted under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures will not be subject to IRS audit automatically, but they may be selected for audit under the existing audit selection processes applicable to a U.S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors, and other sources. Thus, returns submitted under the streamlined procedures may be subject to IRS examination, additional civil penalties, and even criminal liability, if appropriate. Taxpayers who are concerned that their failure to report income, pay tax, and submit required information returns was due to willful conduct and who therefore seek assurances that they will not be subject to criminal liability,
substantial monetary penalties, or both should consider participating in the Offshore Voluntary Disclosure Program and should consult with their tax professional or legal advisors.

After a taxpayer has completed the streamlined filing compliance procedures, she will be expected to comply with U.S. law for all future years and file returns according to regular filing procedures.

E. COORDINATION BETWEEN STREAMLINED PROCEDURES AND OVDP

Once a taxpayer makes a submission under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures, the taxpayer may not participate in OVDP. Similarly, a taxpayer who submits to an OVDP voluntary disclosure letter pursuant to OVDP FAQ 24 on or after July 1, 2014, is not eligible to participate in the streamlined procedures.

A taxpayer eligible for treatment under the streamlined procedures who submits, or who has submitted, a voluntary disclosure letter under the OVDP (or a predecessor Offshore Voluntary Disclosure Program) before July 1, 2014, but who does not yet have a fully executed OVDP closing agreement, may request treatment under the applicable penalty terms available under the streamlined procedures.

Note: A taxpayer seeking such treatment does not need to opt out of the OVDP but will be required to certify, in accordance with the instructions set forth below, that the failure to report all income, pay all tax, and submit all information returns, including FBARs, was due to non-willful conduct. As part of the OVDP process, the IRS will consider this request in light of all the facts and circumstances of the taxpayer’s case and will determine whether or not to incorporate the streamlined penalty terms in the OVDP closing a U.S. Taxpayers Residing in the United States.

F. THE FOLLOWING STREAMLINED PROCEDURES ARE REFERRED TO AS THE STREAMLINED DOMESTIC OFFSHORE PROCEDURES

1. Eligibility for the Streamlined Domestic Offshore Procedures

In addition to having to meet the general eligibility criteria, individual U.S. taxpayers, or estates of individual U.S. taxpayers, seeking to use the Streamlined Domestic Offshore Procedures described in this section must (1) fail to meet the applicable non-residency requirement described in the “Eligibility for the Streamlined Offshore Procedures” (for joint return filers, one or both of the spouses must fail to meet the applicable non-residency requirement described in the “Eligibility for the Streamlined Offshore Procedures”); (2) have previously filed a U.S. tax return (if required) for each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed; (3) have failed to report gross income from a foreign financial asset and pay tax as required by U.S. law, and may have failed to file an FBAR (FinCEN Form 114, previously Form TD F 90-22.1) or one or more international information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) with respect to the foreign financial asset; and (4) such failures resulted from non-willful conduct. Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.

For information on the meaning of foreign financial asset, see the instructions for FinCEN Form 114 and the instructions for Form 8938.

G. DESCRIPTION OF SCOPE AND EFFECT OF PROCEDURES

U.S. taxpayers [U.S. citizens, lawful permanent residents, and those meeting the substantial presence test of IRC section 7701(b)(3)] eligible to use the Streamlined Domestic Offshore Procedures must (1) for each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed (the covered tax return period), file amended tax returns, together with all required information returns (e.g., Forms 3520, 3520-A, 5471, 5472,
(8938, 926, and 8621), (2) for each of the most recent six years for which the FBAR due date has passed (the covered FBAR period), file a delinquent FBARs (FinCEN Form 114, previously Form TD F 90-22.1), and (3) pay a Title 26 miscellaneous offshore penalty. The full amount of the tax, interest, and miscellaneous offshore penalty due in connection with these filings should be remitted with the amended tax returns.

