

Federal Tax Weekly

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IRS Implements Last-Minute AMT Patch; Predicts Most Taxpayers Will Not Face Delays

◆ *IR-2007-202, IR-2007-209*

The IRS is moving quickly to implement the recently passed AMT patch. Congress passed the *Tax Increase Prevention Act of 2007 (H.R. 3996)* just hours before its holiday recess, giving the IRS very little time to reprogram its computer systems for the patch before the start of the 2008 filing season. Nonetheless, the IRS has promised that the filing season will start on time for most taxpayers. Congress also passed several other tax bills, including foreclosure relief, technical corrections, an energy bill, a FY 2008 IRS budget, and more at year-end.

■ **CCH Take Away.** "We are extremely concerned that (the lateness of the AMT patch) will delay the processing of 2007 tax returns and the issuing of refund checks," House Speaker Nancy Pelosi, D-Calif., and Senate Majority Leader Harry Reid, D-Nevada, told President Bush after Congress passed the patch. The IRS reported on December 27 that it will begin processing returns on time, in mid-January, for the "vast majority of taxpayers."

■ **Comment.** For more details about the year-end tax legislation, see *CCH's Tax Briefing* and online explanations at <http://tax.cchgroup.com>.

AMT patch

The AMT patch gives taxpayers higher exemption amounts and allows them to use most nonrefundable personal credits to offset AMT liability for the 2007 tax year. The 2007 AMT exemption amounts are \$44,350 for single

taxpayers and heads of household; \$66,250 for married couples filing jointly; and \$33,125 for married couples filing separately.

The IRS has identified February 11, 2008 as the potential starting date for individuals to begin submitting five AMT-related returns. The five forms are: Form 8863, Education Credits; Form 5695, 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.

Although potentially as many as 13.5 million filers will not be able to file their returns until February 11, the IRS predicted that the effect of the delay "may be lessened by the fact that under previous filing patterns only between three million to four million taxpayers file returns with the five affected forms during these early weeks in the filing season."

■ **Planning tip.** Electronic returns involving the five forms will not be accepted until systems are updated in February, the IRS explained. Paper filers should wait to file as well. All other e-file and paper returns will be accepted starting in January, the IRS assured taxpayers and practitioners.

The IRS also reported that it has successfully reprogrammed its computer systems to begin processing seven other AMT-related forms, including Form 6251, Alternative Minimum Tax – Individuals, starting January 14, 2008. "Taxpayers filing these seven forms should not experience delays in filing," the IRS predicted.

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Government Prevails In Latest Son Of BOSS Case

◆ *Jade Trading, LLC, FCI, December 21, 2007.*

The Federal Claims Court handed the IRS a major victory in its war on tax shelters recently when it ruled that a Son of BOSS transaction lacked economic substance. The court found that *Coltec v. U.S.*, 454 F.3d 1340, (Fed. Cir. 2006) reaffirmed the validity of the economic substance doctrine and mandated additional scrutiny of these transactions.

■ **Comment.** IRS Chief Counsel Donald Korb told CCH, “This case was tried two years ago, but it was certainly worth the wait.” Furthermore, he stated “the holding should leave no doubt that the judicially developed economic substance doctrine does not need to be incorporated into the tax code. Even without an act of Congress, the court in *Jade Trading* had all of the tools it needed not only to decide the case in

favor of the government but also to sustain a 40 percent penalty against the partnership.”

Background

The tax shelter involved limited liability companies (LLCs) that each purchased a spread position with foreign currency options based on the value of the euro.

All of the LLCs then contributed their options to a single partnership. They each computed the basis of their partnership interests solely based on the \$15 million premium of the purchased options. They interpreted Code Sec. 752(b) to mean that, while partners must decrease their partnership basis by any liabilities assumed by the partnership, this did not apply for contingent obligations. They argued that the short-sold options were contingent obligations.

■ **Reminder.** Reg. §1.752-6 now prevents taxpayers from failing to reduce their partnership interest basis

by liabilities not covered in Code Sec. 752(a) or (b). The regulation was not in existence nor effective during the tax years at issue in this case.

The LLCs later caused the partnership to redeem their partnership interests in exchange for assets. When they later sold these assets, they claimed a basis equal to that of their partnership interest. The result was a \$14.9 million tax loss.

Economic substance

The court found that the transaction lacked economic substance. The claimed losses were purely fictitious. The transaction was developed as a tax avoidance mechanism and not as a legitimate investment strategy.

The court also found that the transaction had no reasonable profit potential. The structure of the transaction and the unusually high fees required for participation prevented it from being profitable, no matter how the value of the euro performed.

AMT Patch Adoption

Continued from page 1

■ **Comment.** Where any of these five forms is warranted, Electronic Return Originators (EROs) were told that they should not file prematurely (that is, before the new forms are able to be accepted) in anticipation of filing Form 1040X at a later date, the National Association of Enrolled Agents (NAEA) told CCH. The NAEA and other groups participated in a stakeholder meeting with the IRS about the 2008 filing season on December 27. Additionally, as long as clients are notified that the returns will not be filed until February 11, EROs may hold returns using any of the five forms without violating the

“stockpiling” rule set forth in the November 2004 version of Publication 1345, the NAEA reported.

Foreclosure relief

Congress also helped taxpayers floundering in the mortgage meltdown. The *Mortgage Forgiveness Debt Relief Act of 2007* (H.R. 3648) adds a new exception for mortgage indebtedness on a principal residence. The new law excludes from taxation discharges of up to \$2 million of indebtedness (\$1 million for a married taxpayer filing a separate return), which are secured by a principal residence and which are incurred in the acquisition, construction or substantial improvement of the principal residence. Congress also included mortgage workouts as well as covering foreclosures.

More legislation

Survivor's home sale exclusion. The foreclosure relief act permits qualifying surviving spouses who sell or exchange a principal residence within two years of their spouse's death to exclude up to \$500,000 of gain on the sale.

