Supplement to J.K. Lasser's 1001 Deductions and Tax Breaks 2012

The tax law is not static, and there have been a number of changes affecting 2011 returns, as well as returns in 2012. Since publication of the 2012 edition of *J.K. Lasser's 1001 Deductions and Tax Breaks*, Congress has enacted the Three Percent Withholding Repeal and Job Creation Act and the Temporary Payroll Tax Cut Continuation Act. The courts and the IRS have also made decisions and rulings on many tax items that can impact your 2011 return. Here are key developments, some of which can apply to your 2011 return. Also, factor in 2012 changes if they affect your quarterly estimated tax payments for 2012.

The changes presented in this Supplement are tied to the chapters in the book.

Introduction

Limits on qualifying for tax-favored items. The above-the-line deductions for educator expenses of up to $250 and tuition and fees expired at the end of 2011; they could be extended in 2012 and made retroactive to the start of the year.

Standard deduction amounts. The basic standard deduction amounts for 2012 have been increased for all filing statuses.

Additional standard deduction amounts. The additional standard deduction amounts for age and/or blindness remain unchanged for 2012. These are the only additional standard deduction amounts set to apply in 2012.

Chapter 1—Your Family

Personal and dependency exemptions. The exemption amount has increased for 2012 to $3,800.

Adoption credit. The adoption credit limit for 2012 declines to $12,650 and is no longer refundable.

Earned income credit. The earned income credit amounts, including adjusted gross income limits, have been increased slightly for 2012.

Chapter 2—Medical Expenses

Itemized medical expenses. The IRS has indicated informally that a number of expenditures are deductible medical expenses, including:

- Acupuncture to treat a neuropathy.
- Batteries for hearing aids.
- Glutten-free diet for those with celiac disease (only the amount over the cost of a regular diet is a medical expense).

- Herbs prescribed by a doctor to treat migraine headaches.
- Sex reassignment surgery and hormone treatment for someone with gender identification disorder.

Driving for medical purposes. For 2012, the rate for medical driving is 23 cents per mile.

Long-term care coverage. The portion of long-term care insurance premiums that are treated as a deductible medical expense has increased slightly in 2012 for each age group.

CLASS program. The Community Living Assistance Services and Support (CLASS) Program that was set to become active in 2013 has been killed permanently. The government could not figure out how to make it work fiscally.

Health savings accounts and Archer medical savings accounts. The contribution limits for HSAs and MSAs in 2012 have increased slightly.

Accelerated death benefits. For chronically ill individuals, the daily dollar limit excludable from gross income for 2012 is $310; excess amounts are taxable to the extent they exceed actual long-term care costs.

Chapter 3—Education Costs

American Opportunity credit. The credit of up to $2,500 (40% of which is refundable) runs through 2012. ***Caution***: The IRS is cross-checking the credit against tuition payments reported to students on Form 1099-T.

Lifetime learning credit. The modified adjusted gross income limits on eligibility to claim the credit have been increased slightly for 2012.

Tuition and fees deduction. The above-the-line deduction for tuition and fees of up to $4,000 expired at the end of 2011; it could be extended retroactively for all of 2012.

Student loan interest. The modified adjusted gross income limits on eligibility to claim the deduction have been increased for joint filers in 2012; the limits remain unchanged for other taxpayers.

Interest on U.S. savings bonds. The modified adjusted gross income limits on eligibility to claim the exclusion for interest on bonds redeemed to pay qualified higher education costs have been increased for 2012.

Chapter 4—Your Home

Mortgage interest deduction. The Tax Court has allowed a homeowner to deduct mortgage interest on the construction of a residence that ultimately was never built. The tax law allows mortgage interest within 24 months of the start of construction to be deductible. The court says “under construction” includes preparatory work, such as demolishing the old house, clearing the site, surveying, and drawing up plans as part of the permit process.

Mortgage insurance. The ability to treat mortgage interest as deductible mortgage interest applied only for homes purchased through 2011. It is not yet clear whether Congress will extend this break for homes purchased in 2012.

Homebuyer credit for DC purchasers. The first-time homebuyer credit for those who purchased a home in the District of Columbia expired at the end of 2011. It is not yet clear whether Congress will extend this break for homes purchased in 2012.

Moving expenses. Use of a vehicle for deductible moving purposes in 2012 is figured at the rate of 23 cents per mile.

Energy improvements. The residential energy property credit for making certain improvements, such as adding insulation or installing energy-efficient windows and exterior doors, expired at the end of 2011. This provision probably will *not* be extended, but anything is possible.

Chapter 5—Retirement Savings

Traditional IRAs and Roth IRAs. The modified adjusted gross income limits on eligibility to make contributions have increased for 2012. The contribution limit remains unchanged at $5,000, or $6,000 for those who are at least 50 years old by the end of 2012.

401(k) and similar plans. The elective deferral contribution limit for 2012 has increased to $17,000. However, the additional contribution limit for those age 50 or older by the end of the year remains unchanged at $5,500.

Self-employed retirement plans. Contribution, benefit, and other limits for these plans have been increased for 2012.