The Title 26 miscellaneous offshore penalty is equal to 5% of the highest aggregate balance/value of the taxpayer's foreign financial assets that are subject to the miscellaneous offshore penalty during the years in the covered tax return period and the covered FBAR period. For this purpose, the highest aggregate balance/value is determined by aggregating the year-end account balances and year-end asset values of all the foreign financial assets subject to the miscellaneous offshore penalty for each of the years in the covered tax return period and the covered FBAR period and selecting the highest aggregate balance/value from among those years.

A foreign financial asset is subject to the 5% miscellaneous offshore penalty in a given year in the covered FBAR period if the asset should have been, but was not, reported on an FBAR (FinCEN Form 114) for that year. A foreign financial asset is subject to the 5% miscellaneous offshore penalty in a given year in the covered tax return period if the asset should have been, but was not, reported on a Form 8938 for that year. A foreign financial asset is also subject to the 5% miscellaneous offshore penalty in a given year in the covered tax return period if the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year.

For information on the meaning of foreign financial asset, see the instructions for FinCEN Form 114 and the instructions for Form 8938. For example, foreign financial assets may include the following:

- Financial accounts held at foreign financial institutions
- Financial accounts held at a foreign branch of a U.S. financial institution
- Foreign stock or securities not held in a financial account
- Foreign mutual funds
- Foreign hedge funds and foreign private equity funds

A taxpayer who is eligible to use these Streamlined Domestic Offshore Procedures and who complies with all of the instructions below will be subject only to the Title 26 miscellaneous offshore penalty and will not be subject to accuracy-related penalties, information return penalties, or FBAR penalties. Even if returns properly filed under these procedures are subsequently selected for audit under existing audit selection processes, the taxpayer will not be subject to accuracy-related penalties with respect to amounts reported on those returns, or to information return penalties or FBAR penalties, unless the examination results in a determination that the original return was fraudulent, that the FBAR violation was willful, or both. Previously assessed penalties with respect to those years, however, will not be abated. Further, as with a U.S. tax return filed in the normal course, if the IRS determines an additional tax deficiency for a return submitted under these procedures, the IRS may assert applicable additions to tax and penalties relating to that additional deficiency.

For returns filed under these procedures, retroactive relief will be provided for failure to timely elect income deferral on certain retirement and savings plans where deferral is permitted by the applicable treaty. The proper deferral elections with respect to such plans must be made with the submission. See the instructions below for the information required to be submitted with such requests.
H. SPECIFIC INSTRUCTIONS FOR THE STREAMLINED DOMESTIC OFFSHORE PROCEDURES

Failure to follow these instructions or to submit the items described below will result in returns being processed in the normal course without the benefit of the favorable terms of these procedures.

1. For each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, submit a complete and accurate amended tax return using Form 1040X, Amended U.S. Individual Income Tax Return, together with a required information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) even if these information returns would normally not be submitted with the Form 1040 had the taxpayer filed a complete and accurate original return. You may not file delinquent income tax returns (including Form 1040, U.S. Individual Income Tax Return) using these procedures.

2. Include at the top of the first page of each amended tax return “Streamlined Domestic Offshore” written in red to indicate that the returns are being submitted under these procedures. This is critical to ensure that your returns are processed through these special procedures.

3. Complete and sign a statement on the Certification by U.S. Person Residing in the U.S. certifying (1) that you are eligible for the Streamlined Domestic Offshore Procedures; (2) that all required FBARs have now been filed (see instruction 9 below); (3) that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, resulted from non-willful conduct; and (4) that the miscellaneous offshore penalty amount is accurate (see instruction 5 below). You must maintain your foreign financial asset information supporting the self-certified miscellaneous offshore penalty computation and be prepared to provide it upon request. You must submit an original signed statement and attach copies of the statement to each tax return and information return being submitted through these procedures. You should not attach copies of the statement to FBARs. Failure to submit this statement, or submission of an incomplete or otherwise deficient statement, will result in returns being processed in the normal course without the benefit of the favorable terms of these procedures.

4. Submit payment of all tax due as reflected on the tax returns and all applicable statutory interest with respect to each of the late payment amounts. Your Taxpayer Identification Number must be included on your check. You may receive a balance due notice or a refund if the tax or interest is not calculated correctly.