Mortgage insurance deduction. Congress extended the deduction for qualified mortgage insurance premiums for three years.

Technical corrections. The *Tax Technical Corrections Act of 2007* (H.R. 4839) makes more than 50 changes to nine major tax laws since 1998.

Energy legislation. Congress passed the *Energy Independence and Security Act of 2007* (H.R. 6), which includes two tax-related provisions.

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 Unveils Final Revision Of 2008 Form 990; Provides Transition Relief

◆ IR-2007-204

The IRS has completed a whirlwind redesign of Form 990, the annual information return used by tax-exempt organizations, by issuing the final version just six months after it announced its plan to revise the form. The revised form must be used by exempt organizations (EOs) for 2008 (returns filed in 2009). At the same time, the IRS provided transition relief for some EOs.

■ **CCH Take Away.** The IRS considers Form 990 “the primary compliance tool for EOs.” Form 990 had not been substantially revised since 1979. Both users and the IRS considered it out of date. The IRS has identified approximately 1.3 million charities and other EOs.

Core form and schedules

The revised form consists of an 11-page core form and 16 schedules. Many of the schedules are new: activities outside the U.S., hospitals, tax-exempt bonds, and noncash contributions. Others revise and expand existing reporting

concerning public charity status and public support, lobbying and political activities, fundraising and gaming, compensation, transactions with insiders, and related organizations.

The final version cuts back on some of the questions that were in the draft form. For example, less information is requested about noncash contributions. Various ratios requested about the organization’s financial operations were eliminated. Compensation information will not include fringe benefits.

The revised form addresses privacy and security concerns by limiting the reporting of compensation and of foreign workers and volunteers. Information on foreign grants need only be identified by region, not by country.

■ **Comment.** Lois Lerner, director of IRS Exempt Organizations, explained that compliance initiatives influenced the agency to request more information concerning topics such as political activity, hospitals, and compensation.

■ **Comment.** The IRS modified the public support test in redesigning

Form 990, Schedule A, and plans to issue guidance on the revised test. The IRS also plans to issue instructions for the revised Form 990 in early 2008.

Transition relief

The IRS provided transition relief for 2008 for some organizations. Hospitals do not have to complete Schedule H, except to provide minimal identifying information such as the name of the hospital. Tax-exempt bond issuers do not have to complete Schedule K except to provide a description of an outstanding bond issue. Bonds issued before 2003 do not have to be reported at all.

For smaller EOs, the new Form 990 will be phased in over three years. For 2008, organizations with gross receipts of \$1 million or less and total assets of \$2.5 million or less can use Form 990-EZ. The permanent thresholds, beginning in 2010, will be \$200,000 gross receipts and \$500,000 total assets.

*References: FED ¶46,213;
TRC EXEMPT: 12,252.15.*

IRS Applies Wash Sale Rule To IRA Transaction

◆ Rev. Rul. 2008-5

The IRS has determined that the wash sale rule applies to a taxpayer who sold stock for a loss and caused his individual retirement account (IRA) or Roth IRA to purchase substantially identical stock within 30 days after the sale. Consequently, the taxpayer could not deduct the loss on the sale of the stock.

Background

A taxpayer, an individual, owned 100 shares of X company stock with a basis of \$1,000. On December 20, 2007, the taxpayer sold the shares for \$600.

On December 21, 2007, the taxpayer used an IRA or a Roth IRA, established for the exclusive benefit of the taxpayer or his beneficiaries, to purchase 100 shares of X company stock for its then fair market value.

The taxpayer executed the sale and

purchase with different, unrelated market participants. The taxpayer was not a dealer in stock or securities.

Wash sales

Code Sec. 1091(a) provides that in the case of any loss claimed to have been sustained from any sale of shares of stock or securities within a period beginning 30 days before and ending 30 days after the date of such sale, the taxpayer has acquired substantially identical stock or securities, then no deduction is allowed under Code Sec. 165 unless the taxpayer is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of business.

Code Sec. 1091(d) provides rules for determining the basis of stock or securities the acquisition of which resulted in the non-deductibility under Code Sec. 1091 of the

loss from the sale of substantially identical stock or securities.

Case law

In *Security First National Bank of Los Angeles*, 28 BTA 289 (1933), the taxpayer sold bonds at market price to a corporation of which the taxpayer was the sole shareholder. On the same day, the corporation transferred the same bonds at the same price to a trust over which the taxpayer had absolute control. The court found that the predecessor to Code Sec. 1091(a) applied and disallowed the loss.

Relying on *Security First National Bank*, the IRS determined that the taxpayer’s loss on the sale of stock was disallowed under Code Sec. 1091. The IRS also noted that the taxpayer’s basis in the IRA or Roth IRA was not increased by virtue of Code Sec. 1091(d).

*References: FED ¶46,214;
TRC SALES: 45,152.*

IRS Issues Interim Guidance On Filing Whistleblower Claims

◆ IR-2007-201, Notice 2008-4

The IRS recently issued interim guidance for submitting claims to its Whistleblower Office under Code Sec. 7623(b). The guidance provides threshold requirements for filing a claim and outlines how informants are to report information relating to alleged noncompliance.

■ **CCH Take Away.** “While the IRS has always had an informant program, legislative changes are now in place that offer a real financial incentive for folks to come forward to the extent that they see compliance issues and, if the information significantly contributes to a recovery of tax, interest and possible penalties, to participate in that recovery,” Donald Rocen, former IRS deputy chief counsel, told CCH (*To read a transcript of the full interview with Donald Rocen, see the January 2008 issue of CCH’s TAXES magazine*).

