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IRS Issues Long-Awaited Package Of Preparer Guidance; Plans Complete Overhaul Of Preparer-Penalty Regs

◆ *IR-2007-213, Notices 2008-11, 12 and 13*

Just in time for the start of the 2008 filing season, the IRS has issued interim guidance on the new-for-2008 more-likely-than-not return preparer standard under Code Sec. 6694(a). The IRS also clarified transition relief issued in 2007 and reminded preparers about revised signature requirements.

■ **CCH Take Away.** While the much-anticipated guidance is welcomed, it is only a stop-gap measure. The IRS advises that it intends to overhaul all of the regs governing return preparer penalties and that the final regs may be substantially different from the interim guidance. The extent of those differences may be gleaned from the IRS's requests for comments. For example, the agency asked if specific rules tailored to common situations should be drafted when reaching a more-likely-than-not level of certainty is not practical or possible.

Background

The Small Business and Work Opportunity Tax Act of 2007 (2007 Small Business Tax Act) changed the realistic possibility of success standard in Code Sec. 6694(a) for undisclosed, non-abusive items, to more-likely-than-not. The new law also significantly increased the penalties for violating Code Sec. 6694.

■ **Comment.** Legislation was introduced in December 2007 to equalize the preparer and the taxpayer standards. The interim guidance will enable the filing season to proceed while we continue to pursue legislative relief

that would replace the more-likely-than-not standard for undisclosed, non-tax shelter positions with the substantial authority standard, AICPA Vice President – Taxation Thomas Ochsenschlager told CCH.

Under Notice 2008-13, a preparer may rely in good faith without verification upon information furnished by the taxpayer to determine if he or she has a reasonable belief that the position would more-likely-than-not be sustained on the merits. However, the preparer may not ignore the implications of information furnished to the preparer or actually known to the preparer and must make reasonable inquiries if the information appears incorrect or incomplete, the IRS cautioned.

■ **Comment.** “The challenge for the majority of personal income tax preparers will be the need to understand the legal basis for positions taken on tax returns and the need for discussion (with clients) of penalties associated with taking positions,” Claudia Hill, EA, editor-in-chief of *CCH's Journal of Tax Practice and Procedure*, observed.

Generally, a preparer may rely in good faith and without verification upon information furnished by another advisor, return preparer or other third party. A preparer is not considered to have relied in good faith on a third party if the advice is unreasonable on its face, the preparer knew or should have known that the third-party advisor was not aware of all the facts; or the preparer knew or should have

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Route to: _____

IRS Issues Final Regs On Disclosure Of Return Information; Takes Closer Look At Refund Anticipation Loans

◆ *IR-2008-2, T.D. 9375, Rev. Proc. 2008-12, NPRM REG-136596-07, FAQs on www.irs.gov*

Almost one year after issuing proposed regs governing the disclosure of taxpayer return information, the IRS has finalized the regs. At the same time, the IRS released guidance about the content of taxpayer consents to disclosure and warned that it may tackle refund anticipation loans (RALs) in future regs.

■ **CCH Take Away.** The IRS, despite encouragement from some sectors of the tax preparation community, did not relax the consent rules to permit more informal consent requests. To the contrary, the IRS tightened the rules. The final regs mandate not only the content of consent requests but even the form, down to the type size, to avoid, in the agency's words, "fine print" consent requests. However, the final regs allow preparers to obtain consent through engagement letters.

■ **Comment.** "The final regs also address use of taxpayer return information," Frank Degen, EA, past president

of the National Association of Enrolled Agents (NAEA), told CCH. Degen said that the examples of use in the final regs, while helpful could be clarified. "There may be an implication if you (the preparer) sell additional products that you need to disclose."

Disclosure

Soon after the proposed regs were released, some members of Congress and consumer advocates expressed concern that they would allow practitioners to sell taxpayer data to third parties, particularly for marketing purposes. This reflects a fundamental misunderstanding of the proposed regs, the IRS stressed in the final regs. Practitioners may not disclose a taxpayer's return information without obtaining prior consent, unless there is an authorized exception, the final regs reiterate.

Consent

The consent must identify the purpose of the disclosure and the recipient(s), along with the particular use of the information. Paper and electronic consents from any Form 1040 series taxpayer must meet very specific requirements,

especially about readability. Mandatory consent is also required if the tax information will be disclosed to a preparer outside the U.S.

RALs

The IRS also announced that it is considering prohibiting preparers from disclosing or using taxpayer return information to sell RALs, refund anticipation checks (RACs) and audit insurance. The IRS requested comments on whether RALs and related products create incentives to inflate taxpayer refunds, a practice that critics charge is rampant in the industry.

■ **Comment.** "It's certainly worthwhile for the IRS to assess what is going on with RALs, audit insurance and other products," Degen said. However, he cautioned that it may be unfair to characterize all of the products as predatory.

Effective date

The final regs do not apply for 2008. They kick-in for disclosures and uses of return information after December 31, 2008.

References: FED ¶46,242, 46,243, 46,244, 47,021; TRC IRS: 6,114.10.

Preparer Guidance

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known that the advice was no longer reliable because of changes in the tax laws.

Disclosure

A preparer may disclose a position for which there is a reasonable basis but for which he or she does not have a reasonable belief that the position would more likely than not be sustained on the merits by completing Form 8275 or in accordance with the annual revenue procedure. The final regs also permit the preparer to advise the taxpayer of the standards applicable to the taxpayer under Code Sec.

6662 (d)(2)(B)(i) and the penalty standards applicable to the preparer under Code Sec. 6694, and contemporaneously document in the preparer's files that this advice was provided.

Forms

The IRS also described the returns to which Code Sec. 6694 applies under the interim guidance. These include the 1040-family of returns, estate and gift tax returns, employment tax returns, and some excise tax returns. Preparers of many information returns, such as Forms 1099, will not risk penalties unless they willfully understate tax or recklessly or intentionally disregard rules and regs, the IRS explained.

Transition relief

Shortly after Congress enacted the 2007 *Small Business Tax Act*, the IRS issued transition relief (Notice 2007-54). Subsequently, the IRS reported that practitioners have questioned the scope of the transition relief.

