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Senate Set To Pass Rival Economic Stimulus Package; Conference Negotiations Expected Next

◆ H.R. 5140

All eyes are on the Senate at press time to learn the makeup of the economic stimulus package. A package of individual rebates and business incentives cleared the Senate Finance Committee (SFC) on January 31 with the full Senate expected to vote on it before mid-February. While similar to the economic stimulus bill already passed by the House (*H.R. 5140*), the SFC version is more extensive and controversial. Any differences between the two bills must be resolved in a conference committee, which will then recommend a single package for passage by both the House and Senate.

■ **CCH Take Away.** Senate Majority Leader Harry Reid, D-Nevada, has set up a complex series of votes on the stimulus package to ensure that Democratic priorities, such as extending individual rebates and unemployment insurance, are not subject to a Republican filibuster. The strategy is risky because it requires every Democrat to be present to vote on the bills (and not on the presidential campaign trail) and could become bogged down in amendments from the floor.

Rebates

The House version gives most individuals \$600 rebates and married couples filing jointly \$1,200 rebates (with lesser amounts for individuals with at least \$3,000 of

earned income). The SFC version extends the rebates to seniors and disabled veterans but at lesser amounts: \$500 for individuals and \$1,000 for married couples filing jointly. The SFC version treats Social Security and veterans' disability benefits as taxable income only for purposes of the rebates.

The SFC version, like the House version, caps the rebates for higher income taxpayers. The phase-out amounts in the SFC version are \$150,000 for individuals and \$300,000 for married couples filing jointly (these amounts are twice the phase-out amounts in the House version).

Business incentives

The SFC version allows taxpayers to elect one of three business incentives: (1) extended net operating loss (NOL) carrybacks; (2) bonus depreciation; or (3) enhanced Code Sec. 179 small business expensing.

NOLs. The SFC version increases the general carryback period from two to five years for NOLs in 2006 or 2007 along with suspending the 90 percent limitation on the use of any alternative-tax NOL deduction attributable to carrybacks from tax years ending during 2006 or 2007 and carryovers to tax years ending during 2006 and 2007.

Bonus depreciation. Taxpayers would be eligible for 50 percent bonus depreciation but in the form of 25 percent in the first year and 25 percent in the second year with certain exceptions. Qualifying property generally must be placed in service before January 1, 2009.

The remaining cost is recovered under
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Bush Unveils Final Federal Budget Proposals; Endorses Revision Of Preparer Penalty Standard

◆ Treasury "Blue Book" on FY 2009 Revenue Proposals

For the last time, President Bush has submitted federal budget proposals to Congress. Bush's \$3.1 trillion FY 2009 budget contains many familiar tax cut proposals and a few surprises. For practitioners, one of the biggest surprises is the administration's decision to endorse equalizing the preparer and taxpayer penalty standards.

■ **CCH Take Away.** "This budget will be quickly forgotten," Sen. Kent Conrad, D-N.D., chair of the Senate Budget Committee predicted. Conrad's prediction is likely to come true. The president would have had trouble making his 2001 tax cuts permanent in good economic times, yet alone in today's shaky economy. However, some of the less controversial proposals, such as extending some temporary tax breaks and revising the return preparer standard, could pass before November's presidential election. Surprisingly, the president's proposals to close the tax gap went nowhere last year despite many lawmakers fuming over the more than \$300 billion in lost revenue. The projected \$400 billion federal budget deficit might make lawmakers take a second look at the

tax gap proposals.

■ **Comment.** President Bush used his FY 2009 budget to again call for quick passage of an economic stimulus package. See the article on page 61 for more details.

Preparer standard

Few issues have vexed practitioners as much as the current controversy over the preparer penalty standard. Last year, Congress revised the Code Sec. 6694(a) standard. A preparer must have a reasonable belief that a nonabusive, undisclosed position will more-likely-than-not be sustained on the merits to avoid a penalty.

Bush's FY 2008 budget calls for Congress to remove the more-likely-than-not language from Code Sec. 6694(a). Instead, the preparer standard would be substantial authority; the same standard that applies to taxpayers.

AMT patch

Bush also proposed another AMT patch, this time for 2008, rather than repealing the AMT. The proposal would increase the exemption amounts to \$46,250 for single individuals and heads of household; \$70,050 for married couples filing jointly; and \$35,025 for married couples filing separately.

■ **Comment.** "It's kicking the game

down the road," Robertson Williams, principal research associate at the Tax Policy Center, told CCH. No one thinks keeping the AMT is a good idea but the cost of repeal, estimated at more than \$800 billion, has left Congress with no alternative than "patching" it every year.

Lower individual, dividend and capital gains tax rates, along with marriage penalty relief and repeal of the federal estate tax, will all sunset after December 31, 2010. Bush renewed his call for Congress to make them permanent at a price tag of more than \$2 trillion.

Charitable giving

Two years ago, Congress temporarily allowed taxpayers age 70½ and older to make tax-free withdrawals from their IRAs for charitable giving purposes. This provision was popular but expired at the end of 2007. Bush called for making this treatment permanent. The president also urged Congress to make permanent the temporary deduction for corporate donations of computers and expand the deduction for donations of food inventory.

■ **Comment.** "The IRA charitable rollover enabled many individuals to increase their philanthropy and for non-itemizers it was the equivalent of a charitable deduction," Conrad Teitell, Cummings & Lockwood, LLC, Stamford, Conn., told CCH. Teitell explained that legislation has been introduced in Congress to expand the treatment to also allow IRA rollovers for charities' life income plans at age 59½ or older.

Stimulus Package

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otherwise applicable rules for computing depreciation.

■ **Expensing.** Both versions enhance Code Sec. 179 small business expensing. The deductible amount would increase to \$250,000 and the threshold for reducing the deduction would increase to \$800,000.

Property generally would have to be placed in service in 2008.

■ **Comment.** The business incentives will have a real impact on small business spending as it is still early in the year and many businesses are just starting to make their investment decisions for 2008, Bill Rys, tax counsel for the National Federation of Independent Business, told CCH.