Legislative changes

Under Code Sec. 7623, the IRS is authorized to pay awards from the proceeds of amounts collected as a result of information provided by whistleblowers. Section 406 of the *Tax Relief and Health Care Act of 2006* amended Code Sec. 7623 to provide for increased award payments to certain individuals who report noncompliance with the tax laws to the IRS. Existing regs under Code Sec. 7623(a), which provides the IRS with statutory authority to pay awards, are inconsistent with Code Sec. 7623(b). Notice 2008-4 clarifies that the regs under Code Sec. 7623(a) do not apply to the award program authorized by Code Sec. 7623(b).

New form

Notice 2008-4 explains that individuals submitting information under Code Sec.

7623(a) or 7623(b) must file new Form 211, Application for Award for Original Information. Form 211 requires informants to provide certain information such as an estimate of the tax owed, pertinent facts of the case, an explanation of how the informant obtained the information, and documentation to substantiate the claim.

Eligibility

To be eligible for an award under Code Sec. 7623(b), the tax, penalties, interest, additions to tax and any additional amounts in dispute must exceed \$2 million. If the alleged noncompliant taxpayer is an individual, the individual’s gross income must exceed \$200,000 for any tax year at issue.

The amount of an award must be at least 15 percent, but no more than 30 percent, of the amount collected in cases in which the IRS pursues, including tax, penalties interest and other amounts collected. The Whistleblower Office makes the final determination whether, and to what amount, an award will be paid. Moreover, awards will

be paid in proportion to the value of information furnished, which must substantially contribute to the IRS’s recovery of the tax. In some cases, an award may be reduced. All awards are subject to current federal reporting and withholding requirements. Award recipients are to receive a Form 1099, or other form.

■ **Comment.** “Code Sec. 7623 was modified to import the *False Claims Act* concepts into the Internal Revenue Code under which recoveries for whistleblowers can range from 15 to 30 percent of the recovery in certain situation,” Rocen told CCH. “Given the potential for recovery and the fact that people might see this as an opportunity to participate in substantial awards, companies may need to be a little more vigilant...even innocent mistakes that are brought to the attention of the IRS could, under the statutory scheme, lead to a recovery.”

References: FED ¶¶46,207, 46,208;
TRC IRS: 63,060.05.

IRS Develops New Form For Misclassified Workers

The IRS has released a new form for employees who have been misclassified as independent contractors by their employers. Workers who meet one of several criteria must now use Form 8919, Uncollected Social Security and Medicare Taxes on Wages, to calculate and report their share of uncollected Social Security and Medicare taxes. The new form must be used beginning with the 2007 tax year.

Workers should no longer use Form 4137, Social Security and Medicare Tax on Unreported Tip Income, as misclassified workers have in the past, the IRS indicated. Form 4137 should only continue to be used by employees who receive tips.

In addition to completing Form 8919, a worker must meet one of several criteria demonstrating that they were an employee of the employer, such as showing he or she is a Code Sec. 530 designated employee, receiving correspondence from the IRS stating he or she is an employee or filing a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, among others.

IR-2007-203, FED ¶46,212; TRC PLANIND: 9,102.

New Regs Explain Recapture Of Overall Domestic Losses; Affect Foreign Tax Credit Claims

◆ *T.D. 9371, NPRM REG-141399-07*

The IRS has issued temporary, final and proposed regs that explain the recapture of overall domestic losses under new Code Sec. 904(g), as enacted by the *American Jobs Creation Act of 2004 (2004 Jobs Act)*. The regs also update guidance on overall foreign losses and separate limitation losses. The regs generally are effective for tax years beginning after December 21, 2007. However, taxpayers may apply the regs to years beginning after December 31, 2006.

■ **CCH Take Away.** Code Sec. 904(g) recharacterizes U.S. source income as foreign source income where a taxpayer's foreign tax credit limitation has been reduced because of an overall domestic loss, the IRS reported. This is designed "to create parity in the treatment of overall domestic losses and overall foreign losses in order to prevent double taxation of income."

U.S. source loss

When a U.S. source loss is used to reduce foreign source income, the foreign tax credit limitation is reduced for the year. This may produce excess foreign tax credits. U.S. source income in a subsequent year after the loss cannot be offset by the loss allocated to foreign income in the prior year, and the tax on the U.S. income cannot be offset by the foreign tax credit carryforward. Because this may lead to double taxation of foreign source income over time, the overall domestic loss recapture provisions are designed to relieve this result.

■ **Comment.** An overall domestic loss is defined as any domestic loss that offsets foreign source taxable income for the current year or a preceding year.

Domestic losses

The regs describe how to establish and maintain overall domestic loss accounts for an overall domestic loss. A separate account must be maintained for each separate category of foreign source income that is offset by a domestic loss.

The regs also describe when an overall domestic loss is sustained and when to make additions and subtractions to the account.

Treating a portion of a taxpayer's U.S. source taxable income as foreign source income recaptures domestic losses. If the taxpayer has more than one account, the recharacterized income is allocated among the accounts pro rata.

The temporary regs update regs under Code Sec. 904(f) regarding the establish-

ment and recapture of separate limitation loss accounts. Taxpayers must maintain a separate limitation loss account for a category from which a foreign source loss may offset foreign source income in another category.

References: FED ¶¶47,007, 49,779; TRC INTLOUT: 6,262, CONSOL: 45,250.

January 2008 AFRs Issued

Rev. Rul. 2008-4

The IRS has released the short-term, mid-term, and long-term applicable interest rates for January 2008.