The IRS clarified in Notice 2008-11 that the transition relief applies to timely amended returns or refund claims (other than 2007 employment and excise returns) filed on or before December 31, 2007. The cutoff date for 2007 employment and excise returns is January 31, 2008. Similar treatment applies to original returns due on extension after December 31, 2007 but which had been filed before December 31, 2007. Furthermore, transition relief applies to nonsigning preparers for advice provided on or before December 31, 2007.

Finally, the IRS announced that it will issue regs implementing the signature requirements under Code Sec. 6695(b) in 2008. Notice 2007-12 identifies the returns and refund

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Reference Key

FED references are to *Standard Federal Tax Reporter*
 USTC references are to *U.S. Tax Cases*
 CCH Dec references are to *Tax Court Reports*
 TRC references are to *Tax Research Consultant*

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IRS Kicks Off Filing Season With Reminders About AMT Patch, Split Refunds, And More

◆ *IR-2008-01, FS-2008-1 through 10*

As the 2008 filing season gets underway, the IRS has issued a series of 10 Fact Sheets to highlight important tax law changes and to encourage taxpayers to e-file and consider splitting their refunds, along with tips about choosing a tax preparer and avoiding tax scams. The IRS expects to begin processing e-filed returns on January 14. However, taxpayers who file any of five forms impacted by the recently enacted AMT patch will have to wait until mid-February to file their returns.

■ **CCH Take Away.** The delayed processing date for taxpayers filing any of the five AMT-patch affected forms does not extend the filing deadline beyond April 15. These individuals, just like everyone else, can request an automatic six-month extension of time to file (but not to pay).

Form 1040 packages

The IRS is sending 16.5 million 2007 Form 1040 packages to individuals who have filed paper returns in the past. Five tax credit forms are not included in the 2007 Form 1040 packages because they do not reflect the AMT patch. The five forms are:

- Form 8863, Education Credits;
- Form 5965, Residential Energy Credits;
- Form 1040A, Schedule 2, Child and Dependent Care Expenses for Form 1040A Filers;
- Form 8396, Mortgage Interest Credit; and
- Form 8859, District of Columbia First-Time Homebuyer Credit.

Preparer Guidance

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claims that must be signed to avoid a penalty and describes who is a signing preparer.

■ **Comment.** The IRS has eliminated the requirement that practitioners send a paper signature document to the agency in support of electronically filed returns.

References: FED ¶¶46,226, 46,227, 46,228, 46,229; TRC IRS: 6,156.

Updated versions of these forms, which reflect the AMT patch, may be immediately downloaded from www.irs.gov.

■ **Caution.** Taxpayers who attempt to e-file any of these five forms prematurely will receive an electronic message asking them to resubmit their returns when the IRS is ready to process them, the agency warned.

Refund splitting

Despite heavy promotion, refund splitting failed to attract much interest in 2007. The feature allows taxpayers to directly deposit their refunds in more than one account, such as a savings account as well as a checking account. The IRS is hoping for better participation in 2008 and highlights refund splitting options in Fact Sheet 2007-5.

■ **Comment.** “The ability to deposit the refund, or some part of it, directly into an earning investment account gets the money working sooner,” James Smith, CPA, chair of the Texas Society of Certified Public Accountants, told CCH. “Too many people fall victim to a form of financial inertia that results in the refund sitting in the first place it lands indefinitely.”

Fact Sheets

Legislation and other changes. Fact Sheet 2008-1 highlights tax changes for the 2007 tax year, most notably the AMT patch. The

IRS also reminds taxpayers that inflation adjustments have increased the personal and dependency exemptions, the standard deduction and other items.

Tax credits. The IRS reminds taxpayers about some overlooked tax credits in Fact Sheets 2008-2 and 2008-8. These include the saver’s, alternative motor vehicle and Hope and Lifetime Learning education credits.

Signatures. Practitioners no longer must send a paper signature document along with the e-filed return, Fact Sheet 2008-3 reminds preparers.

E-file. In Fact Sheet 2008-4, the IRS predicts a record number of e-filers in 2008, noting that 95 million individuals are eligible this filing season for no-cost Free File.

Electronic payment. Fact Sheet 2008-6 reviews electronic payment options for the 2008 filing season, highlighting the Electronic Federal Tax Payment System (EFTPS).

Taxpayer assistance. Various types of free assistance are available to taxpayers online at www.irs.gov and in print publications, the IRS reminds taxpayers in Fact Sheet 2008-7.

Scams. Bogus emails, purportedly from the IRS but in reality from con artists, are proliferating on the internet, the IRS warns taxpayers in Fact Sheet 2008-9.

Preparers. Fact Sheet 2008-10 cautions taxpayers to use the services of a reputable preparer.

References: FED ¶¶46,230, 46,231, 46,232, 46,233, 46,234, 46,235, 46,236, 46,237, 46,238, 46,239, 46,240; TRC IRS: 3,058.

President Signs Year-End Tax Legislation

Over the past two weeks, President Bush has signed the tax bills passed by Congress at year-end into law. The first two bills to be signed by the president were the *Prevent Taxation of Payments to Virginia Tech Victims and Families Act (P.L. 110-147)* and the *Energy Independence and Security Act of 2007 (P.L. 110-140)* on December 19. The next day, December 20, Bush signed the *Mortgage Forgiveness Debt Relief Act of 2007 (P.L. 110-142)*.

On December 26, the president signed legislation extending the AMT patch, the *Tax Increase Prevention Act of 2007 (P.L. 110-166)* and the omnibus FY 2008 federal government spending bill, the *Consolidated Appropriations Act, 2008 (P.L. 110-161)*. The *Tax Technical Corrections Act of 2007 (P.L. 110-172)* was signed by the president on December 29. Finally, President Bush signed legislation (P.L. 110-176) clarifying the length of term of the IRS commissioner on January 4.

For analysis of the new tax laws, see CCH’s online law, explanation and analysis of the 2007 Tax Acts on the CCH Tax Research Network.