SEPs. Contribution limits for these plans have been increased for 2012.

SIMPLEs. There have been no changes in the contribution limits for SIMPLEs in 2012.

Retirement saver's credit. The modified adjusted gross income limits on eligibility to claim the retirement saver's credit for contributions to IRAs, 401(k)s, and similar plans have been increased for 2012.

Charitable transfers of IRA distributions. The tax-free transfer to a public charity of IRA funds up to $100,000 annually by those age 70$^1/_2$ expired at the end of 2011; it may be extended retroactively to apply for all of 2012.

Chapter 6—Charitable Giving

Real estate donated for conservation purposes. The favorable percentage limitations on donations of realty for conservation purposes (50% of the contribution base, or 100% for farmers and ranchers) expired at the end of 2011. It may be extended retroactively to apply for all of 2012

IRA transfers to charity. See Chapter 5.

Chapter 7—Your Car

Business use of your personal car. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for business driving in 2012 is 55.5¢ per mile.

The dollar limits on depreciating passenger cars when the standard mileage rate is not used have not yet been announced for 2012.

Similarly, the inclusion amounts for leased vehicles used in business in 2012 have not yet been announced.

Electric vehicles. For 2012, there is no credit for low-speed or plug-in vehicle conversion costs. Congress could extend these breaks, but so far there has been no such indication.

Chapter 8—Investing

Reporting basis. Issuers of Form 1099-B for 2011 must include the basis of stock acquired in 2011 and sold in the same year. Going forward, issuers will continue to track the basis of stock acquired after 2010. For 2012, the basis of mutual fund shares acquired after 2011 will have to be reported annually. For 2013, the basis of debt securities acquired after 2012 will have to be reported annually.

Form 8949. Capital gain and loss transactions are reported on this new form. The totals are then transferred to Schedule D, which now acts as a summary of capital asset transactions.

Gain on the sale of small business stock. Gain on the sale of qualified stock acquired after 2011 is subject to a 50% exclusion. However, as a way to stimulate investments in small businesses, Congress may extend the 100 percent exclusion that had applied for such stock acquired in 2011.

Gain on empowerment zone assets. The rollover of gain from empowerment assets expired at the end of 2011. This break may be extended for 2012, and the extension may be made retroactive to the start of the year.

Foreign assets and accounts. If you own certain foreign assets, referred to as specified foreign financial assets (SFFAs), you must file this new form (commonly referred to as FATCA, which is the acronym for the law creating the reporting obligation) with Form 1040 if the value of the assets exceed the following limits, which depend on filing status and whether you are a U.S. citizen or resident living within the United States or abroad:

- For those within the U.S. Form 8938 must be filed with the 2011 Form 1040 if SFFAs exceed $50,000 on the last day of the year or $75,000 at anytime during the year ($100,000/$150,000 for joint filers).
- For those living outside the United States, the threshold is $200,000 on the last day of the year or $300,000 at any time during the year ($400,000/$600,000 for joint filers).

If you are required to file the form but fail to do so, you may be subject to substantial penalties. Filing Form 8938 with Form 1040 does not replace filing requirements for the Report of Foreign Bank and Foreign Assets (FBAR) on Form TD F

90-22.1, which is filed directly with the Treasury on June 30 each year by those holding certain foreign accounts (e.g., bank accounts, brokerage firms, and retirement accounts).

Chapter 9—Travel

Business travel per diem rates. The maximum federal per diem rate for travel starting October 1, 2011, through September 30, 2012, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $123 per day ($77 for lodging and $46 for M&IE). A number of the rates to certain areas have changed. These rates can be found at www.gsa.gov (click on “Per Diem Rates”).

The high-low substantiate rates for high-cost and all other areas within CONUS for the period October 1, 2011, is $242 for travel to high-cost localities and $163 for travel to all other areas with CONUS. Of these rates, the meal portion is $65 for high-cost areas and $52 for all other areas within CONUS. These rates are slightly higher than the rates for the prior 12-month period. Note that while no new areas have been added to the high-cost list, 5 areas have been removed and the period of the year for which others qualify as high cost areas have been changed.

Conventions. The list of countries in which foreign conventions are not treated as being held outside the North American Area has been expanded to include Panama (for conventions as of April 18, 2011).

Medical and moving for work with your car. The IRS standard mileage rate for 2012 is 23 cents per mile.

Chapter 11—Real Estate

Passive activity loss rule. The IRS has redefined a limited partner for purposes of passive activity losses (PALs) so as to clarify the treatment of limited liability company (LLC) members. Under proposed regulations, an LLC member who does not have the authority to bind the business to a contract is treated like a limited partner (i.e., automatically subject to the PAL rules). However, a member-manager is not treated like a limited partner and can demonstrate material participation in order to avoid the application of the PAL rules.

The PAL rules do not apply to a real estate professional. Having a full-time job does not automatically prevent a taxpayer from demonstrating that he or she is a real estate professional. A full-time tugboat pilot successfully convinced the Tax Court that he was a real estate professional because of the scope of his activities and the time spent in them.