Applicable Federal Rates (AFR) for January 2008

<i>Short-Term AFR</i>	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>110% AFR</i>	3.51%	3.48%	3.46%	3.46%
<i>120% AFR</i>	3.83%	3.79%	3.77%	3.76%
<i>130% AFR</i>	4.15%	4.11%	4.09%	4.08%
<i>Mid-Term</i>				
<i>AFR</i>	3.58%	3.55%	3.53%	3.52%
<i>110% AFR</i>	3.95%	3.91%	3.89%	3.88%
<i>120% AFR</i>	4.31%	4.26%	4.24%	4.22%
<i>130% AFR</i>	4.67%	4.62%	4.59%	4.58%
<i>150% AFR</i>	5.40%	5.33%	5.29%	5.27%
<i>175% AFR</i>	6.31%	6.21%	6.16%	6.13%
<i>Long-Term</i>				
<i>AFR</i>	4.46%	4.41%	4.39%	4.37%
<i>110% AFR</i>	4.91%	4.85%	4.82%	4.80%
<i>120% AFR</i>	5.36%	5.29%	5.26%	5.23%
<i>130% AFR</i>	5.81%	5.73%	5.69%	5.66%

Adjusted AFRs for January 2008

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-term adjusted AFR</i>	3.05%	3.03%	3.02%	3.01%
<i>Mid-term adjusted AFR</i>	3.39%	3.36%	3.35%	3.34%
<i>Long-term adjusted AFR</i>	4.25%	4.21%	4.19%	4.17%

The IRC §382 adjusted federal long-term rate is 4.25; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 4.34%; the IRC §42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.93% and 3.40%, respectively; and the IRC §7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 4.4%.

FED ¶46,205; TRC ACCTNG: 36,162.05.

IRS Explains Allocation Of Benefit Recapture Among Controlled Group Members

◆ *T.D. 9369, NPRM REG-104713-07*

The IRS has issued temporary and proposed regs that explain how to calculate and allocate certain taxes among the component members of a controlled group of corporations. The regs apply to additional corporate taxes imposed under Code Sec. 11(b)(1) and to the reduction of the alternative minimum tax (AMT) exemption under Code Sec. 55(d)(3).

■ **CCH Take Away.** Code Sec. 11(b)(1) imposes a graduated corporate income tax using four income brackets. The additional corporate taxes offset the benefit of the lower brackets for higher-income corporations. Code Sec. 1561 prevents component members of a controlled group from claiming multiple tax benefits from the lower tax brackets. Similarly, the \$40,000 AMT exemption can only be claimed once by members of the controlled group.

Application to controlled group

Under Code Sec. 1561, the tax benefit of the lower brackets and the AMT exemption is divided equally among the component members, unless the group adopts an unequal allocation. A corporation is a component member if it was a member of the group on December 31 (the group's "testing date") and for half of the same year before December 31 (the group's "testing period").

■ **Comment.** The December 31 date applies whether the corporation is on a calendar or a fiscal year. A member with a short year that does not include December 31 uses the last day of its short year as its testing date.

The members of the controlled group must combine their taxable incomes for the years that include the same December 31 testing date when applying the additional tax and the AMT exemption phase-out.

■ **Comment.** The IRS noted that corporations must arrange to obtain the necessary information from other corporations that are or were members of the controlled group.

Allocation of benefit recapture

The temporary regs provide two methods for apportioning the additional taxes among members: the proportionate method and the first-in-first-out (FIFO) method. Under the proportionate method, the additional tax is allocated to any member who benefited from a tax-bracket amount, in the same proportion as the member's benefit

was to the total benefit. Under the FIFO method, the first dollars of the additional tax are allocated to each member to whom a bracket amount was apportioned.

The reduction in the AMT exemption must be allocated in the same manner as the exemption itself.

*References: FED ¶¶47,008, 49,780;
TRC CCORP: 42,050.*

Regs Apply Reduction Of Foreign Tax Credit Limitation Categories

The IRS issued regs that implement the *American Jobs Creation Act's* reduction of foreign tax credit limitation "buckets" from eight to two: passive category income and general category income. The previous categories included shipping income, high withholding tax interest, financial services income, certain dividends from a domestic international sales corporation (DISC), certain foreign trade income (FTI), and certain distributions from a foreign sales corporation (FSC). The regs apply to tax years of U.S. taxpayers beginning after December 31, 2006 and ending on or after December 21, 2007.

Passive category income includes passive income and specified passive category income. The latter includes dividends from a DISC, foreign trade income, and distributions from an FSC that results in FTI.

The temporary regs provide rules and safe harbors for the treatment of post-1986 undistributed earnings and foreign income taxes, the carryover of pre-2007 excess foreign taxes, and the carryback of post-2006 excess foreign taxes. The temporary regs also provide transition rules for the recapture in a post-2006 year of an overall foreign loss or a separate limitation loss in a pre-2007 separate category that offset income in another category before 2007.

T.D. 9368, NPRM REG-114126-07, FED ¶¶47,006, 49,778; TRC INTLOUT: 6,112.

Tax Court Rules AMTI Includes Qualified Dividends

The Tax Court recently held that two taxpayers erred in excluding qualified dividends from the calculation of their alternative minimum tax (AMT). AMT is imposed, in addition to all other taxes, upon a taxpayer's alternative minimum taxable income (AMTI), according to the court.

When computing AMT, qualified dividends receive special treatment, insofar as they enter into the net capital gain of individual taxpayers, the court explained. Such special treatment essentially caps the amount of AMT by reference to a formula that taxes net capital gain at rates that mirror preferential rates that apply for regular tax purposes under Code Sec. 1(h).

However, the court emphasized that the special treatment does not mean that qualified dividends may be disregarded altogether in calculating AMT. The court found that the taxpayers mistakenly omitted their qualified dividends from gross income, which contributed to an understatement of their AMTI, which gave rise to the tax deficiency.

References: Weiss, 129 T.C. No. 18, CCH Dec. 57,206; TRC FILEIND: 30,400.

Tax Briefs

Internal Revenue Service

The IRS has provided insurance companies with tables setting forth the loss payment patterns, discount factors and salvage discount factors for 2007.

Rev. Proc. 2008-10, FED ¶46,203; Rev. Proc. 2008-11, FED ¶46,204; TRCCORP: 9,000.