Proposed Regs To Require New Forms, Procedures For Employment Tax Adjustments And Refund Claims

◆ *NPRM REG-111583-07*

The IRS has issued proposed regs to modify both the procedure for making interest-free employment tax adjustments and for filing employment tax refund claims. Employers would use a new separate adjusted return to make interest-free adjustments to correct underpayments and overpayments of *Federal Insurance Contributions Act (FICA) taxes*, *Railroad Retirement Tax Act (RRTA) taxes*, and federal income tax withholding.

■ **CCH Take Away.** Congress designed the interest-free adjustment process specifically for employment tax claims, as a way to fix errors made in prior periods as soon as they were discovered, without having to use more burdensome refund or collection procedures. The proposed changes are intended to reduce taxpayer burden by aligning the employment tax return requirements under Code Sec. 6011 with the IRS's development of new adjustment reporting forms.

Interest-free adjustments

Code Sections 6205(a) and 6413(a) allow employers to make interest-free adjustments for underpayments and overpayments of employment tax. Under existing regs, interest-free adjustments for both overpayment and underpayment of tax must be made as a line adjustment on the employer's regularly filed employment tax return. The current regs also require employers to make adjustments for past return periods on current returns filed as an attachment.

Time for filing

The proposed regs would enable an employer to file a separate adjusted return for an overpayment or underpayment as soon as it discovers the error, instead of waiting to report the adjustment with its regularly filed employment tax return. Moreover, the adjusted return would not be filed as an attachment to the employer's current return and would not affect the liability reported therein. The adjustment must be reported on the adjusted return within a certain amount of time after discovery to be interest-free.

Underpayments

Under the proposed rules, an adjustment for an underpayment would be interest-free if the adjusted return is filed by the due date of the return for the period in which the error was discovered. An employer can collect the amount that was withheld by deducting the amount from any remuneration due to employees.

Overpayments

To qualify as an interest-free adjustment, the proposed regs retain the current rule that the employer must repay the employee's share of the taxes before making the overpayment adjustment. The repayment must be made by the due date of the return for the period following the period in which the error was discovered.

Refund claims

The proposed regs still allow an employer to file a refund claim under Code Sec. 6402 or 6414 when an interest-free adjustment cannot be made. However, employers could no longer use Form 941c, Supporting Statement to Correct Information, to claim the refund, but would have to file a prescribed form.

Deposit obligations

Finally, proposed Code Sec. 6302 regs would require employers making an interest-free adjustment to pay the amount on or before filing an adjusted return. For interest-free underpayment adjustments, the amount must be paid when the adjusted return is filed.

References: FED ¶49,782;

TRC PAYROLL: 3,352.

IRS Moves Against Transactions That Seek To Repatriate Earnings Tax-Free

◆ *Notice 2008-10*

The IRS has announced that it will issue regs under Code Sec. 367(a) to stop transactions that attempt to repatriate foreign earnings tax-free. The IRS claims that taxpayers are moving cash or property from a foreign subsidiary to a U.S. parent without recognizing gain or dividends. The regs will apply to transactions occurring on or after December 28, 2007.

■ **CCH Take Away.** The IRS sought to stop other earnings repatriation schemes in Notice 2006-85 and Notice 2007-48. Congress passed Code Sec. 965 to allow corporations temporarily to repatriate earnings at a significantly lower tax rate.

Coordination rule

Sec. 367(a) requires a U.S. corporation to recognize gain when it transfers appreciated property to a foreign corporation. Under the coordination rule, gain must be recognized under Code Sec. 367 on an indirect stock transfer, which involves a Code Sec. 361 or 351 transfer of stock or securities to a foreign corporation. Two exceptions to the coordination rule allow nonrecognition of gain for

certain outbound reorganizations and certain successive Code Sec. 351 transfers.

Sample transaction

A U.S. parent owns 100 percent of U.S. and foreign subsidiaries. The U.S. sub sells zero basis assets to the foreign sub for \$100,000 and then liquidates. The foreign sub transfers the same assets back to a new wholly owned U.S. sub, in exchange for the U.S. sub's stock (the "transaction").

Taxpayers claim that the U.S. sub's transfer of property is not taxed under Code Sec. 367 because the parent reduced its basis in the foreign sub's stock before the transaction, as required by the first exception.

New regs

Exception One will require that the basis reduction be made to stock of the foreign sub received in the Code Sec. 361 reorganization. If this cannot be done, gain must be recognized under Code Sec. 367. Exception Two will no longer apply to a Code Sec. 351 transfer that is also a Code Sec. 361 exchange; only Exception One will apply.

References: FED ¶46,225;

TRC INTL: 30,354.

New Reliance Regs Help Determine Contribution Requirements Under PPA

◆ *IR-2007-212, NPRM REG-139236-07*

The IRS has issued proposed regs for measuring plan assets and liabilities, to help determine funding requirements for single employer defined benefit plans. The regs implement the tighter funding rules in Code Sec. 430 of the Pension Protection Act of 2006 (PPA).

■ **CCH Take Away.** The regs follow earlier regs issued to help plan sponsors determine contribution requirements for the first year of the new funding rules. Earlier regs provided mortality tables (NPRM REG-143601-06) and limited the payout of benefits by underfunded plans (NPRM REG-113891-07). The IRS intends to issue further regs under Code Sec. 430 in the first part of 2008.

Effective dates

While the PPA rules generally apply to plan years beginning on or after January 1, 2008, the

regs are proposed to apply to plan years beginning on or after January 1, 2009. However, plan sponsors can rely on the proposed regs for plan years beginning in 2008. The IRS will apply the same effective dates to the earlier regs.

Funding requirements

The minimum required contribution to a plan whose assets are less than its funding target is based on its target normal cost. The funding target is the present value of all benefits that would have been accrued or earned under the plan as of the first day of the plan year. The target normal cost is the present value of all benefits that accrue or are earned under the plan during the plan year. The regs also described how to determine at-risk funding target and at-risk target normal cost for a significantly underfunded plan.

Plan assets

The value of plan assets generally is their fair market value on the plan's valuation

date. The valuation date must be the first day of the plan year, except for a small plan. Alternatively, plans may use an average value, based on the assets' value at the valuation date and one or two preceding valuation dates.

