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2010 SECOND QUARTER FEDERAL TAX DEVELOPMENTS

During the second quarter of 2010, there were many important federal tax developments. This letter highlights some of the more important federal tax developments for you. As always, please give our office a call or send us an email if you have any questions about these developments.

Tax legislation. Congress recessed for its Independence Day holiday without passing a tax extenders bill and a small business tax relief bill. The House approved versions of both bills earlier in 2010 but the bills stalled in the Senate over their price tags. The American Jobs and Closing Tax Loopholes Act (H.R. 4213) would extend over 40 temporary individual, business, charitable, energy, and infrastructure tax incentives that mostly expired at the end of 2009. The Small Business Jobs Tax Relief Act of 2010 (H.R. 5486) would, among other things, provide Code Sec. 6707A penalty relief to small businesses and increase the Code Sec. 195 deduction for qualified start-up expenses. Congress did, however, pass two smaller bills: the Homebuyer Assistance Improvement Act of 2010 (H.R. 5623) and the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (H.R. 3962). The homebuyer act extends the closing date deadline from June 30, 2010 to September 30, 2010 for homebuyers who signed sales contracts prior to May 1, 2010. The pension relief act includes a package of defined benefit pension funding relief measures. The homeowner act is offset, by among other things, by extension of the Code Sec. 6657 bad check penalty to electronic payments.

Health care reform. The IRS issued significant guidance on various provisions of the new health care reform package (the Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010) enacted earlier this year. The IRS issued taxpayer-friendly guidance on the new extended exclusion from income for employer-provided health insurance for any employee's child who has not attained age 27 as of the end of the tax year. For most individuals, this is the calendar year. The IRS also issued temporary and proposed regulations implementing the new requirement that health insurance plans that provide coverage for children continue to make such coverage available until the child turns 26 years of age. The IRS also issued temporary and proposed regulations under which health insurance plans will be treated as grandfathered plans under the PPACA. Additionally, the IRS described notice requirements that grandfathered plans must give to participants and beneficiaries.

Small employer health insurance tax credit. The IRS and the Department of Health and Human Services (HHS) issued a key component of the new Code Sec. 45R small employer health insurance tax credit. The agencies released the average premium for the small group market in each of the 50 states for the 2010 tax year. The IRS also issued guidance clarifying eligibility for the Code Sec. 45R credit, premiums, coverage, state tax credits, and more.

Form 990 filing deadline. An exempt organization required to file and failing to file for three consecutive years automatically loses its federal tax-exemption status. Form 990 is due on the 15th day of the fifth month after an organization's fiscal year ends. For calendar-year organizations, the date was Monday, May 17, 2010, since May 15th fell on a Saturday this year. Exempt organizations could request an extension to file Form 990 by filing Form 8868, Application for Extension of

Time To File An Exempt Organization Return, by the original due date. The IRS cautioned that many small tax-exempt organizations failed to file the required information return in time. Very small tax-exempt organizations must file Form 990-N (also known as the "e-Postcard"). The IRS indicated that it will provide additional guidance on how these small tax-exempt organizations can maintain their tax-exempt status even if they missed the May 17, 2010 deadline.

Basis overstatement. The Tax Court, in a court-reviewed decision, invalidated the IRS's temporary and proposed regulations extending the limitations period for partnership assessments based on omissions of income. The court found the regulations contrary to the Supreme Court's decision in *Colony, Inc.*, 58-2 ustrc P. 9593 .

Wrongful death payments. The IRS determined that a survivor could exclude from income a payment received for the wrongful death of another, including claims for emotional distress. The payment was intended to provide compensation for wrongful death and personal injury including the resulting claim for emotional distress.

Tax accrual workpapers. In a controversial move, the U.S. Supreme Court declined to review the decision of the Court of Appeals for the First Circuit allowing the IRS access to a corporation's tax accrual workpapers. The First Circuit in *Textron Inc. v. U.S.*, 2009-2 ustrc P. 50,574 found that the work product privilege did not protect tax accrual workpapers.

HIRE Act payroll tax forgiveness. The IRS unveiled a revised Form 941, Employer's Quarterly Federal Tax Return, and its instructions to reflect payroll tax forgiveness under the Hiring Incentives to Restore Employment (HIRE) Act.

Tax Court e-filing. Beginning with petitions filed on or after July 1, 2010, taxpayers represented by counsel must file all documents with the U.S. Tax Court using the court's electronic filing (e-filing) system. The requirement brings the Tax Court into conformity with e-filing policies applicable to other federal courts.

401(k) compliance project. The IRS's Employee Plans Compliance Unit (EPCU) launched a compliance check on 401(k) plans by sending a comprehensive questionnaire to a random sample of 1,200 plans. The IRS intends to use the information from the compliance checks to obtain a comprehensive view of 401(k) plans, which the agency can then use to focus its 401(k) education, outreach, guidance and enforcement efforts. As information is obtained, the IRS will focus on compliance problems. The project is designed to determine potential compliance issues, gain a better understanding of the reasons for noncompliance, and determine any potential plan operational issues. The survey includes more than 60 basic questions.

SSN and back-up withholding. Due to a change in practice by the Social Security Administration (SSA), the IRS amended the method required for recipients of interest, dividends, and other reportable amounts to validate their Social Security Number (SSN) with the payor of those amounts. As a result of the new procedure, recipients of a second "B notice" from a payor indicating that their SSN is incorrect must obtain a Social Security Number Printout from their local SSA office. Payee recipients of second B notices can no longer request the SSA to send Form SSA-7028 to the payor to validate the payee's SSN. Instead, the payee must obtain a Social Security Number Printout and send a copy to the payor.

Registered domestic partnerships. In a series of memoranda, IRS Chief Counsel concluded that registered domestic partners in California must each report one-half of the community property income on their separate federal income tax

returns. The determination applies for tax years beginning after December 31, 2006, and applies to compensation as well as income from property, such as investment income from community assets.

FICA student exception. The U.S. Supreme Court decided to take up the long-standing dispute between medical schools and the IRS over the treatment of medical residents for FICA tax purposes. The Supreme Court has agreed to hear an appeal from a 2009 case, Mayo Foundation for Medical Education and Research, CA-8, 2009-1 ustrc P. 50,432 . In that case, the Court of Appeals for the Eighth Circuit upheld the IRS's final regs in T.D. 9167, which generally provide that full-time employees are not students for purposes of the FICA student exception.

Indoor tanning tax. The IRS issued temporary and proposed regulations to implement the new 10 percent Code Sec. 5000B indoor tanning excise tax. The tax applies to amounts paid after June 30, 2010 for qualified indoor tanning services.

Whistleblower cases. The IRS posted guidelines on its web site about the investigation and processing of whistleblower claims. The guidelines reflect changes made to the whistleblower rules by the Tax Relief and Health Care Act of 2006.

Therapeutic discovery project credits. The IRS began accepting applications on newly-issued Form 8942, Application for Certification of Qualified Investments Eligible for Credits and Grants Under the Qualifying Therapeutic Discovery Project Program, from companies seeking investment tax credits or tax-free grants for therapeutic discovery projects.

These are just some of the many federal tax developments during the second quarter of 2010. Please contact our office if you have any questions about these or any tax developments.

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