The IRS has released the dollar amounts, increased by the 2008 inflation adjustment, for Code Sec. 1274A debt instruments arising out of sales or exchanges.

Rev. Rul. 2008-3, FED ¶46,210; TRACCTNG: 36,256.20.

The Treasury has released final regulations governing disclosure of certain tax return information to the Bureau of the Census. The regulations amend the types of information to be disclosed.

T.D. 9372, FED ¶47,008; TRC IRS: 9210.

Rental assistance payments made to a building owner under the Indian Housing Block Grant program authorized by the *Native American Housing Assistance and Self-Determination Act of 1996* are not grants that reduce eligible basis for purposes of the low-income housing tax credit.

Rev. Rul. 2008-6, FED ¶46,220; TRC BUSEXP: 54,208.15.

Treasury has announced that the sixth round of competition for the allocation of up to \$3.5 billion in tax credits under the new markets tax credit program is now open. The application deadline is March 5, 2008.

Treasury Department News Release HP-744, FED ¶46,218; TRC BUSEXP: 57,304.50.

The IRS has updated its publication, *The Truth About Frivolous Tax Arguments*.

IR-2007-205, FED ¶46,215; TRC PENALTY: 3,308.

S Corporations

Payments made by an S corporation on behalf of brother and sister shareholders for the purchase of their father's shares did not

IRS Grants Effective Date Relief For Transfers To Unrelated Person Of Subsidiary Stock Loss

On January 23, 2007, the IRS released proposed regs applicable to transfers of loss shares of subsidiary stock by members of a consolidated group. The proposed effective date makes the regs applicable to all transfers on or after the date final regs are published in the Federal Register.

Practitioners expressed concern that the proposed effective date would present a significant burden on taxpayers attempting to negotiate transactions prior to the publication of the final regs. Accordingly, the IRS concluded that the regs will not apply to transfers to unrelated persons if the transfer is pursuant to an agreement that is binding before the date the regs are published and at all times thereafter.

■ **Comment.** Code Sec. 267(b) will be incorporated into the final regs for purposes of determining whether persons are related.

References: Notice 2008-9, FED ¶46,217; TRC CCORP: 45,410.

IRS Extends PPA Transitional Guidance For Defined Contribution Plans

The IRS has extended transitional guidance and relief for compliance with the *Pension Protection Act of 2006 (PPA)* by defined contribution plans holding publicly traded employer securities. Until the agency completes proposed regs on diversification rights of employees for employer securities, the plans may continue to follow the 2007 transition rule for grandfathered investments stated in Notice 2006-107.

The PPA amended Code Sec. 401(a) by requiring defined contribution plans to allow certain employees to split their investment in employer securities under the plan into other diversified investments. Although the plan may restrict the frequency of exercising this right to a reasonable period, occurring no less than quarterly, the plan may not discriminate against the diversification right by imposing restrictions on the divestment of employer stock that are not applied to the employee's other investments under the plan.

In Notice 2006-107, the IRS announced that plans in existence on December 18, 2006 could impose some discriminatory restrictions on exercise of the diversification right for employer stock until the end of calendar year 2007. However, because the IRS has yet to complete its planned regs on diversification rights, the agency has extended this transitional rule for periods after 2007 until the regs go into effect.

Notice 2008-7, FED ¶46,206; TRC RETIRE: 3,214.40.

create a second class of stock, nor did corporate distributions to all shareholders on an as-needed basis predicated on ownership percentage. Therefore, the corporation's pass-through status was not terminated.

Minton, TC, CCH Dec. 57,207(M), FED ¶47,906(M); TRC SCORP: 162.

Jurisdiction

The Tax Court lacked jurisdiction to review IRS actions with respect to abatement of interest where the IRS had not issued a notice of deficiency or notice of final determination. The Letter 853C

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issued to the taxpayers by the IRS denying their request for penalty relief was not a notice of final determination not to abate interest.

Ward, TC, CCH Dec. 57,209(M); FED ¶47,908(M); TRC IRS: 33,410.

Jurisdiction did not exist to consider partnership items or affected items while a partnership proceeding was pending; however, jurisdiction did exist over itemized deductions claimed by married taxpayers the following year. The deductions were not claimed on the partnership return or claimed by the taxpayers as their distributive share of any deduction on the partnership return.

Bedrosian, TC, CCH Dec. 57,210(M), FED ¶47,909(M); TRC PART: 60,056.

The Tax Court lacked jurisdiction to re-determine married taxpayers' deficiency attributable to a partnership interest because they paid part of the deficiency before the issuance of the affected items notice.

Bedrosian, TC, CCH Dec. 57,211(M), FED ¶47,910(M); TRC LITIG: 6,100.

Retirement Plans

The IRS has announced the procedures for electing an alternative funding schedule for certain defined benefit plans sponsored by an employer that is a commercial passenger airline or whose principal business is providing catering services to a commercial passenger airline.

Announcement 2008-2, FED ¶46,216; TRC RETIRE: 30,156.

Sham Transactions

A married couple's tiered business trust arrangement was properly disregarded for federal tax purposes because it was a sham that lacked economic substance. Also, the wife was not entitled to innocent spouse relief because of her active participation in the sham trust scheme.

Richardson, CA-11, 2008-1 USTC ¶50,101; TRC INDIV: 18,054.10.

The Tax Court properly determined that the income of an unincorporated business "trust" was attributable to an individual

IRS Provides Transitional Relief For Type III Supporting Organizations

Transitional relief and filing procedures are now available for certain charitable trusts that fail to satisfy the responsiveness test for Type III supporting organizations. The relief reflects changes made by the *Pension Protection Act of 2006 (PPA)*.

Transitional relief. Charitable trusts that became private foundations due to changes made by the PPA should file Form 990, Return of Organization Exempt from Income Tax, for tax years beginning before January 1, 2008. Normal due dates and submission rules for filing Form 990 apply.