Interest rates

The proposed regs specify the interest rates used to determine present value under Code Sec. 430. The rates are based on 24-month moving averages of three separate segment rates for the month that includes the valuation date: benefits paid within the next five years beginning on the valuation date; benefits paid in five to 20 years; and benefits paid after 20 years. The rates use the corporate bond yield curve during the particular segment.

References: FED ¶¶46,224, 49,785;

TRC Retire: 30,552.

Proposed Reliance Regs On Cash Balance Plans Cover Tough New PPA Rules

◆ *NPRM REG-104946-07, IR-2007-211*

Interpreting Code Sections 411(a)(13) and 411(b)(5), as amended by the Pension Protection Act of 2006 (PPA), the IRS has released proposed regs for statutory hybrid (cash balance) plan requirements. The regs interpret new provisions introduced by the PPA, including the three-year minimum vesting requirement, the age discrimination safe harbor, and employee conversion protection for senior employees.

Definitions

The new regs define "lump-sum based benefit formulas" as the formula used to calculate benefits using a balance in a hypothetical account or the current value of an accumulated percentage of the participant's final average compensation. Code Sec. 411(a)(13)(C)(ii) requires the IRS to define when traditional benefits plans have an effect similar to this formula. The regs define this as periodic adjustments or repeated plan amendments

creating a larger annual benefit at normal retirement age for the employee than for similarly situated, younger individuals participating in the plan. Defined benefits plans with lump-sum benefit formulas or traditional defined benefits plans with a similar effect are defined as "statutory hybrid plans;" commonly known as "cash balance" plans.

Minimum Vesting

Code Sec. 411(a)(2) gives employees the right to 100 percent of their accumulated benefits in a cash balance plan after three years of service. If both a traditional defined benefit plan formula and lump-sum based formula are used to determine benefits, the proposed regs would preserve the right to all accumulated amounts.

Age discrimination safe harbor

While defined benefits plans may not reduce distributions of benefits based on age under Code Sec. 411(b)(1)(H), there is a safe harbor

for accumulated benefits of the participant equal to or more than those of a similarly situated younger participant. The proposed regs limit this safe harbor to comparison of benefits expressed as annuities payable at normal retirement age, the balance of the hypothetical account, or the accumulated percentage of final average compensation.

Conversion protection

Code Sec. 411(b)(5)(B)(ii) protects a participant's accumulated benefits when a traditional defined benefits plan is converted to a cash balance plan. The participant is entitled to benefits accumulated under each type of plan. To ensure this, the proposed regs would allow a plan to substitute the participant's pre-conversion benefits from the traditional defined benefits plan with an independent hypothetical account. The balance in this account would equal those pre-conversion benefits.

References: FED ¶¶46,223, 49,781,

TRC RETIRE: 39,058.

IRS Issues Annual Updates For Ruling Request Procedures; No Major Surprises

◆ *Rev. Proc. 2008-1 through 8*

The IRS has issued its annual series of revenue procedures for issuing private letter rulings, revenue rulings, determination letters, and similar taxpayer-requested guidance, as well as for technical advice requested by IRS personnel.

- **CCH Take Away.** While a fairly quiet year in the way of major changes, this 2008 series of annual updates does indicate the IRS's continuing refocus in certain areas such as exempt organizations and international tax enforcement. It also shows the IRS's continuing interest in conserving resources by issuing more generally applicable public guidance that removes the need for it to issues private rulings.

TAM guidelines

Rev. Proc. 2008-2 updates the procedures by which the associate chief counsel's office furnishes technical advice to a field director or appeals area director. The procedure also explains the rights a taxpayer

has when such directors request technical advice memoranda (TAMs) regarding a tax issue.

- **Comment.** The major revision to this procedure took place last January when it was updated to reflect the streamlined TAM process first announced by Chief Counsel Donald Korb in May 2006. Little information has been released so far, however, on how successful such "revitalization of the TAM process" has been.

No-rule areas

Rev. Proc. 2008-3 describes the areas the IRS will not issue advance rulings or determination letters. Covering jurisdictions that include Tax Exempt and Government Entities, Corporate, Financial Institutions & Products, Income Tax, Accounting, Passthroughs & Special Industries and Procedure and Administration, this procedure contains a host of new "no-rulings" areas. They include whether a transfer is a gift; certain issues involving ownership of qualifying production and film property;

charitable contributions involving limited partnership interests, and single yields on qualified mortgage or student loan bonds. Additional no-ruling areas include certain issues associated with annuity contracts and charitable remainder trusts

Employee plans and exempt organizations

Rev. Proc. 2008-4 provides many minor revisions to the procedures for obtaining guidance on issues relating to employee plans and exempt organizations. Several larger changes have also been made, however, reflective of this "hot" area of tax law:

- IRS Exempt Organizations (EO) Technical will no longer issue letter
- rulings under Code Sections 507, 4941 or 4945 involving the tax consequences of the termination of a charitable remainder trust under certain circumstances;
- Taxpayers no longer must attach a waiver of disclosure violations resulting from a fax transmission to a request to receive a copy of a private letter ruling by fax; and
- Taxpayers may request a conference regarding a determination letter not subject to Code Sections 7428, 501 or 521.

Technical advice

Rev. Proc. 2008-5 updates the procedures for furnishing TAMs within the employee plan and exempt organizations areas. The procedure also explains certain taxpayer rights.

Rev. Proc. 2008-6 provides revised procedures, mostly minor, for issuing determination letters on the qualified status of pension, profit-sharing, stock bonus, annuity, and employer stock ownership plans (ESOPs), and on the status for exemption of any related trusts or custodial accounts under Code Sec. 501(a).

International issues

In another increasingly active area for IRS examination, Rev. Proc. 2008-7

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No Abuse Of IRS Discretion Despite Notice of Determination Issued Without Considering Offer-In-Compromise

The Tax Court, in its continuing effort to fine-tune the rules within its exclusive review jurisdiction, has determined that an IRS settlement officer did not abuse her discretion during a collection due process (CDP) hearing when she issued a notice of determination without considering an offer-in-compromise (OIC) that was based solely on doubt as to liability.