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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Tax gap

The tax gap proposals are generally same ones proposed for FY 2008 that Congress did not enact. The proposals include requiring basis reporting on security payments, information reporting on merchant payment card reimbursements and increased information return penalties. One new proposal would impose an additional penalty for failing to report foreign trust income. Bush

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Effective Date Of New Funding Regs For Single Employer Pension Plans Pushed Back To 2009

◆ Notice 2008-21, TDNR HP-794

The IRS announced that it is pushing back the effective date of final regs on funding that will apply to single employer pension plans under Code Sections 430 and 436. The regs, proposed to take effect in 2008, will not take effect until plan years beginning on or after January 1, 2009.

■ **CCH Take Away.** Jan Jacobson, director, retirement policy for the American Benefits Council, told CCH that the IRS had provided informal notice that it intended to take this action. Notice 2008-21 formalizes its action regarding the effective date. Earlier in 2007, the IRS issued proposed regs under Code Sec. 430 on mortality tables (NPRM REG-143601-06) and on benefit restrictions (NPRM REG-113891-07). On December 28, the IRS proposed regs on funding and hybrid rules (NPRM REG-104946-07) with an effective date of 2009. At that time, the IRS said it would apply the 2009 effective date to the regs on mortality tables and benefit restrictions.

Reasonable interpretation

Code Sections 430 and 436, both enacted in the *Pension Protection Act of 2006 (PPA)*, were scheduled to take effect January 1, 2008. The IRS has no discretion but to keep that deadline firm. However, while plans must comply with the statute for plan years beginning in 2008, they no longer are required to follow the proposed regs. The

IRS will not challenge a reasonable interpretation of the statute. Taxpayers can rely on the proposed regs or another reasonable interpretation.

■ **Comment.** Code Sec. 430 changes the funding requirements for single employer defined benefit plans. Code Sec. 436 limits distributions and benefit accruals for underfunded plans.

2008 requirements

For 2008, the IRS indicated that it will not challenge a reasonable interpretation except for certain requirements:

- Employer-specific substitute mortality tables may be used as provided under the proposed regs only if the employer obtains IRS approval using Rev. Proc. 2007-37;
- Methods of estimating the funding target attainment percentage (FTAP) for the preceding year (2007 in this case) can only be used for applying the benefit limitations of Code Sec. 436 if the methods are permitted in Treasury regs (final regs will permit the estimation methods in the proposed regs to be used for 2008);
- Benefit restrictions under Code Sections 436(d) (accelerated distributions) and 436(e) (benefit accruals) must begin, as provided in the proposed regs, on the fourth month of the plan year if the plan does not have an actuary's certification of the plan's adjusted FTAP (AFTAP); and

■ Plans must use fair market value and averaging only as permitted by the proposed regs to determine the value of plan assets under Code Sec. 430(g)(3).

■ **Comment.** Jacobson commented that this asset valuation provision is the "big thing" in these 2008 requirements and is controversial. Notice 2008-21 still requires averaging for 2008, like the proposed regs. Plans in the past have used "asset smoothing," which yields a higher asset value than averaging.

Small plans

Notice 2008-21 provides transition rules for small plans with a valuation date on the last day of the plan year for years beginning in 2006-2008. The rules will provide a method for determining the plan's FTAP for the 2007 plan year, which can be used to apply the benefit limitations of Code Sec. 436 during 2008.

■ **Comment.** A small plan has 500 or fewer participants.

Comments requested

The IRS requested comments on actions it might take if Congress passes technical corrections to the *PPA* that provide the authority to prescribe rules for plans whose funding valuation date is not on the first date of the plan year. The rules would concern the determination and certification of the AFTAP.

References: FED ¶46,283; TRC RETIRE: 30,000; 30,622.

Budget Proposals

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also called on Congress to extend the statute of limitations when a state tax adjustment affects federal tax liability.

■ **Comment.** The basis proposal could help practitioners feel more confident about the basis information they receive from clients, Thomas Ochenschlager, AICPA Vice President – Taxation told CCH. "The proposal would elimi-

nate some of the confusion taxpayers often have about basis."

Extenders

Congress is likely to take up a package of extenders, popular but temporary tax breaks, this year. Many of the extenders expired at the end of 2007. Bush urged Congress to extend some and to make some permanent. Bush wants two very popular extenders, the higher education tuition deduction and the research tax credit, made permanent. Among the incentives that would be extended are the

New Markets Tax Credit, military tax breaks and some Subpart F temporary provisions.

More proposals

- New standard deduction for health insurance costs;
- New retirement savings options;
- Expand health savings accounts (HSAs);
- Repeal the federal excise tax on local telephone service; and
- Tighten earnings stripping rules for corporate inversions.

IRS Finds Anti-Backloading Rules Not Violated By Cash Balance Plan Conversion; Provides Relief At Least Until 2009

◆ *Rev. Rul. 2008-7, TDNR HP-796*

A recent IRS ruling concluded that the anti-backloading rules in Code Sec. 411(b)(1)(A)-(C) were not violated by a defined benefit plan that converted from a traditional benefit formula to a cash balance formula in 2002. The IRS allowed the payment of retirement benefits after conversion that were the greater of the benefits under the old plan and the benefits under the new cash balance formula. It also announced general relief from “backloading” and the “greater of” formula for plan years beginning before 2009, as well as relief being planned for post-2008 years.

■ **CCH Take Away.** “Some of the positions in the ruling are bound to be controversial even though they don’t come as a complete surprise,” Kurt Lawson of Pillsbury Winthrop Shaw Pittman, LLP, Washington D.C. told CCH. “The ruling confirms that the IRS does not think an immediate wear-away (where the plan’s old formula is frozen at the time of the conversion) violates the 133 1/3 percent anti-backloading rule, but does think that a delayed wear-away (where the plan’s old formula is continued for a while after the conversion) can violate the 133 1/3 percent anti-backloading rule.”

■ **Comment.** The backloading rules essentially impose minimum accrual rules on defined benefit pension plans. Benefits must accrue ratably over the employee’s worklife, generally from the beginning of employment.