Filing procedures. Charitable trusts that became private foundations due to changes made by the PPA must file Form 990-PF, Return of Private Foundation, for taxable years beginning on or after January 1, 2008. Such trusts must file paper Form 990-PF and write "Notice 2008-6 status change" at the top of the form. Normal due dates and submission rules for filing Form 990-PF otherwise apply.

■ **Comment.** "This is significant relief for those organizations impacted by the changes made by the PPA," Catherine Wilkinson, a partner with Steptoe & Johnson LLP, Washington D.C. told CCH.

References: Notice 2008-6, FED ¶46,219; TRC EXEMPT: 21,208.

who set up the trust because the trust was a sham. In addition, depreciation and charitable deductions were properly disallowed because the taxpayer failed to substantiate them. Finally, the negligence penalty was properly imposed because the taxpayer had no reasonable cause for his failure to report his business income.

Sparkman, CA-9, 2008-1 USTC ¶50,102; TRC INDIV: 63,102.25.

Income

A married couple was entitled to exclude gain from the sale of their home under Code Sec. 121, as the Tax Court found both the husband and wife used it as their principal residence. However, the couple was not allowed to exclude gain from the sale of a lot bordering the residence, because they were not the lot's owners.

Ramsay, TC, CCH Dec. 57,203(M), FED ¶47,902(M); TRC REAL: 15,156.05.

Deductions

Three related couples were denied deductions for non-cash charitable contributions pursuant to Code Sec. 170 and for business expenses under Code Sec. 183. The couples failed to comply with the regulations regarding non-cash charitable contributions. In addition, two of the couples were denied business expense deductions because they did

not pursue their farming activities with a profit motive.

Smith, TC, CCH Dec. 57,202(M), FED ¶47,901(M); TRC INDIV: 51,456.20.

An individual could not deduct gambling losses beyond the amount conceded by the IRS due to her failure to provide any substantiation. The taxpayer argued that because she was in debt at the end of the year, her losses from playing slot machines must have exceeded her gains. Because the taxpayer presented no credible evidence to corroborate this theory, the *Cohan* rule was inapplicable, and the Court did not estimate the taxpayer's gambling losses.

Jackson, TC, Dec. 57,208(M), FED ¶47,907(M).

Stock Options

The IRS recently published its plans to issue regulations governing a corporation's responsibilities under Code Sec. 6039 to file an information return with the agency when employees exercise options to purchase stock.

Notice 2008-8, FED ¶46,209; TRC PAYROLL: 3,356

Enrolled Actuaries

Final regs revise the user fees for individuals initially applying for enrollment as an enrolled actuary and for individuals who are renewing their enrollment.

T.D. 9370, FED ¶47,005; TRC IRS: 3,204.15

Practitioners' Corner

Client Letter: Congress Passes AMT Patch And More Year-End Tax Legislation

Congress passed a much-anticipated AMT patch and foreclosure relief shortly before its holiday recess along with many other tax-related bills. Practitioners can use the following Client Letter to inform clients about the patch and the other new tax acts and invite them to contact their offices for more details.

Dear Client:

Happy New Year! For many of you, the new year is a little brighter now that Congress has passed an alternative minimum tax (AMT) "patch." The patch and a host of other bills passed Congress just before lawmakers left Washington, D.C. in late December for their holiday recess.

AMT patch

The patch is a temporary fix to a big problem. Nearly 40 years ago, Congress created the AMT so that a handful of very wealthy taxpayers would not avoid taxation. The idea worked well at the beginning but over time inflation has eroded the value of the dollar. That handful of very wealthy taxpayers has grown to be many millions. Even more taxpayers, especially taxpayers with household incomes of between \$75,000 and \$100,000, would have been liable for the AMT this year but for the patch. The Treasury Department predicted that without the patch, up to 25 million taxpayers would face an average tax increase of \$2,000 for the 2007 tax year.

The patch prevents the AMT from spreading by giving taxpayers higher exemption amounts and allowing them to use most nonrefundable personal credits to offset AMT liability for the 2007 tax year. The 2007 AMT exemption amounts are \$44,350 for single taxpayers and heads of household; \$66,250 for married couples filing jointly; and \$33,125 for married couples filing separately. These

amounts are slightly higher than the 2006 exemption amounts, which is also good news for many taxpayers.

The new law allows taxpayers to use most nonrefundable personal credits to

offset AMT liability. These include the HOPE and Lifetime Learning credits and the District of Columbia first-time homebuyers' credit. The adoption, child and saver's credits were already allowed under prior law to the full extent of a taxpayer's regular tax and AMT.

"Lawmakers still have a lot of tax legislation on their agenda when they return from their holiday recess."

offset AMT liability. These include the HOPE and Lifetime Learning credits and the District of Columbia first-time homebuyers' credit. The adoption, child and saver's credits were already allowed under prior law to the full extent of a taxpayer's regular tax and AMT.

Calculating the AMT is far from simple. In fact, it is one of the most complicated provisions in the U.S. Tax Code. The patch is also very complex. Our office is ready to help you. If you have any questions about the patch and AMT liability, please give us a call today.

2008 filing season

The IRS needs time to reprogram its computer systems for the patch. According to top IRS officials, the agency could need as many as seven to 10 weeks to reprogram its systems for the patch. The start of the 2008 filing season is already less than seven to 10 weeks away. Consequently, return processing and refunds could be delayed. The IRS has promised to get its computer systems reprogrammed as quickly as possible and to ensure that they process returns with 100 percent accuracy.

Some filers may have to wait until February 11, 2008 to file their returns, the IRS has indicated. Everyone else, according to the IRS, should not experi-

ence delays. We'll monitor the latest news from the IRS and keep you updated. The IRS has already revised many of the 2007 tax forms that are impacted by the AMT patch.