The latest case before the Tax Court was elevated by the court to a "regular" decision, no doubt because of the court's concern that the CDP rules are still not clear to some taxpayers despite almost ten years in existence.

Under the most recent case, the IRS issued a notice of deficiency to taxpayers, a married couple. During a CDP hearing the taxpayers did not challenge the underlying liability but made an OIC based only on doubt as to liability (DATL). The Tax Court held that Code Sec. 6330 prohibited them from challenging the amount of the liability at the CDP hearing. They previously had an opportunity to challenge the underlying tax liability after receiving the notice of deficiency but failed to do so.

Baltic, 129 T.C. No. 19, TRC IRS: 51,056.

Tax Briefs

Internal Revenue Service

The IRS has compiled a list of the announcements it made during 2007 regarding the validation of certain contributions made during the pendency of declaratory judgment proceedings brought by organizations to challenge the revocation of their exempt status.

*Announcement 2008-1,
FED ¶46,255; TRC EXEMPT: 12,156.*

The IRS and the Treasury Department have announced that they will work toward publishing guidance on a method for integrated utilities to use when calculating the tax deduction for domestic production activities. The goal is the development of an alternative method that integrated utility companies may use to compute qualified production activities under Code Sec. 199(c).

*IR-2008-3, FED ¶46,245;
TRC BUSEXP: 6,154.*

International

The Treasury Department announced that three protocols amending existing income tax treaties with Denmark, Finland and Germany, as well as a new income tax treaty and protocol with Belgium, entered into force upon the exchanges of required notifications and instruments of ratification in Washington, D.C., on December 28, 2007. All generally apply to tax years beginning on or after January 1, 2008, although certain provisions of the protocols with Germany and Finland are effective on or after January 1, 2007.

*TDNR HP-753, FED ¶46,241;
TRC INTL: 18,050.*

Qualified Research Expenses

The IRS and Treasury Department have issued a temporary and proposed regulation adding an additional item of tax return information, concerning total qualified research expenses, which the Treasury Secretary may disclose to the Bureau

of the Census (Bureau) for use in the latter's annual Survey of Industrial Research and Development. The regulation permits disclosure of such data from the taxpayers' Forms 6765, Credit for Increasing Research Activities.

*T.D. 9373, FED ¶47,010; Proposed
Regulations, NPRM REG-147832-07,
FED ¶49,783; TRC IRS: 9,254.*

Nuclear Decommissioning Costs

The IRS has issued proposed, temporary and final regulations concerning deductions for contributions to trusts maintained for decommissioning nuclear power plants. The temporary regulations apply beginning on December 31, 2007, with respect to tax years ending on or after that date.

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IRS Issues Proposed Reliance Regs On Employer-Securities Diversification Requirements For DC Plans; Mirrors Prior Notice

The IRS has released proposed reliance regs under Code Sec. 401(a)(35) governing the tightened diversification requirements required by the Pension Protection Act of 2006 (PPA) for certain defined contribution (DC) plans that hold publicly traded employer securities. The proposed regs generally mirror guidance in Notice 2006-107.

Under the proposed regs, if an applicable defined contribution pension plan holds employee contributions, including rollover contributions or elective deferrals, of an individual invested in the employer's securities, the plan must provide the individual with the option to divest the employer's securities and reinvest an equal amount in another investment. The proposed regs also impose restrictions on the frequency and timing of investment elections, provide certain exemptions from the diversification requirements, allow certain restrictions and conditions on diversification rights in order to comply with securities laws and the statute, and clarify that the prohibition on restrictions or conditions on the investment of employer securities applies to direct or indirect restriction on an individual's divestment rights.

The proposed regs would be effective for plan years beginning on or after January 1, 2009. Plans may apply the proposed regs for plan years before the effective date. Notice 2006-107 will continue to apply.

NPRM REG-136701-07, FED para 49,782; TRC RETIRE: 3,214.40.

2008 GMC Vehicles Qualify For Hybrid Vehicle Credit

The IRS has certified five 2008 model year General Motors Corporation (GMC) vehicles for the qualified alternative fuel motor vehicle credit. The vehicles and their credit amount are:

- 2008 Chevrolet Tahoe Hybrid (2WD): \$2,200;
- 2008 Chevrolet Tahoe Hybrid (4WD): \$2,200;
- 2008 GMC Yukon Hybrid (2WD): \$2,200;
- 2008 GMC Yukon Hybrid (4WD): \$2,200; and
- 2008 Saturn Vue Green Line: \$1,550

The 2008 Chevrolet Malibu hybrid (\$1,300) and the 2008 Saturn Aura Hybrid (\$1,300) were previously certified. Based upon hybrid vehicles sold so far by GM, the full credit is available to consumers through at least June 30, 2008.

IR-2007-210, TRC INDIV: 57,708.

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T.D. 9374, FED ¶47,011; Proposed Regulations, NPRM REG-147290-05, FED ¶49,789; TRC.

Income

A Tax Court determination that an individual received a taxable dividend was supported by evidence. The individual did not demonstrate prejudice sufficient to support a reversal due to the Tax Court's acceptance of witness testimony without reviewing the witness's plea agreement in a related case.

Bussell, CA-9, 2008-1 USTC ¶50,107; TRC LITIG: 6,750.

A married couple could not exclude Social Security disability benefits from their gross income and were not entitled to a loss deduction with respect to an uncollected damage award for personal injuries.

Green, CA-9, 2008-1 USTC ¶50,108; TRC INDIV: 6,202.

Frivolous Arguments

The government was entitled to summary judgment with respect to a taxpayer's frivolous suit that challenged the use of summary disposition, where all administrative procedures were properly followed. The taxpayer failed to raise either an issue of material fact or any issue of law that would preclude the entry of summary judgement under Tax Court Rule 121.

Broderick, TC, CCH Dec. 57,303(M), FED ¶47,916(M); TRC IRS: 42,120.

Deficiencies and Penalties

The Tax Court refused to vacate a stipulated judgment that upheld the IRS's deficiency determination against an individual who merely objected to the use of his tax dollars.