Backloading rules

A defined benefit plan must satisfy one of three rules for benefits accruing under the plan: the 3 percent method, the 133 1/3 percent rule, and the fractional rule.

The IRS concluded that the particular plan conversion under consideration violated the 3 percent method because its benefits, both before and after conversion, accrued over a period exceeding 33 1/3 years.

133 1/3 percent rule. This rule requires that the annual rate at which the participant accrues benefits in any later plan year cannot exceed 133 1/3 percent of the rate of accrual in the prior plan year. The IRS concluded that the plan satisfied this rule for new employees who began work after December 31, 2001; for non-grandfathered participants, whose benefits were frozen under the old formula as of December 31, 2001 but who began to accrue benefits under the new formula immediately; and for grandfathered participants age 55 and older on January 1, 2002.

The remaining grandfathered participants (age 50 to 55) violated the rule; however, they satisfied the fractional rule.

■ **Comment.** Lawson said that “according to the ruling, if the old formula is continued for any period

of time after the conversion it can’t be ignored and also can’t be tested separately for compliance with the anti-backloading rule. This analysis suggests that even permanent “greater-of” formulas could have problems.”

Later years

The IRS also announced general relief to assure that plans that have requested or received a determination letter, as well as certain other plans, will not be disqualified for plan years beginning before January 1, 2009, solely because the plan provides benefits based on the greater of two or more formulas, as long as one of the formulas would satisfy an accrual rule in Code Sec. 411(b)(1).

Further, the IRS announced that it expects to propose reg amendments, to be effective for plan years beginning on or after January 1, 2009, that will allow separate testing of backloading with respect to the situation presented in the ruling and other “greater of” formulas.

References: FED ¶¶46,286, 46,287; TRC RETIRE: 15,100.

IRS Discovers Scams About Expected Tax Rebates

Scam artists are using the promise of expected tax rebates to trick taxpayers into revealing their personal and financial information, the IRS recently warned. The rebate scams join the growing roster of phishing scams on the internet. The IRS expects these scams to continue through the end of the return filing season and beyond.

■ **Comment.:** Taxpayers who receive questionable e-mails or phone calls should notify the IRS by sending an e-mail to phishing@irs.gov. The IRS has been notified of almost 33,000 scam e-mails, reflecting more than a thousand different incidents.

Tax Rebates. At least one scam is using the word to lure taxpayers into revealing their financial information. A taxpayer receives a phone call from an individual claiming to be an IRS employee. The perpetrator informs the taxpayer of his or her eligibility for a rebate and requests the taxpayer’s bank account information for direct deposit of the rebate. The taxpayer is told that he or she will not receive a rebate check without the account information.

The IRS does not contact taxpayers by telephone to obtain personal and financial information. Nor does the agency send unsolicited, tax-account related e-mails to taxpayers.

IR-2008-11, FED ¶46,279; TRC IRS: 3,154.15.

Broad Definition Of “Prior Involvement” Disqualifies Appeals Officer; Tax Court Reversed

◆ *Cox, CA-10, January 30, 2008*

In a case of first impression, the Court of Appeals for the Tenth Circuit has held that an Appeals officer’s consideration of subsequent tax liabilities, for which he had already made an adverse determination, during a collection due process (CDP) hearing for a prior tax year, constituted impermissible prior involvement in the case. The Tenth Circuit reversed the Tax Court which had upheld the IRS’s narrow interpretation of prior involvement.

■ **CCH Take Away.** The Tenth Circuit took a very expansive view of the word involvement, finding that it covered awareness and consideration of self-reported liabilities. Another circuit could find, as the dissent would have, that mere consideration of a self-reported and unpaid tax liability or tangential consideration of any such conceded liability does not implicate any matter centered on the unpaid tax liability.

■ **Comment.** “It’s a victory for taxpayers in that the Tenth Circuit has come up with a fairly liberal standard for what an impartial Appeals officer is,” Kevin Planegger of the Merriam Law Firm, P.C., Denver, which represented the taxpayers in this case, told CCH. “We got the impression very early that we were not going to get a fair second hearing,” Planegger said. Planegger noted that it would have been easy for the IRS to have assigned the case to another Appeals officer. If it had, the case might never would have gone to the Tenth Circuit.

■ **Comment.** The independence of Appeals was recently questioned in a survey by the ABA Taxation Section. A number of practitioners reported their impressions that some Appeals officers were under pressure to close cases quickly and this pressure could compromise their independence.

Background

The taxpayers, a married couple, requested a CDP hearing after receiving a notice of intent to levy regarding their unpaid 2000

taxes. To be considered for collection alternatives, the taxpayers were told by an Appeals officer that they needed to file all tax returns for which they were liable. The couple filed returns for 2001 and 2002, which the Appeals officer considered in his review. The Appeals officer determined that the taxpayers were not eligible for an installment agreement or an offer-in-compromise and levy was appropriate.

Because the taxpayers filed their 2001 and 2002 returns without payment, the IRS issued a notice of intent to levy with respect to those liabilities. The couple again requested a CDP hearing and the same Appeals officer was assigned to their case.

The taxpayers requested that the Appeals officer remove himself from the case. He did not and, as in the first case, determined that levy was appropriate.

Tax Court

Before the Tax Court, the taxpayers argued that they did not receive a fair CDP hearing for 2001 and 2002 by an impartial Appeals officer with no prior involvement in the case. The Tax Court found that the Appeals officer’s consideration of the taxpayers’ 2001 and 2002 self-reported liabilities was not prior involvement in the case.

Tenth Circuit

Code Sec. 6330 requires that taxpayers receive a fair hearing conducted by an

impartial Appeals officer. An impartial Appeals officer is one who has no prior involvement with respect to the unpaid tax specified in the CDP notice.

The Tax Code does not define “no prior involvement,” the court found. However, IRS regs from 2004 defined prior involvement as including participation or involvement in an Appeals hearing (other than a CDP hearing held under either Code Sections 6320 (pre-lien) or 6330 (pre-levy)) that the taxpayer may have had with respect to the tax and the tax periods shown on the CDP notice.