Home office deduction. If you use part of your home for business, you may be eligible for a home office deduction. The exclusive use requirement for claiming a home office deduction is not met when there is even occasional use of the space. Thus, a bathroom used once in a while by a guest (not a business guest) prevented a deduction for this space.

Special breaks for certain disaster victims. Unfortunately, natural and other disasters continue to occur. Check with the IRS for special relief that may be available with respect to reality at www.irs.gov/businesses/small/article/0,,id=156138,00.html.

Chapter 13—Insurance and Catastrophes

Extended eligibility for Ponzi scheme theft loss safe harbor. In the wake of the Madoff debacle, the IRS created a safe harbor rule to help affected investors write off their unreimbursed losses. Essentially, they could deduct either 75% or 95% of their qualified investment, less any actual or projected recovery from insurance, loss-protection arrangement, or the Securities Investor Protection Corporation (SIPC). The 95% recovery applied if the investor was not pursuing a third-party recovery, while the 75% recovery applied if the investor had brought or intended to bring suit for recovery.

Originally, this safe harbor applied only if the lead figure had been charged by federal or state authorities with fraud, embezzlement, or other similar crime that would be considered a theft, and the deduction was allowed only in the year of discovery. The expended safe harbor now applies if the assets have been frozen or a receiver or trustee is appointed after a federal or state agency files a civil complaint in a court or administrative proceeding alleging a fraudulent arrangement conduced by the lead figure and the lead figure died before being charged with the crime of theft. Also, the discovery year has been expanded to include the year of the lead figure's death if that is later than the year in which the civil complaint is filed.

No theft loss for poor investment decision. Taking advice from acquaintances can be costly; you can lose your investment and not be able to take an ordinary deduction. That's what happened to one individual, who relied on an investment suggestion from a fellow parishioner. He lost his investment, but could not take a theft loss deduction because the loss was not a theft under state law. He merely made a bad investment decision, which results in a capital loss.

Damages. Restitution payments to victims of human trafficking are tax free even though they are for amounts other than personal physical injury. There is no dollar limit on this exclusion for payments covering lost wages, housing assistance, retraining, and other costs.

Chapter 14—Your Job

Extended cut in Social Security tax. The 2 percentage point reduction in the employee's share of Social Security tax, which is part of FICA, was extended through February 29, 2012. This reduction is built into the withholding tables to boost your take-home pay during this 2-month period. If your employer failed to implement the cut at the start of the year and over-withheld from your paycheck, an adjustment must be made no later than March 31, 2012.

The 2 percentage point reduction is likely to be extended through the end of 2012. Check JKLasser.com for future updates on this subject.

Cell phones. Employer-provided cells phones are not taxable to you as long as there is a noncompensatory reason you receive the phone (e.g., your employer needs to contact you after hours, you need to be available to customers after hours, or you have clients/customers in other time zones). Even the personal use of the phone is not taxable (it’s viewed as a de minimis fringe benefit).

Educator expenses. See Chapter Introduction.

Home office deduction. See Chapter 11.

Income earned abroad. The foreign earned income exclusion for 2012 has been increased to $95,100.

Chapter 15—Your Business

Bonus depreciation. After September 8, 2010, and before January 1, 2012, eligible property can qualify for 100% bonus depreciation; 50% bonus depreciation applies to eligible property placed in service in 2012. However, Congress may extend the 100% limit for 2012 and this limit could apply for the entire year.

Home office deduction. See Chapter 11.

Employment-related tax credits. The Work Opportunity credit generally expired at the end of 2011, but could be extended retroactively for all of 2012. Nonetheless, there are 2 new categories of eligible workers, effective for those hired from November 22, 2011, through December 31, 2012. These include:

- Returning heroes (veterans unemployed more than 6 weeks, with a higher credit for those who are unemployed for more than 6 months).
- Wounded warriors (veterans with service-related disabilities who are unemployed).

Standard mileage rate. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for 2012; it is 55.5 cents per mile.

Those who own their vehicles and use the standard mileage rate for 2012 must reduce the vehicle’s basis by 23 cents per mile.

Chapter 16—Miscellaneous Items

State and local sales taxes. For those who itemize their personal deductions, the option to deduct state and local sales taxes instead of state and local income taxes, which had expired at the end of 2011. This break may be extended retroactively for all of 2012.

Government benefits. Payments under the Emergency Homeowners’ Loan Program (EHLP) are tax free.

Alternative minimum tax. The alternative minimum tax (AMT) exemption amounts have not yet been set for 2012. Likely there will be a patch for 2012, and it will apply for the entire year.

Tax credit offsets to the AMT. The ability to use nonrefundable personal tax credits, such as the lifetime learning credit and the dependent care credit, to offset not only regular income tax, but also the alternative minimum tax expired at the end of 2011. Likely, this break will be extended for 2012, and will apply for the entire year. However, if it does not, then for 2012, the only nonrefundable personal credits that can offset AMT will be the adoption credit, the child tax credit, and the retirement saver's credit.