Harper, TC, CCH Dec. 57,214(M), FED ¶47,914(M); TRC LITIG: 6,952.15.

An individual's action against the IRS was dismissed for failure to prosecute. The taxpayer failed to cooperate with the IRS in preparing for trial.

Long, TC, CCH Dec. 57,302(M), FED para47,915(M); TRC LITIG: 6,456.35.

A taxpayer failed to show that she was entitled to an abatement of interest on her deficiency. She was not liable for the delay penalty.

Thomas, TC, CCH Dec. 57,305(M), FED ¶47,918(M); TRC PENALTY: 9,056.20.

Ruling Request Procedures

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provides what appears to be a growing list of international issues for which the IRS will not issue advance letter rulings or determination letters. These no-rule areas include: whether foreign income tax laws deny any opportunity for the foreign use of dual consolidated loss; whether a possibility of foreign use exists; whether an event presumptively constitutes a triggering event; whether the presumption of a triggering event is rebutted; and whether a domestic use agreement terminates. Rev. Proc. 2008-7 also provides that the IRS will not ordinarily rule on the corresponding provisions of prior regs under Code Sec. 1503(d).

User fees

Rev. Proc. 2008-8 describes the IRS' user fee program for letter rulings, determination letters and similar requests for matters under the jurisdiction of the IRS's Tax Exempt and Government Entities Division. The procedure reflects Section 8244 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 (P.L. 110-28), which makes user fees permanent.

Rev. Proc. 2008-1, in appendices on standard letter ruling and closing agreement fees, notes that effective February 1, 2008, certain fees will increase, including those for accounting period requests (from \$1,500 to \$3,200), accounting method requests (from \$1,500 to up to \$4,000), and general ruling and closing agreement requests (from \$10,000 to \$11,500).

IRS Overreached In Use Of Economic Substance Doctrine To Prevent Partnership Tax Strategy

The IRS recently lost a significant battle in the Tax Court over when the economic substance doctrine can override technical compliance with partnership tax rules. The court determined that partners receiving liquidating distribution consisting of third-party promissory notes did not have to recognize any gain from under Code Sec. 731(a)(1) since the notes were neither cash nor marketable securities. Additionally, they were allowed to increase their partnership interest basis by their pro rata share of debt assumed by the partnership to purchase the notes under Code Sec. 752.

The taxpayer admitted that the distribution was structured to defer tax. However, the court still ruled that these actions had economic substance because all of the parties involved had a business purpose for their actions. The partnership sought to eliminate the partnership interests, while the partners wanted to convert their partnership investment into interest-bearing promissory notes. The manner in which these goals were accomplished, the court reported, only had a "collateral favorable tax effect."

Countryside Limited Partnership, T.C. Memo. 2008-3, Dec. 57,304(M); TRC INDIV: 48, 152.10

Practitioners' Corner

Jumpstarting The 2008 Tax Year

Happy New Year! The start of a new year brings plenty of tax planning opportunities. Here are eight considerations for tax planning as 2008 begins.

#1 Foreclosure Help

Every practitioner knows clients caught in the subprime mortgage crisis. The high-flying housing market of recent years is in serious trouble in many localities. Homeowners who took advantage of “low teaser” interest rates are suddenly looking at foreclosure when they cannot make their payments.

When a lender forecloses on property, sells the home for less than the borrower’s outstanding mortgage and forgives part or all of the unpaid mortgage debt, the Tax Code had considered the cancelled debt to be taxable income to the homeowner. Congress passed some relief for distressed homeowners late in 2007.

The *Mortgage Forgiveness Debt Relief Act of 2007* excludes discharges of up to \$2 million of indebtedness from taxation (\$1 million for a married taxpayer filing a separate return) if the debt is secured by a principal residence and if it was incurred in the acquisition, construction or substantial improvement of the principal residence. This special relief is temporary and is available for three years, retroactively applied for discharges from January 1, 2007, through December 31, 2009. The new law also addresses mortgage workouts.

#2 Kiddie tax

Until recently, the kiddie tax kicked-in at 14. The *Small Business and Work Opportunity Tax Act of 2007* (2007 *Small Business Tax Act*) raised the age to 19, 24 if a student, under which the unearned income of minors who provide less than half their support is taxed at their parents’

tax rate for tax years beginning after May 25, 2007 (2008 for most calendar year taxpayers). Congress decided that it was time to lessen the effectiveness of intra-family transfers of income-producing property, which shift income produced from such

and consequences. The sooner a taxpayer addresses the tax consequences, the easier it is to focus on the event itself.

Most clients plan for post-death distributions. The one-year repeal of the federal estate tax, set for 2010, is fast approaching.

“The start of a new year brings plenty of tax planning opportunities.”

property from the parents’ high marginal tax rate to the child’s generally lower tax bracket, thereby reducing a family’s overall income tax liability.

Key figures. Generally, the kiddie tax applies when a child’s income exceeds \$1,800 for 2008. For tax years beginning in 2008, the inflation-adjusted amount used to reduce the net unearned income reported on a child’s return that is subject to the kiddie tax is \$900. For tax years beginning in 2008, the amount of a dependent’s standard deduction is the greater of \$900, as adjusted for inflation, or the sum of \$300 and the dependent’s earned income.

Reminder. For purposes of the kiddie tax, the source of the income-producing property is irrelevant. For example, the property may have been transferred to the child, by gift from the child’s parents, grandparents or anyone else, in any type of trust, by gift under the *Uniform Gift to Minors Act*, by inheritance.

#3 Life changes

Change is the only constant in life, so the saying goes. Many clients may be undergoing a life changing event now or are anticipating one, such as marriage or the birth of a child, starting a new job or business venture, retiring, or closing a business. Almost every event has tax implications

In 2001, Congress repealed the federal estate tax but only for one year (2010) and replaces it with a carry-over basis regime. However, for 2008, the maximum estate tax rate is 45 percent and the estate tax exclusion amount is \$2 million.