5. Submit payment of the Title 26 miscellaneous offshore penalty as defined above.

6. If you seek relief for failure to timely elect deferral of income from certain retirement or savings plans where deferral is permitted by an applicable treaty, submit:
   ■ a statement requesting an extension of time to make an election to defer income tax and identifying the applicable treaty provision;
   ■ a dated statement signed by you under penalties of perjury describing
     — the events that led to the failure to make the election,
     — the events that led to the discovery of the failure,
     — if you relied on a professional advisor, the nature of the advisor’s engagement and responsibilities; and
   ■ for relevant Canadian plans, a Form 8891 for each tax year and each plan and a description of the type of plan covered by the submission.
The documents listed above, together with the payments described above, must be sent in paper form (electronic submissions will not be accepted) to:

Internal Revenue Service
3651 South I-H 35Stop 6063 AUSC
Attn: Streamlined Domestic Offshore
Austin, TX 78741

This address may only be used for returns filed under these procedures. For all future filings, you must file according to regular filing procedures.

7. For each of the most recent six years for which the FBAR due date has passed, file delinquent FBARs according to the FBAR instructions and include a statement explaining that the FBARs are being filed as part of the streamlined filing compliance procedures. You are required to file these delinquent FBARs electronically at FinCen. On the cover page of the electronic form, select “Other” as the reason for filing late. An explanation box will appear. In the explanation box, enter “streamlined filing compliance procedures.” If you are unable to file electronically, you may contact FinCEN's Regulatory Helpline at 1-800-949-2732 or 1-703-905-3975 (if calling from outside the United States) to determine possible alternatives to electronic filing.

II. DELINQUENT FBAR SUBMISSION PROCEDURES

A. TAXPAYERS WHO DO NOT NEED TO USE EITHER THE OVDP OR THE STREAMLINED FILING COMPLIANCE PROCEDURES TO FILE DELINQUENT OR AMENDED TAX RETURNS TO REPORT AND PAY ADDITIONAL TAX, BUT WHO:

■ have not filed a required Report of Foreign Bank and Financial Accounts (FBAR) (FinCEN Form 114, previously Form TD F 90-22.1);
■ are not under a civil examination or a criminal investigation by the IRS;
■ have not already been contacted by the IRS about the delinquent FBARs; and
■ should file the delinquent FBARs according to the FBAR instructions.

B. FOLLOW THESE STEPS TO RESOLVE DELINQUENT FBARS.

■ Review the instructions.
■ Include a statement explaining why you are filing the FBARs late.
■ File all FBARs electronically at FinCEN.
■ On the cover page of the electronic form, select a reason for filing late.
■ If you are unable to file electronically, contact FinCEN's Regulatory Help line at 1-800-949-2732 or 1-703-905-3975 (if calling from outside the United States) to determine possible alternatives to electronic filing.

The IRS will not impose a penalty for the failure to file the delinquent FBARs if you properly reported on your U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs, and you have not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted.

FBARs will not be automatically subject to audit but may be selected for audit through the existing audit selection processes that are in place for tax or information returns.
II. OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

The Offshore Voluntary Disclosure Program (OVDP) is a voluntary disclosure program specifically designed for taxpayers with exposure to potential criminal liability, substantial civil penalties, or both due to a willful failure to report foreign financial assets and pay all tax due in respect of those assets. OVDP is designed to provide to taxpayers with such exposure: (1) protection from criminal liability and (2) terms for resolving their civil tax and penalty obligations.

For complete information about the Offshore Voluntary Disclosure Program, please go to 2012 Offshore Voluntary Disclosure Program

III. 20.1.1.3.6.1 (08-05-2014) FIRST TIME ABATE (FTA)

A. RCA PROVIDES AN OPTION FOR PENALTY RELIEF FOR THE FTF [IRC 6651(A)(1), IRC 6698(A)(1), AND IRC 6699(A)(1)]; FTP [IRC 6651(A)(2) AND IRC 6651(A)(3)]; FTD (IRC 6656); OR ALL OF THESE PENALTIES IF THE FOLLOWING ARE TRUE FOR THE TAXPAYER.