■ **Comment.** A 2006 version of the reg provides that prior involvement exists only when the taxpayer, the tax and the tax period at issue in the CDP hearing also were at issue, was invalidated by implication.

The IRS argued that “no prior involvement” should be interpreted as applying only to an Appeals officer who had not previously conducted a hearing other than a Code Sec. 6320 or 6330 hearing for the taxpayer regarding the collection of the same unpaid tax. The court found that Congress did not intend the IRS’s narrow interpretation. Congress contemplated only one scenario where an Appeals officer with prior involvement in the taxpayer’s case could conduct a subsequent CDP hearing; that is, that the same Appeals officer can conduct a pre-lien hearing under

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FASB Grants Nonpublic Companies One-Year Delay In Applying FIN 48

FASB Staff Position, No. FIN 48-2, February 1, 2008, officially confirms what had been expected for several months: a one year deferral of the effective date of FIN 48, Accounting for Uncertain Income Tax Positions, for nonpublic enterprises, including not-for-profit organizations. Under the delay, FIN 48 will apply to annual financial statements for fiscal years beginning after December 15, 2007 (applied as of the beginning of the enterprise’s fiscal year).

To avoid complexity, the Board decided to extend the FIN 48 delay to all nonpublic enterprises (as defined in Statement 109, paragraph 289), not just tax-exempt organizations and passthroughs such as S corporations or partnerships, which especially complained that they were unprepared. There are two exceptions to the extension, however. The December 15, 2006 FIN 48 deadline remains for (1) any nonpublic entity that is a consolidated member of a public entity that applies U.S. GAAP; and (2) any nonpublic enterprise that already has issued a full set of U.S. GAAP statements using FIN 48.

IRS Regs Describe Release Of Tax Lien And Discharge Of Property To Third-Party Owners

◆ *T.D. 9378*

Recent final regs describe the procedures for the IRS to follow when an owner of property asks the IRS to release a lien on the property and discharge the property to the owner. The regs apply to a property owner who is not the taxpayer that owes the tax (“a third-party owner”). The property owner is required to deposit money with the IRS or to provide a bond, as a substitute for the IRS’s interest in the property.

■ **CCH Take Away.** The *IRS Restructuring and Reform Act of 1998 (RRA ‘98)* provides a remedy to third-party owners who may want to sell or dispose of their property that is subject to tax lien. Courts have held that a lien can attach to money held by a nondelinquent third person or a court, or to property that the taxpayer sold to a third party. The *RRA ‘98* provisions were enacted after the Supreme Court recognized the right of a third party who paid another person’s tax liability under protest to file a refund suit; otherwise, the person had no judicial remedy.

Tax lien

The IRS automatically has a lien on a taxpayer’s property for an outstanding tax liability of that taxpayer. In some cases,

the IRS may seek to impose a lien on third-party property. The IRS may also file a notice of federal tax lien to protect its interest against other creditors.

The regs implement Code Sections 6325(b)(4) (administrative procedures), 6503(f)(2) (tolling of collections statute of limitations), and 7426(a)(4) and (b)(5) (judicial procedures), which were added to the Tax Code by the *RRA ‘98*. The new regs apply to requests for a release and discharge after January 31, 2008.

The final regs made one change to the proposed regs. Code Sec. 6325(b)(4) does not apply to a property owner who is the taxpayer owing the tax that gave rise to the lien. The proposed regs did not allow the use of the discharge procedures for property co-owned by a third-party and the taxpayer who owes the tax. The final regs change this, allowing a third-party co-owner with the taxpayer to use the procedures.

Release of lien

The request for a certificate of discharge must be made to the local IRS collection official. Under Code Sec. 6325(b)(4)(A), the IRS shall discharge property from the lien within 30 days if the third-party owner deposits money or furnishes an acceptable bond equal to the IRS’s interest in the property (as determined by the IRS).

The IRS must refund any excess if it determines that the value of the taxpayer’s

property is less than it previously determined, or that the taxpayer’s property is no longer needed.

■ **Comment.** The IRS has discretion whether to make this determination and whether to refund a deposit or release a bond.

A third-party owner who obtains a certificate of discharge has 120 days to ask the IRS, or to sue in federal district court, for a determination whether the IRS overvalued the taxpayer’s property.

Collection

If no suit is filed, the IRS has 60 days to apply the deposit or to collect on the bond after the 120 days. The regs allow the IRS to take these actions after the 180 day period. At the end of the 180-day period, the IRS will no longer charge interest to the taxpayer for the amount that would have been credited to the taxpayer’s liability, and the IRS will pay interest to the third-party owner on any amount that should have been refunded.

The collection statute of limitations is suspended from the date any person becomes entitled to a certificate of discharge until the date 30 days after the earlier of:

- The date on which the IRS no longer holds any deposit or bond on the property; or
- The date that a court judgment becomes final.

References: FED ¶47,015; TRC IRS: 48,200.

Appeals

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Code Sec. 6320 and a pre-levy CDP hearing under Code Sec. 6330.

The court concluded that the Tax Court’s application of the 2004 reg was invalid. Moreover, the 2006 version was invalidated by implication.

■ **Comment.** The dissent would have found that the Appeals officer’s consideration of self-reported tax liabilities did not constitute prior involvement in the unpaid taxes.

References: FED ¶(to be reported); TRC FILEBUS 3,052.

IRS Fine-Tunes E-Filing Specs For Form 1042-S

The IRS recently announced some changes for e-filing Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding. The changes are effective for the 2007 tax year returns filed in calendar year 2008. They affect the reporting of income paid to nonqualified intermediaries or flow-through entities.

With respect to the Recipient “Q” Record of the form, the following changes have been made:

- A new state code field was added to positions 643-644;
- Additional instructions were added to the country code positions 647-648;
- An explanatory note was added for nominees that are Code Sec. 1447 withholding agents; and
- The field title was changed and additional instructions were added to the postal code/zip code positions 649-657.

Additionally, some of the Canadian province codes were changed.