#4 Hybrid vehicles

With gasoline selling at all-time record highs, consumer interest in hybrid vehicles is also at an all-time high. Not only will taxpayers save on fuel costs, they also may qualify for a tax break. However, be careful. Not all models of hybrid vehicles qualify for the same tax credits. Moreover, the tax break has expired for others. Legislation has been introduced in Congress to remove the vehicle-production cap that gradually phases out the credit for certain manufacturers.

#5 Child care and education

A married couple with a combined annual income of \$100,000 can expect to spend nearly \$300,000 on rearing a child until age 18, according to the U.S. Department of Agriculture. Child care and education are a large chunk of these costs. Fortunately, there are some tax-friendly savings strategies, such as Coverdell Educational Savings Accounts (ESAs) and qualified tuition plans, also known as “529” plans.

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Washington Report

by the CCH Washington News Bureau



White House weighs stimulus plan

President Bush is considering whether to unveil an economic stimulus package by the State of the Union address on January 28, a White House spokesman confirmed on January 4. "Tax cuts would be an option that is certainly under consideration" White House Deputy Press Secretary Tony Fratto said at a press briefing.

Following a White House meeting with the President's Working Group on Financial Markets, Bush acknowledged there are mixed signals on the health of the U.S. economy. Several factors are contributing to a slowdown in economic growth, including a slumping housing market combined with soaring oil prices. Bush stressed that raising taxes would be "the worst thing that Congress could do" as part of any package to stimulate the economy. The president added that once Congress returns, he intends to work with them to address "the economic realities of the moment."

IRS Commissioner. In related news, Bush signed legislation clarifying the term of the IRS Commissioner on January 4 (Sen. 2436). The new law removes some doubt as to the length of the term of a new commissioner when the previous commissioner leaves office before completing his or her term. The president has nominated Douglas Shulman, currently vice chair of the Financial Industry Regulatory Authority, to succeed Mark Everson as IRS Commissioner. Confirmation hearings are expected to take place in the near future.

Paulson warns of wave of subprime mortgage resets. Treasury Secretary Henry Paulson, Jr. predicted a "wave" of subprime mortgage resets in prepared remarks before the New York Society of Securities Analysts on January 7. "Over the next two years, we face an unprecedented wave of 1.8 million subprime

mortgage resets, raising the potential of market failure" Paulson cautioned.

Paulson touted that the Bush Administration "has met this challenge without committing any taxpayer money." The development of new mortgage products is one solution, Paulson indicated, as is fast-tracking borrowers to assistance. "The industry needs this streamlining to manage the volume of resets that cannot be addressed through individual, loan-by-loan negotiations."

Just before its holiday recess, Congress passed the Mortgage Debt Forgiveness Act of 2007. The new law, among other things, excludes from taxation qualifying discharges of up to \$2 million. The treatment is retroactive to January 1, 2007 and ends December 31, 2009.

TIGTA audits fees paid to private tax collectors

A recent audit of fees paid by the IRS to private collection agencies revealed no significant problems, the Treasury Inspector General for Tax Administration (TIGTA) has uncovered (Invoice Audit of Fees Paid Under the Private Debt Collection Initiative, 2008-10-054). TIGTA is also conducting a separate report about the overall initiative.

Between September 2006 and April 2007, the IRS processed 18 invoices, containing more than 6,000 expense transactions, from the three contractors totaling approximately \$2.7 million, TIGTA reported. TIGTA audited a sample of the invoices and determined that the fees were accurate, supportable and allowable. Minimal discrepancies were subsequently remedied by the IRS.

TIGTA also reported that its staff is performing an overall evaluation of the initiative to measure its performance and evaluate its effectiveness. The overall evaluation will also examine IRS oversight of the program, contractors;

compliance with laws and procedures and taxpayers satisfaction with the program.

New leader set to take charge of DOJ Tax Division

Nathan Hochman, a principal at Hochman, Rettig, Toscher and Perez, Los Angeles, Calif, will be sworn-in as Assistant Attorney General (Tax Division) for the U.S. Justice Department on January 22. Hochman succeeds Eileen O'Connor, who left DOJ in June of 2007.

Hochman was nominated by President Bush in November and confirmed by the Senate on December 18, 2007. Hochman will head up all civil and criminal tax enforcement at DOJ.

Under O'Connor's leadership, the Tax Division successfully prosecuted high-profile tax shelter cases and also continued the government's tough stance toward the FICA exception for medical residents.

VA reminds veterans of refunds

More than 25,000 veterans may be eligible for refunds of tax paid on benefits from two vocational rehabilitation programs in the past three years, the U.S. Department of Veterans Affairs (VA) announced on January 7. Participants in the VA Compensated Work Therapy (CWT) and Incentive Therapy (IT) programs may qualify.

Last year, the Tax Court held that CWT payments were tax-free benefits in *Roosevelt Wallace v. Commr.*, 128 T.C. No. 11. The IRS subsequently acquiesced in the decision, reversing its long-held position that the payments had to be included in gross income as compensation for services.

Recipients of CWT and IT payments no longer receive a Form 1099 (Miscellaneous Income) from the VA. Veterans who paid tax on these benefits in the 2004, 2005 or 2006 tax years can claim a refund by filing an amended return, the VA indicated.

IRS Chief Counsel Cancels Tax Rate Reconciliation Workpapers Notice

◆ CCN-2008-008

Without official explanation, the IRS Chief Counsel's Office recently cancelled its previous notice, CC-2007-015, that had instructed field counsel not to include effective tax rate reconciliation workpapers within the umbrella of protection under the IRS's "policy of restraint." in determining whether to issue a summons for tax accrual workpapers or audit workpapers. As a result, the IRS will no longer routinely request them during examinations.

Under section 4.10.20.3 of the Internal Revenue Manual (IRM), the IRS may request tax reconciliation papers at the beginning of an

examination. However, audit or tax accrual workpapers are only requested in unusual circumstances under what the IRS calls its "long-standing policy of restraint."

Chief Counsel's Office had initially reasoned in CC-2007-015 that because they are not prepared for the purpose of determining the proper amount of reserve for contingent tax liabilities, are not retained by an auditor to document the performance of an audit and do not reflect procedures followed or tests performed by auditors in review of the taxpayer's financial statements, effective tax rate reconciliation workpapers should be excluded from the agency's policy of restraint.