1. Has not previously been required to file a return or has no prior penalties (except the estimated tax penalty, TC 17X) for the preceding three years on the same MFT [except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)].

2. Has filed, or filed a valid extension for, all currently required returns and paid, or arranged to pay, tax due. Example: Consider the taxpayer current if she has an open installment agreement and is current with her installment payments.

B. NOTE: IF THE TAXPAYER IS NOT CURRENTLY IN COMPLIANCE PER (1)(B) BUT ALL OTHER FTA CRITERIA ARE MET, PROVIDE THE TAXPAYER AN OPPORTUNITY TO FULLY COMPLY BEFORE CONSIDERING REASONABLE CAUSE.

C. FIRST TIME ABATE (FTA) IS AN ADMINISTRATIVE WAIVER AND DOES NOT CARRY AN ORAL STATEMENT AUTHORITY (OSA) DOLLAR THRESHOLD. SEE IRM 20.1.1.3.6.3 FOR ADDITIONAL OSA INFORMATION. ALSO, FTA CARRIES ITS OWN PRCS, 018 FOR NON-RCA/MANUAL LOOK-BACK, OR 020 FOR RCA BEING USED TO MAKE THE DETERMINATION. SEE IRM 20.1.1.3.6.2.

D. A PENALTY ASSESSED AND SUBSEQUENTLY REVERSED IN FULL WILL GENERALLY BE CONSIDERED TO SHOW COMPLIANCE FOR THAT TAX PERIOD UNLESS THE EXCEPTION IN (5)(C) APPLIES. RCA CONSIDERS FULLY REVERSED PENALTIES IN ITS FTA ANALYSIS.

E. THE FTA ADMINISTRATIVE WAIVER CAN ONLY APPLY TO A SINGLE TAX PERIOD FOR A GIVEN MFT. FOR EXAMPLE, IF A REQUEST FOR PENALTY RELIEF IS BEING CONSIDERED FOR TWO OR MORE TAX PERIODS ON THE SAME MFT AND THE EARLIEST TAX PERIOD MEETS FTA CRITERIA, PENALTY RELIEF BASED ON FTA ONLY APPLIES TO THE EARLIEST TAX PERIOD, NOT ALL TAX PERIODS BEING CONSIDERED. PENALTY RELIEF FOR ALL SUBSEQUENT TAX PERIODS WILL BE BASED ON THE SHOWING OF REASONABLE CAUSE (AND, AS APPLICABLE, AN ABSENCE OF WILLFUL NEGLECT).
F. THE REASONABLE CAUSE EXPLANATION PROVIDED BY THE TAXPAYER WILL BE CONSIDERED AFTER RCA PERFORMS THE FTA ANALYSIS. IF FTA CRITERIA DOES NOT APPLY BASED ON REASONS SHOWN IN (5) BELOW, THEN THE TAXPAYERS EXPLANATION WILL BE USED TO DETERMINE IF REASONABLE CAUSE PENALTY RELIEF CRITERIA IS MET [SEE NOTE IN PARAGRAPH (1)]. IF THE RCA DETERMINATION IS TO ABATE THE PENALTIES, PENALTY RELIEF CAN BE GRANTED AS APPROPRIATE PER THE RCA CONCLUSION (I.E., REASONABLE CAUSE, OFFICIAL DISASTER RELIEF AREA, IRS ERROR, STATUTORY AND ADMINISTRATIVE WAIVERS). USING THE FTA ANALYSIS UPFRONT WAS BASED ON A REQUEST FROM HQ CUSTOMER ACCOUNTS SERVICES.

G. A FTA CONCLUSION WILL NOT APPLY IF ANY OF THE FOLLOWING CRITERIA APPLIES.

1. A tax period in the prior three years, for the same MFT [except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)], is in TDI Status 02 or 03, or IMF Status 04.

2. An unreversed penalty for a significant amount (see Caution for an explanation of significant amount) is present (except the ES penalty) on a tax period in the prior three years, for the same MFT [except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)], and a notice was issued showing the assessed penalties.