Ann. 2008-6, FED ¶46,285; TRC FILEBUS: 12,302.20.

Accounting Partner In Firm Merger Not Allowed To Delay Immediate Tax On Stock Contrary To Agreement

◆ *M.J. Fletcher, DC Ill., January 15, 2008*

A district court has rejected the argument that the IRS cannot recover a refund based on an amended return that claimed a partner in an acquired tax and accounting firm should not be taxed immediately on all the stock received in the acquisition, even though much of it had some restrictions on its sale. Transaction documents, read and signed by the taxpayer, and additional extrinsic evidence indicated that the transaction participants intended to realize income from the entire value of their interest in the transaction in the year the deal closed. Absent fraud or strong proof of the parties' contrary intention, the court would not upset the tax allocations agreed to in the transaction agreement.

The transaction

The taxpayer was a partner in a large tax and accounting firm, a cash method tax-

payer. Her firm sold part of its business in return for shares of the acquiring company. As a result of the transaction, the taxpayer and other partners received restricted stock shares in the newly formed company. Upon closing in 2000, there was to be an immediate sale of 25 percent of the taxpayer's stock in the company and the 75 percent balance transferred to her account. The documents stipulated that the taxpayer was to report the transaction as a taxable sale of her entire \$2.5 million partnership interest in the year of closing, despite restrictions placed on her ability to sell the stock.

Erroneous refund

The court rejected the taxpayer's arguments that the provisions of the documents requiring the realization of income for the entire amount of stock violated public policy and were inconsistent with stock transfer restrictions set

forth in the transaction documents. The court reasoned that respect for a strict interpretation of Code Sec. 451 was not the only public policy consideration in this case; the ability of parties to contract freely and predict reliably the tax consequences of their business decisions was also critical.

Undue influence and duress

The court also found that the taxpayer was not under duress or undue influence when she entered into the transaction. The taxpayer was unable to overcome with "strong proof" the presumption that the tax consequences of the deal were not intended by the parties to be as stated in the documents. Moreover, she failed to provide testimony or other evidence that she would have been fired if she did not agree to the transaction.

References: FED ¶(to be reported); TRC IRS: 33,312.

Tax Briefs

Jurisdiction

Jurisdiction was lacking over an individual's claim for damages for the IRS's alleged violation of the Internal Revenue Code. The alleged IRS conduct arose from activities other than collection.

Bryant, DC D.C., 2008-1 USTC ¶50,157; Wesselman, DC D.C., 2008-1 USTC ¶50,158; TRC IRS: 45,114.

Summons

A federal district court properly held an individual in civil contempt following his failure to comply with the court's order enforcing two IRS summonses. The taxpayer failed to explain his refusal to provide the ordered testimony and documents at his show cause hearing, but merely advanced irrelevant arguments as to why he was not required to comply

with the summonses.

Ford, III, CA-10, 2008-1 USTC ¶50,155; TRC IRS: 21,312.

Income

Taxpayers could not exclude from income amounts earned for services performed in Antarctica because Antarctica is not a foreign country.

McDonald, TC, CCH Dec. 57,312(M), FED ¶47,926(M); McPike, TC, CCH Dec. 57,313(M), FED ¶47,927(M); TRC EXPAT: 12,100.

Deductions

A married couple was not entitled to business bad debt deductions for amounts the husband advanced on behalf of the couple's corporation because the advances were not bona fide loans. The

husband and the corporation did not have a debtor-creditor relationship. Furthermore, the couple was liable for Code Sec. 6651(a)(1) additions to tax because their failure to file a timely return was due to willful neglect.

Bynum, Jr., TC, CCH Dec. 57,315(M), FED ¶47,929(M); TRC BUSEXP: 48,052.

A merchant sailor was entitled to certain substantiated employee business expense deductions for two tax years. However, he was not entitled to other job-related and miscellaneous deductions because such expenses were unsubstantiated or not ordinary and necessary business expenses.

Balla, TC, CCH Dec. 57,319(M), FED ¶47,933(M); TRC BUSEXP: 24,606. Continued on page 68

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Anti-Injunction Act

Individuals were not entitled to damages for alleged IRS misconduct, refunds or an order enjoining the IRS from future collection activity. The taxpayers failed to establish that they had exhausted administrative remedies prior to filing suit. Their request to enjoin the IRS from further collection activities was barred by the *Anti-Injunction Act*.

Anderson, DC D.C., 2008-1 USTC ¶50,151;

Diebel, DC D.C., 2008-1 USTC ¶50,152;

Eleson, DC D.C., 2008-1 USTC ¶50,153;

Hallinan, DC D.C., 2008-1 USTC ¶50,154;

TRC IRS: 45,114.

Fivolous Arguments

Sanctions were imposed on an individual for filing a frivolous appeal from the Tax Court's decision dismissing his petition for failure to state a claim. The individual renewed frivolous arguments for which the Tax Court had previously admonished him.

Malan, CA-10, 2008-1 USTC ¶50,150;

TRC LITIG: 6,816.

Abatement of Interest

The IRS's denial of an individual's request for full abatement of interest accruing on three years' unpaid taxes was not an abuse of discretion. Denial of the abatement request was proper because the individual was unable to establish a direct causal link between a claimed error or delay and a specific period during which interest accrued.

Franklin, TC, CCH Dec. 57,314(M),

FED ¶47,928(M); TRC PENALTY: 9,056.20.

Statute of Limitations

A Form 872-A, Special Consent to Extend the Time to Assess Tax, is a unilateral waiver of the statute of limitations on assessment, not an executory contract that can be extinguished in bankruptcy. Filing a Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax, is the only way to revoke the consent. Finally, the IRS letters to the taxpayers contained neither a false statement nor a misleading silence with regard to the statute of limitations

for one tax year.

Greenfield Est., TC, CCH Dec. 57,317(M),

FED ¶47,931(M); TRC IRS: 30,254.05.

Liens and Levies

The government was entitled to foreclose its tax liens on a tax protestor's interest in residential property owned by him and his wife as tenants by the entirety. The taxpayer's interest in the tenancy constituted "property" or "rights to property."