Additionally, the agency was concerned that its policy of restraint could be misinterpreted to include all documents prepared by a taxpayer in the course of a financial records audit; not just those unrelated to preparation of an income tax return.

Now, effective rate tax reconciliation workpapers may be considered audit or tax accrual workpapers. No explanation for the change was given, although some observers suspect that criticism of the initial policy among certain large corporations caused Chief Counsel's Office to back off, at least temporarily, on reconciliation workpaper requests until the issue could be more fully vetted.

Practitioners' Corner

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Contributions to a Coverdell ESA are not tax deductible. However, earnings are not currently taxed and withdrawals from Coverdell ESAs are tax-free when used to pay for qualified educational expenses. Funds saved in a Coverdell ESA can be used for kindergarten through 12th grade as well as post-secondary education expenses. Contributions to a 529 plan are also not tax deductible but the amounts earned by the funds invested in the plan grow tax-free and the original investment and earnings are tax-free when withdrawn if they are used for qualified education expenses.

#6 Roth IRAs

The *Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA)* eliminated the \$100,000 adjusted gross income ceiling for converting a regular IRA to a Roth IRA for tax years after 2009. A conversion is treated as a taxable distribution, but is not subject to the 10 percent early withdrawal penalty. Taxpayers who convert in 2010 can elect to recognize the conversion income in 2010 or average it over the next two years.

Although this provision in *TIPRA* does not extend to 401(k) plans, nothing would apparently prevent Roth IRA conversions of traditional IRAs that have received proceeds of 401(k) balances when an individual leaves employment. Nor does the new law prevent high-income taxpayers from contributing to

nondeductible traditional IRAs now in anticipation of converting to Roth IRAs in 2010. Additionally, 2010 is also the last year before the lower individual marginal tax rates in the *Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)* sunset.

■ **Comment.** The older an individual is, the more likely that he or she is relying primarily on Social Security for his or her retirement income. Social Security accounts for more than one half of the retirement income of individuals age 85 and older, according to the Employee Benefits Research Institute. In comparison, Social Security accounts for roughly one-third of the retirement income of individuals age 65 to 69.

#7 Lower capital gains and dividends tax rates

The taxpayer-friendly lower capital gains and dividend tax rates in recent legislation are temporary. The maximum rate of 15 percent will disappear after 2010 as will the zero percent rate for individuals in the 10 or 15 percent tax brackets.

■ **Caution.** The capital gains and dividend tax rates have been changed so often in recent years that practitioners need a scorecard to keep up with them all. For tax years ending on or after May 6, 2003, and through the end of 2010, up to four different rates could apply to long-term capital gains: 28 percent for collectible gain

and gain on qualified small business stock, 25 percent for unrecaptured gain from the sale of certain depreciable realty, 15 percent for other gain, or five percent for other gain for taxpayers in the 10 percent or 15 percent income tax rate brackets. For tax years beginning after 2007, the five percent rate is reduced to zero.

Reminder. For small business owners, capital gains have another advantage. Unlike the money a small business owner earns in his or her business, capital gains are not subject to the 15.3 percent self-employment tax.

#8 Small business expensing

Generous small business expensing under Code Sec. 179 is also temporary. The enhanced amounts in the 2007 Small Business Tax Act will sunset after 2010. For 2008, the maximum expense amount is \$128,000. The \$128,000 amount is reduced, but not below zero, by the amount by which the cost of qualifying property placed in service exceeds \$510,000.

The timing of purchases is always an important consideration. As long as the taxpayer starts using your newly purchased business equipment before the end of the tax year, the taxpayer receives the entire expensing deduction for that year, whether it started using the equipment in January or on December 31st. The amount that can be expensed depends upon the date the qualifying property is placed in service, not when it's purchased or paid for.

Compliance Calendar

■ January 10

Employees who received \$20 or more in tips during December report them to their employers.

■ January 11

Employers deposit Social Security, Medicare, and withheld income tax for January 5, 6, 7, and 8.

■ January 15

Individuals make a final 2007 estimated tax payment if they did not pay income tax through withholding.

Monthly depositors deposit Social Security, Medicare, and withheld income tax for December 2007.

■ January 16

Employers deposit Social Security, Medicare, and withheld income tax for January 9, 10 and 11.

■ January 18

Employers deposit Social Security, Medicare, and withheld income tax for January 12, 13, 14 and 15.

From the Helpline

The following questions have been answered recently by our "CCH Tax Research Consultant" Helpline (1-800-449-8114)

Q Once mortgage debt forgiveness avoids income recognition because of the new Mortgage Forgiveness Debt Relief Act, is any subsequent gain realized on account of basis reduction considered capital gain covered by the homesale exclusion?

A Yes. Unlike the Code Sec. 108 insolvency exclusion from indebtedness income that requires a basis reduction under Code Sec. 1017, the new Code Sec 108 principal residence exclusion requires basis reduction only under Code Sec 108(d). This difference allows the homeowner to avoid recapture of the basis reduction as ordinary income and also allows use of the \$250,000/\$500,000 homesale exclusion. In contrast, when the insolvency exclusion is used, gain on a subsequent sale is recaptured as ordinary income to the extent of prior basis reduction and the homesale exclusion is inapplicable to that portion of the gain.

Q Did the "extenders" legislation finally pass in December?

A No. To the great disappointment of many and despite agreement between Democrats and Republicans that they were necessary, the extenders provisions did not pass. The extenders –that include such tax breaks as for sales taxes, qualified tuition, the research credit and a classroom deduction for educators– were held hostage by other tax and budget issues and, in the end, Congress ran out of time to bring the matter to a vote before both chambers. While the provisions addressed by the extenders expired on December 31, 2007, the expectation is that any legislation will be made retroactive to January 1, 2008. Passage by March is anticipated, although political maneuvering may again delay consideration. If delayed beyond mid-year, there is the possibility that some of the provisions would be made retroactive only to July 1, 2008, because of budget considerations.

TRC Text Reference Table

The cross references at the end of the articles in CCH Federal Tax Weekly (FTW) are text references to CCH Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.

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