According to the IRS, taxpayers filing the following forms may experience delays. The forms are Form 8863, Education Credits; Form 5695, 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. Additional forms are affected by the AMT patch but the IRS has indicated that it has successfully reprogrammed its computer systems to begin processing those forms.

The IRS Oversight Board has estimated how long potential delays may be and how many taxpayers will be affected. The Oversight Board is a group of individuals that do exactly what their title says...they oversee the agency. According to the Oversight Board, if the filing season starts on January 28, 2008, approximately 6.7 million tax returns will be delayed and \$17 billion in refunds will not be issued. If the filing season starts on February 4, 2008, roughly 15 million tax returns will be delayed and \$39 billion in refunds will not be issued. If the filing season starts on February 18, 2008, nearly 38 million tax returns will be delayed and \$87 billion in refunds will not be issued.

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Washington Report

by the CCH Washington News Bureau

AMT patch, foreclosure help and more are now law

Shortly before its holiday recess, Congress passed several tax bills. The *Tax Increase Prevention Act of 2007* (H.R. 3996) extends the AMT patch for the 2007 tax year. The *Mortgage Forgiveness Debt Relief Act of 2007* (H.R. 3648) includes tax relief for debt forgiveness and mortgage insurance payments. The *Energy Independence and Security Act of 2007* (H.R. 6) contains two tax provisions. The *Virginia Tech Victims and Family Assistance Act* (H.R. 4118) excludes from income payments from a special memorial fund to victims of the Virginia Tech tragedy in April 2007. Congress also passed the *Technical Corrections Act of 2007* (H.R. 4839) and the *Consolidated Appropriations Act, 2008* (H.R. 2764). Finally, an untitled bill (*Sen. 2436*) clarifies the term of the IRS Commissioner. Several unfinished bills, most notably a comprehensive farm bill, a package of extenders and military tax relief, are likely to be taken up early this year. *For more details see page 1 in this issue and CCH's Tax Briefing online at <http://tax.cchgroup.com/Tax-Briefings>.*

Treasury explores corporate tax relief

A major report detailing several approaches for reforming the U.S. business tax system to improve global competitiveness was released by Treasury on December 20. Treasury Assistant Secretary for Tax Policy Eric Solomon clarified that the report doesn't advocate any approach or legislation, but is intended to outline several broad possible approaches to, and inform the public policy debate on, business tax reform. He underscored that the goal of this project "is to look at the big picture." The U.S. has the second-highest corporate tax rate in the industrialized world.

Solomon stressed that the approaches outlined in the report affect the non-corporate sector as well. "This isn't just about corporations." The business tax reforms outlined in the report affect other enterprises as well, including S corporations, limited liability partnerships and sole proprietorships.

Three specific approaches were highlighted: (1) Replacing the business income tax system with a broad-based business activity system (BAT); (2) Broadening the business tax base and either lowering the statutory business tax rate or providing a faster write-off of the cost of investment; and (3) Changing the taxation of corporate income by changing the tax treatment of corporate capital gains and dividends.

In related news, the International Tax Policy Forum and Urban-Brookings Tax Policy Center in Washington, D.C., on December 18, held a conference on corporate taxes. During the conference, the panel of economists—including individuals from Treasury—arrived at a consensus, "there needs to be a change in the way corporate income tax burdens are distributed."

Eric Toder, senior fellow, Urban Institute, and former Treasury deputy assistant secretary for tax analysis, questioned if government change of the distribution of the U.S. corporate tax burden would have any effect.

FASB proposes FSP on FIN 48 delay for nonpublic enterprises

Following up on its decision to delay the effective date for FIN 48, Accounting for Uncertainty in Income Taxes, for nonpublic enterprises, FASB released a proposed staff position (FSP) on December 20 (proposed FSP FIN 48-b). The proposed FSP notes that all nonpublic enterprises, and not just pass-through entities and nonprofit organizations, may be eligible to take advantage of the delayed effective date.

When FIN 48 was first issued, many practitioners were unaware that FIN 48 was applicable to nonpublic enterprises, especially pass-through entities. Groups such as the Private Company Financial Reporting Committee (PCFRC) asked FASB to delay the effective date of FIN 48 for nonpublic companies to give them more time to understand and apply the new standard. At its November 7, 2007 meeting, FASB decided unanimously to delay the effective date of FIN 48 for nonpublic enterprises that had not already implemented the standard. FASB is requesting comments on the FSP. The deadline for submitting written or electronic comments is January 18, 2008.

Treasury official describes COBE regs

Marc Countryman from Treasury's Office of Tax Legislative Counsel announced at a December 18 District of Columbia Bar Association event that Treasury and the IRS will issue a notice providing transition relief from the effective date of the loss disallowance regs. Stock sales to an unrelated party made under a binding contract in effect before the regs' effective date will be governed by the existing rules, Countryman indicated. Treasury is working on final regs and may be able to issue them within the next several months, he told CCH.

The program focused on the continuity of business enterprise (COBE) regs issued in October 2007. Countryman noted that the transaction must meet either asset COBE, which requires the acquiring corporation to maintain a sufficient percentage of the target corporation's assets, or business COBE, which requires the acquiring corporation to retain a portion of the target's historical business. Countryman said that Reg. §1.368-1(d), which solely relates to COBE *proper*, is a rule and not just a safe harbor.

Practitioners' Corner

Continued from page 9

Foreclosure relief

The housing boom in many areas of the country is in danger of becoming a housing bust. Problems in the lending industry, especially with so-called sub-prime mortgages, have contributed to the slide in home sales and home values. Congress and the Bush Administration have proposed a variety of measures to help homeowners who are caught in the mortgage meltdown. One measure is in the recently-enacted *Mortgage Forgiveness Debt Relief Act of 2007*.

When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the mortgage debt, the Tax Code treats the cancelled debt as taxable income to the taxpayer. The new law temporarily excludes from taxation discharges involving up to \$2 million of indebtedness (\$1 million for a married taxpayer filing a separate return) secured by a principal residence and incurred in the acquisition, construction or substantial improvement of the residence.