Miller, DC Ind., 2008-1 USTC ¶50,148;

TRC IRS: 48,106.30.

A federal district court denied the government's motion for summary judgment in a lien foreclosure action because it failed to prove that a trust was the nominee or alter ego of the delinquent taxpayers. The government could not rely on the alter ego theory because the property had been transferred into the trust before the government had assessed the delinquent taxes.

Lena, DC Fla., 2008-1 USTC ¶50,147;

TRC IRS: 48,110.30.

The IRS did not abuse its discretion by sustaining its decision to file notices of federal tax lien on an individual's

property to collect taxes and interest previously determined as due and owed by the individual. The IRS had correctly followed all notice and information requirements.

Scott, CA-5, 2008-1 USTC ¶50,156;

TRC IRS: 48,056.25.

Offer-in-Compromise

The IRS did not abuse its discretion by rejecting an attorney's offer-in-compromise when there were outstanding excise and income liabilities, nor by determining the attorney's reasonable collection potential to be the full amount of his liabilities. The IRS properly balanced the need for efficient tax collection against the concern that collection be no more intrusive than necessary.

Lloyd, TC, CCH Dec. 57,316(M),

FED ¶47,930(M); TRC IRS: 42,120.

Alimony

Under pre-1985 law, a husband's payment to his ex-wife was not deductible alimony. Also, his obligation to pay over a portion of his pension distributions did not give his ex-wife an ownership interest in his pension plan.

Platt, TC, CCH Dec. 57,318(M),

FED ¶47,932(M); TRC INDIV: 21,104.

IRS Observes "Earned Income Tax Credit Awareness Day"

The IRS marked Earned Income Tax Credit (EITC) Awareness Day on January 31 by promoting the EITC's value to low-wage workers and families, issuing guidance on the EITC and related issues, and highlighting that the credit has been overlooked by too many qualifying individuals to be an acceptable statistic. With more than 60 percent of tax returns that claim the EITC being filed in February in the past, the government emphasized that now was the perfect time to get the word out about the availability of the credit.

Amounts and eligibility. The amount of the EITC is determined by income and family size. Qualifying taxpayers can claim up to \$4,700 on their 2007 return. The maximum amount of investment income that a taxpayer can have without decreasing his or her credit also increased to \$2,900 for tax year 2007, up from \$2,800.

Free preparation services. Taxpayers who qualify for the EITC may also be eligible to receive free tax preparation services. IR-2008-12 announces expanded free tax preparation services available to low-income and elderly taxpayers. Specifically, the IRS Volunteer Income Tax Assistance (VITA) Program offers free tax help to people earning less than \$40,000. The Tax Counseling for the Elderly (TCE) Program offers free tax assistance to individuals age 60 and older.

References: FED ¶¶46,280, 46,281, 46,282; TRC INDIV: 57,250.

Practitioners' Corner

Tax-Accrual Workpapers --- Where Do We Stand?

The government has formally appealed the decision in *Textron, D.C. R.I., No. 6-198T, August 29, 2007*, another chapter in the continuing controversy over the treatment of tax-accrual workpapers for practitioners with publicly-traded corporations as clients/employers. The IRS often attempts to collect tax-accrual workpapers under its Code Sec. 7602 summons authority and a favorable Supreme Court ruling, yet, the agency only claims to use this power in certain circumstances. While the IRS failed in its efforts to collect the documents in the original *Textron* case, the government's brief reflects its renewed arguments.

■ **Comment.** Reinhart, Boerner, & Van Dueren attorney Michael Goller, told CCH, "a lot of practitioners and directors of tax are watching *Textron* to see how it comes out. Part of it is it's fascinating...People are watching this case very closely." "The work product doctrine and the status of the attorney-client privilege, and tax practitioner privilege are unfolding," he continued, "this will have ramifications outside of just tax practice. This is sort of an exciting time in terms of both doctrines right now."

IRS summons authority

Code Sec. 7602 grants IRS the authority to examine a taxpayers "books, papers, records, or other data" relevant to determining a tax liability; subject to evidentiary privileges such as the work product privilege, attorney-client privilege, and tax practitioners' privilege. As affirmed in *Arthur Young & Co., U.S. Sup. Ct., March 21, 1984*, the IRS has authority to demand delivery of accrual workpapers prepared in the course of a financial audit; despite the accountant-client privilege.

Specifically, it has the authority to request tax-accrual workpapers; those documents supporting the company's tax reserve

to have good tax accrual workpapers. The IRS has recognized that to date."

"The IRS continues to emphasize that it will apply a "policy of restraint" when it comes to requesting these documents...however, the issue remains controversial."

for deferred or contingent tax liabilities and related representations in its audited financial statements.

The IRS continues to emphasize that it will apply a "policy of restraint" when it comes to requesting these documents, meaning that it will not routinely request them during the course of an examination. However, the issue remains controversial. Because these documents contain sensitive tax information, in addition to significant amounts of confidential or privileged information, companies are hoping that the IRS does not make these requests a standard examination technique. Furthermore, this fear remains vibrant because there are exceptions to the "policy of restraint."

■ **Comment.** Goller also told CCH, "I don't think the IRS will at present expand its demands outside of its current policy. I think it, as a matter of law, could do that. The *Arthur Young* case says that much. I think it would be a bad idea and I believe the IRS recognizes that because the financial reporting system works well when there are good tax accrual workpapers which are well thought out and are accurate. If the IRS is routinely asking for tax accrual workpapers in all cases, the system may break down. Clients would have a disincentive

As part of its efforts to close the tax gap, the IRS has grown increasingly aware of and more concerned about certain tax avoidance transactions, which it has declared "listed transactions." In Announcement 2002-63, it declared an exception to its policy of restraint granting agents the right to request documents specifically related to these abusive transactions. It has begun exercising its authority to demand tax-accrual workpapers for taxpayers alleged by engaging in listed transactions; hoping to crack down on uncollected tax liabilities.