Let's take a look at an example. Cara's principal residence is subject to a \$300,000 mortgage debt. Cara's creditor forecloses in 2008. The residence is sold for \$240,000 in satisfaction of the debt later that year. Cara has \$60,000 in income from the discharge of indebtedness. Before the new law, the \$60,000 would have been includible in Cara's gross income. Now it is exempt.

The new law also addresses mortgage workouts. Sometimes, a mortgage workout or renegotiation may result in forgiveness of indebtedness income that would be taxable. The new law helps these taxpayers by giving them a full exclusion, too.

The exclusion in the new law is only temporary. Taxpayers have three years...until December 31, 2009... to take advantage of the change. The exclusion is also retroactive to January 1, 2007.

If you have any questions about foreclosure relief, give our office a call. We'll explain the fine points of the new law and explore if it can benefit you. We'll also keep an eye on further developments to help taxpayers facing foreclosure and reforms for the lending industry when Congress returns to work after its holiday recess.

Mortgage insurance deduction

In addition to foreclosure help, Congress also extended the itemized mortgage insurance deduction for three years. If you're unsure if your mortgage insurance qualifies, give our office a call. We'll let you know.

Survivor's home sale exclusion

The new law may also help some recently-widowed individuals. The new law extends the time in which a surviving spouse may use the joint-filers' \$500,000 home sale gain exclusion before being treated as a single individual who is entitled to the \$250,000 home sale exclusion. As of January 1, 2008, the sale of a residence that had been jointly owned and occupied by the surviving spouse and the deceased spouse is entitled to the \$500,000 exclusion if the sale occurs no later than two years after the death of the individual's spouse. Some special rules about use and occupancy also apply.

Tax acts

As if the AMT patch and foreclosure help weren't enough last-minute tax legislation, Congress also passed a package of technical corrections to past tax laws, tax relief for volunteer emergency responders, an energy bill with some tax-related provisions, legislation to clarify the term of the IRS Commissioner, a bill to exclude memorial fund payments from gross income for the victims of the 2007 Virginia Tech tragedy, and an IRS budget for FY 2008.

Congress gave the IRS more money for enforcement in the agency's FY 2008

budget. The IRS is under great pressure from Congress to close the tax gap. That's the difference between what taxpayers owe and what they actually pay. The IRS estimates that the tax gap is roughly \$300 billion. One of the IRS' most controversial initiatives to help close the tax gap is outsourcing tax collection. The IRS has contracted with several private collection agencies to work on what it calls minor cases, but it may expand the program to more substantial cases. The House voted to end outsourcing when it passed an IRS appropriations bill. However, the final appropriations bill does not eliminate the program.

Looking ahead

Lawmakers still have a lot of tax legislation on their agenda when they return from their holiday recess. The House and the Senate have passed different versions of a military tax relief package. They also have passed different versions of a farm bill, which includes many farm-related tax breaks. Lawmakers are expected to iron-out the differences in both of these bills in early 2008. Congress also may pass a package of extenders. These are popular but temporary tax breaks, such as the state and local sales tax deduction, the higher education tuition deduction and the teacher's classroom expense deduction. Congress could also revisit some of the consumer tax incentives that were dropped from the final energy bill, including extending some tax breaks for energy-efficient improvements to your home. There's also talk on Capitol Hill of holding hearings on abolishing the AMT. We'll be sure to keep you posted of all the important tax legislative developments in 2008.

As always, please do not hesitate to contact us if you have any questions about these new tax laws or pending bills. Meanwhile, we'll be watching for more developments to help you plan a tax strategy that meets your needs.

Sincerely,

Compliance Calendar

■ January 4

Employers deposit Social Security, Medicare, and withheld income tax for January 1.

■ January 9

Employers deposit Social Security, Medicare, and withheld income tax for January 2, 3 and 4.

■ 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 16

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

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

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

Conferences

January 8: CCH presents a live audio seminar on Code Sec. 199 developments and opportunities for passthrough entities. For more information call (800)775-7654 or visit tax.cchgroup.com.

January 10-11: The American Institute of Certified Public Accountants (AICPA) sponsors a conference on international tax issues in Washington, D.C. To register or for more information call (888) 777-7077 or visit www.cpa2biz.com.

January 14-18: The University of Miami School of Law presents the 42nd Annual Heckerling Institute on Estate Planning in Orlando, Florida. For more information visit www.law.miami.edu or call (303)284-4762.

January 16: The District of Columbia Bar Association's Taxation Section hosts a program on like-kind exchanges in Washington, D.C. For more information call (202) 626-3463 or visit www.dcbbar.org.

January 17-19: The American Bar Association (ABA) Section of Taxation presents its 2008 Midyear Meeting in Lake Las Vegas, Nevada. To register or for additional information visit www.abanet.org or call (202) 662-1000.

January 20-23: The AICPA sponsors a personal financial planning conference in Las Vegas, Nevada. For additional information call (888) 777-7077 or visit www.cpa2biz.com.

January 28-29: The Council for International Tax Education (CITE) presents a program on the latest IRS tax reporting requirements for U.S. companies with foreign operations in San Diego. The same conference will be held in Fort Lauderdale, Fla. on February 11 and 12. To register or for more information visit www.citeusa.org or call (914) 328-5656.

January 29: The District of Columbia Bar Association's Taxation Section presents a program on recent issues of interest to employee benefits practitioners in Washington, D.C. For more information call 202-626-3463 or visit www.dcbbar.org.

February 21-23: American Law Institute-American Bar Association (ALI-ABA) hosts a program entitled Representing the Growing Business: Tax, Corporate, Securities, and Accounting Issues in Pasadena, Calif. To register or for additional information visit www.ali-aba.org or call (800) CLE-NEWS.

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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