■ **Comment.** "The IRS has the view that, if you're engaging in what they refer to as a listed transaction, that's a tax shelter," Goller stated. "That's not behavior they want to encourage. They're going to go as far as they can under the law. The *Arthur Young* case says they have a right to request tax accrual workpapers. There's no privilege there."

Original *Textron*

In the highly-followed *Textron* case, one of the company's subsidiaries had engaged in nine instances of a sale-in, lease-out transaction, which the IRS has termed a "listed transaction" and recharacterized as a sale of tax benefits. The documents

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Washington Report

by the CCH Washington News Bureau

Senate debates economic stimulus bill

At press time, the Senate is debating its version of an economic stimulus package. Senate Majority Leader Harry Reid, D-Nevada, said that the House version (*H.R. 5140*) is a good start and the Senate can improve on it, with no delay in getting rebates into taxpayers' hands. See the article on page 61 for more details and the CCH Tax Research Network for continuing coverage.

Shulman appears before SFC

Douglas H. Shulman, President Bush's nominee to be the next IRS Commissioner, appeared before the Senate Finance Committee (SFC) on January 29 as part of his confirmation process. Shulman told the SFC that he intends to focus on enforcement, collection, employee development, and modernization of the IRS's aging computer systems.

SFC Chair Max Baucus, D-Montana, outlined a laundry list of problems that Shulman would face as IRS Commissioner. At the top of his list was the tax gap. Baucus repeated his demand that the Service boost the voluntary compliance rate to 90 percent by 2017 to help close the \$300-billion tax gap. According to Baucus, the voluntary compliance rate currently is 83 percent. "I think we can get to 90 percent," Shulman responded.

SFC Ranking Member Charles Grassley, R-Iowa, noted that many IRS employees are at, or near, retirement age and encouraged Shulman to hire America's war veterans. Grassley called on the IRS to hire "1,000 Iraq and Afghanistan war veterans this year, with particular emphasis on disabled veterans."

"I can't believe the IRS is using a computer system from the 1960s," Baucus told Shulman. The agency's antiquated computer systems have long been a bone of contention with Baucus and Grassley. Shulman did not address any specific component of the modernization program but indicated

that it is important to get "real-time information into taxpayer's hands."

Controversy continues over preparer penalty examples

Practitioners should not rely too heavily on the examples in Notice 2008-13, which illustrate the interim regulations for the new more-likely-than-not preparer standard in Code Sec. 6694, warned Special Counsel, Thomas Kane, IRS Office of Chief Counsel, on January 30. One example in particular, Example 10, has generated many questions from practitioners, Kane recently told the Taxation Section of the District of Columbia Bar Association.

"Some practitioners have interpreted Example 10 literally," Bryan C. Skarlatos, a partner with Kostelanetz & Fink, LLP, New York, N.Y., and incoming chair of the Civil and Criminal Tax Penalties Committee of the American Bar Association Section of Taxation, told CCH. "They read the example to mean that, when the law is unclear, one does not have to disclose and no penalty would apply. This is not an accurate interpretation."

"What the IRS intended was for Example 10 to be an example of reasonable cause. The proper analysis is that the practitioner did violate the standard. Nevertheless, the practitioner may be eligible for a reasonable cause/good faith defense on the grounds that the law was so unclear."

Kane advised practitioners not to read too much into Example 10 or any of the other examples. "Don't over- or under-analyze the examples." The examples are designed to illustrate common situations, he added.

Senate may vote in February to ban tax patents

Legislation to ban tax strategy patents may move in the Senate in February, an official with the American Institute of Certified Public Accountants (AICPA) told CCH. The House has already approved legislation pro-

hibiting the U.S. Patent and Trademark Office from issuing patents for tax strategies as part of a comprehensive patent reform bill, the *Patent Reform Bill of 2007 (H.R. 1908)*. The Senate is expected to take up similar legislation (*H.R. 2365*) in February.

"Legislation [to ban the patenting of tax strategies] is the best solution" Eileen Sherr, AICPA technical manager, said. The AICPA has repeatedly warned that tax patents have a negative impact on taxpayers, tax professionals and tax administration. Tax patents can mislead taxpayers into believing that a patented strategy has the IRS's stamp of approval. In reality, the IRS has no say in the patenting of tax strategies; only the Patent Office can grant or deny a patent for a tax strategy.

H.R. 1908 would prohibit the Patent Office from granting patents for any "tax-planning method." *H.R. 1908* excludes return-preparation software from the ban.

IRS employee moral at low ebb, union president warns

Colleen Kelley, president of the National Treasury Employees Union (NTEU), recently told CCH that heavy work loads are forcing IRS employees to focus on the quantity of their work and not quality. The IRS's controversial private collection initiative is also sapping employee morale and could impact the effectiveness of the agency this filing season.

The IRS has 20,000 fewer employees than it had 10 years ago, Kelly explained. However, the volume of work has increased for IRS employees as the taxpayer population has grown significantly over the past 10 years. "Employees are looking forward to retiring from such an unpleasant work environment," Kelley said.

Kelley blamed part of the morale problem on the IRS's outsourcing of tax collection. "It's a waste of American taxpayers' money. IRS employees could collect more money for less," Kelley said.

Anticipated Changes to U.S. Corporate Tax System Selected By Tax Council Policy Institute As #1 Issue In 2008

The Tax Council Policy Institute (TCPI) has chosen the future of the U.S. corporate tax system as the focal point of its Ninth Annual Tax Policy Symposium on February 20-21 in Washington, D.C. That system soon will be facing unprecedented pressure for change, according to the unanimous opinion of the TCPI's planning committee, which represents a broad cross-section of corporate America, both by region and industry, as well as by domestic and international operations.

CCH discussed the reasons behind this forecast and its prominent position on TCPI's upcoming conference agenda with Douglas Bates, chair of TCPI's board of directors, and Hank Gutman, from KPMG's Washington National Tax practice and former chief of staff of the Joint Committee on Taxation.

In evaluating specific tax policy top-

ics for their 2008 symposium, TCPI members, "without question or hesitation," expressed universal concern "about the coming turbulence in the tax area," Bates told CCH. The expiration of a trillion dollars of tax cuts in 2010, an expanding deficit and the growing difficulty for businesses to compete globally under outmoded tax laws, will combine to force a re-evaluation of the entire tax system.

That expectation is also echoed in the Treasury's recent "Blue Book" on the Administration's FY 2009 budget where it highlights plans to further explore several broad approaches "to improve the competitiveness of American workers and businesses in the global economy."

The symposium will first attempt to obtain a prediction from former Treasury Secretary Lawrence Summers on the fiscal situation for 2009 and 2010,

Gutman indicated. Having set the stage, prominent tax executives, think-tank members, former Treasury officials and academics will explore, in sequence, the realistic tax reform options (including eliminating the corporate tax), alternative tax regimes for domestic business and foreign source income, the role of the corporate tax officer in the policy debate, and how corporations can identify their own interests and make them known. The symposium will end with a summary session on designing a U.S. business tax system, with Eric Solomon of Treasury providing comments. John Samuels will be the luncheon keynote speaker. KPMG is the program manager.

CCH, a Wolters Kluwer business, will publish the proceedings from TCPI's Ninth Annual Symposium in the June issue of *Taxes Magazine*.

Practitioners' Corner

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are crucial for listed transactions, according to the government, because determining whether a transaction has economic substance requires it to place the formal documents involved into a context that only the taxpayer is likely to understand. Therefore, the IRS needed the tax accrual documents to gain this perspective and determine whether it should pursue the suspected issues further. Ultimately, however, the court found that the taxpayer was not required to comply with the IRS summons.

The court found that, although the taxpayer had waived the attorney-client and Code Sec. 7525 tax practitioner privileges by communicating tax-accrual workpaper information to an independent auditor, the work product privilege was not waived. The court held that the communication was not with an adversary, yet was in anticipation of litigation. After the ruling, the government filed an appeal in the Court of Appeals for the Second Circuit.

Textron On Appeal

The issue in *Textron* on appeal, as framed by the government, is whether the taxpayer's tax-accrual workpapers were protected from IRS scrutiny by the work-product doctrine when it shared them with its independent auditor. According to the government, the lower court decision misapplied the work-product test and conflicted with the Supreme Court's decision in *Arthur Young*.

Work product. According to the taxpayer, the work product privilege protected its tax-accrual papers from disclosure. It argues that they were prepared in anticipation of litigation. And, as the government points out in its brief, the district court applied the "but-for" version of the work product test, holding that the taxpayer would not have prepared the documents, but for the prospect of litigation.

The government argues that the documents were not protected by the work product test because they were created for the purpose of complying with filing requirements of the Securities and

Exchange Commission (SEC). This would not be equivalent to the prospect of litigation, but instead would be in the ordinary course of business because the papers "back up a figure on a financial balance sheet." It points out that many companies often create tax reserves without anticipating actual litigation. Furthermore, the taxpayer conceded that some of the tax reserve it created was to cover amounts it planned on settling outside of litigation.

Arthur Young. As further support for its argument that the work product privilege could not apply to documents shared with independent auditors, the government argued that, under *Arthur Young*, independent auditors were different from taxpayers' advocates. Instead, the government continued, they are gate keepers of information, ensuring the accuracy of public company financial statements and communicating the full extent of the corporation's exposure to additional tax liability. This role, the government argued, takes precedence over any argument of confidentiality or privilege.

Compliance Calendar

■ February 8

Employers deposit Social Security, Medicare, and withheld income tax for February 2, 3, 4, and 5.

■ February 11

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

Employers file Form 940 to report federal unemployment tax for 2007 if the tax was deposited for the year in full and on time.

Employers file Form 941 for the fourth quarter of 2007 if the tax was deposited for the year in full and on time.

Employers file Form 945 to report income tax withheld for 2007 if the tax was deposited for the year in full and on time.

Certain small employers file Form 944 to report Social Security, Medicare, and withheld income tax for 2007 if the tax was deposited for the year in full and on time.

■ February 13

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

■ February 15

Individuals who claimed exemption from income tax withholding on Form W-4 in 2007 must file a new Form W-4.

Monthly depositors must deposit Social Security, Medicare, and withheld income tax for January.

Employers deposit Social Security, Medicare, and withheld income tax for February 9, 10, 11, and 12.

■ February 16

Employers begin withholding income tax from the pay of any employee who claimed exemption from withholding in 2007, but did not provide a new Form W-4 to continue the exemption in 2008.

Conferences

February 10-12: The American Society of Pension Professionals & Actuaries (ASPPA) presents a 401(k) Summit in Orlando. Call (703) 526-9300 or visit www.asppa.org for more information.

February 13: The American Law Institute-American Bar Association (ALI-ABA) presents a live webcast on the choice of business entities. To register or for additional information visit www.ali-aba.org or call (800) 253-6397.

February 14: The District of Columbia Bar Association presents a discussion on the interim guidance applicable to preparer penalties. Call (202) 626-3463 or visit www.dcbbar.org.

February 20-21: The Tax Council Policy Institute (TCPI) presents its 9th Annual Tax Policy & Practice Symposium in Washington, D.C. To register or for additional information e-mail symposium@tcpi.org or call (202) 822-8062.

February 21-22: The ESOP Association hosts its 10th Annual S Corporation ESOP Seminar in Lake Buena Vista, Florida. Call (866) 366-3832 or visit www.esopassociation.org.

February 21-23: 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 call (800) CLE-NEWS or visit www.ali-aba.org.

February 27-29: The Tax Law Section of the Florida Bar presents its 2nd Annual Southeastern Nonprofit Symposium in Fort Lauderdale. For more information or to register e-mail VYarbrough@flabar.org.

February 28-29: The American Institute of Certified Public Accountants (AICPA) hosts a Fair Value Measurements workshop in New York. Call (888) 777-7077 or visit www.cpa2biz.com for more information.

February 29: The Tax Policy Center hosts a conference on Taxes and Health Insurance: Analysis and Policy in Washington, D.C. To register or for additional information visit www.taxpolicycenter.org or call (202) 833-7200.

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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