

# Federal Tax Weekly

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## Housing Bill With \$15.1 Billion In Tax Incentives Goes To President's Desk

### ◆ *Housing Assistance Tax Act of 2008 (H.R. 3221)*

The long-awaited housing bill is almost law. Shortly after President Bush lifted his veto threat, Congress passed the \$300 billion housing bill with more than \$15 billion in tax incentives. The housing bill passed in the House on July 23 and, after a brief delay, in the Senate on a rare Saturday session on July 26. President Bush has promised to sign the bill as soon as it reaches the White House. To pay for new and expanded tax breaks, Congress imposed, among other things, information reporting requirements on merchant payment card transactions and tighter home sale exclusion rules.

■ **CCH Take Away.** While lawmakers were finalizing the housing bill, they were also considering a second economic stimulus package to give the flagging economy another shot in the arm. A second stimulus bill, reaching \$50 billion, could include another round of tax rebates. Details are likely to emerge in September.

### First-time home buyer credit

Qualifying first-time homebuyers can take a tax credit of 10 percent of the purchase price of the residence, capped at \$7,500 for married couples filing jointly and single individuals and at \$3,750 for a married individual filing separately. The new credit phases out for married couples with modified adjusted gross income (AGI) between \$150,000 and \$170,000 and for single taxpayers with modified AGI between \$75,000 and \$95,000.

■ **Planning Note.** The credit is effective for homes purchased on or after April 9, 2008 and before July 1, 2009.

■ **Caution.** Taxpayers who elect to take the credit must repay it. They have 15 years to repay the credit in equal installments. However, repayment is interest-free.

■ **Comment.** "Many first-time homebuyers, especially young families, do not intend to keep their homes for 15 years," Cynthia Jeanguenat, EA, Virginia Beach, Va., told CCH. "If they sell before the 15-year period ends, the loan is due and payable immediately." Jeanguenat noted that the 15-year repayment period is likely to be a special hardship for military families who typically serve a three-year tour of duty at a location; not 15 years."

### Property tax deduction

The new law gives non-itemizers a limited deduction for state and local real property taxes. It increases the amount of their standard deduction by the lesser of:

■ The amount of real property taxes paid during the year; or

■ \$500 (\$1,000 for a married couple filing jointly).

■ **Planning Note.** The deduction is available only for 2008.

### Help for businesses

One of the business incentives in the *Economic Stimulus Act of 2008* is bonus depreciation. However, companies in a loss position

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# Impasse Continues Over AMT Patch, Extenders, Energy Tax Incentives

◆ *Jobs, Energy, Families and Disaster Relief Act of 2008, Sen. 3335*

The Senate could vote before its August recess on an alternative minimum tax (AMT) patch, a package of extenders and energy tax breaks and tax relief for taxpayers in the flood-ravaged Midwest. Previous attempts to bring the extenders bill before the Senate have not survived a threatened filibuster by opponents and it remains uncertain if supporters have enough votes to prevail.

■ **Comment.** The extenders would largely be paid for by requiring basis reporting by brokers on the sales of stock.

## AMT patch

The cost of an AMT patch for 2008 (to keep the AMT from encroaching on more

middle income taxpayers) is estimated at nearly \$64 billion. The decision to offset the patch is sharply dividing lawmakers. Many Democrats want to offset the patch to adhere to pay-as-you-go rules. The White House is opposed to offsetting the patch.

## Extenders

Included in the extenders bill are more than 30 popular but temporary tax breaks, such as the research and development credit, 15-year straight-line recovery for leasehold, restaurant and retail improvements and the higher education tuition deduction. The bill would also extend and modify the renewable energy production and the residential

energy-efficient property credits along with creating a new credit for plug-in electric drive vehicles.

## Disaster help

Lawmakers from Midwest states recovering from recent floods and tornadoes are calling for a \$4 billion tax relief package modeled after the hurricane tax relief acts of 2005. Taxpayers in parts of 10 states would be eligible for temporary incentives, such as enhanced small business expensing and net operating loss carry backs, increased charitable contributions and loans from qualified plans, among other incentives.

## Housing Act

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cannot take advantage of bonus depreciation because they do not have any taxable income against which to take the deductions. The housing act allows taxpayers (corporations) to use accumulated alternative minimum tax (AMT) credits as well as research and development tax credits to make investments that would qualify for bonus depreciation, if the taxpayers were profitable.

## Help for borrowers

The new law allows eligible subprime borrowers to use their state's mortgage revenue bond program to refinance into a loan with more favorable rates. The borrower must have an adjustable single-family mortgage loan made after December 31, 2001 and before January 1, 2008. The bond issuer must determine that without refinancing, the borrower would be reasonably likely to experience financial hardship.

■ **Caution.** Expansion of mortgage revenue bonds to cover subprime loans would not apply to any bonds issued after December 31, 2010.

## REITs

The housing bill includes a package of real estate investment trust (REIT) reforms. A REIT may treat certain foreign currency gains as qualified income for purposes of income tests. Congress also clarified other aspects of the income tests and modified other REIT provisions.

## More incentives

Additional tax incentives in the housing act include:

- Increased and simplified low-income housing tax credit (LIHTC);
- Simplified tax-exempt housing bonds;
- Additional funding for mortgage revenue bonds;
- Enhanced rehabilitation tax credit;
- Expanded Gulf Opportunity Zone (GO Zone) tax breaks;

- Allowing taxpayers to use LIHTC and rehabilitation tax credit to offset AMT liability; and
- Excluding tax-exempt interest on certain housing bonds from being a preference item for AMT purposes.

## Offsets

**Merchant payment card reporting.** The housing act requires processors of merchant payment card transactions to report the merchant's annual gross payment card receipts to the IRS and to the merchant. The new law also requires reporting on third party network transactions, which are frequently used by online retailers.

**Home sale exclusion.** The new law prorates the home sale exclusion between the time that a home is used as a principal residence and the total length of ownership, which includes any "non-qualifying" use as a rental or vacation property. Non-qualifying use before the January 1, 2009 effective date of the provision is not used in the calculation; neither are periods after a qualified use of the property or temporary absences of less than two years.

Additional offsets include:

- Delay in worldwide interest allocation; and
- Accelerated corporate estimated tax payments for 2013.

### 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 Breaks New Ground On Write-Off Of Transaction Costs Incurred To Acquire Corporation

◆ *LTR 200830009*

The IRS recently issued a private letter ruling providing comprehensive guidance on the treatment of costs incurred by a corporation that entered into a merger and became the subsidiary of another corporation. The ruling addresses the allocation of transaction costs and service provider fees under the capitalization rules of Code Sec. 263, the amortization of investigatory costs as start-up expenditures and the write-off of financing costs. Transaction costs, the IRS determined, were properly allocated to the entity to which the services were provided. Investigatory costs could be deducted because they did not facilitate the acquisition.

■ **CCH Take Away.** “This is the first private letter ruling issued in the area of acquisition costs,” Ellen McElroy, partner, Pepper Hamilton, LLP Washington, D.C. told CCH. “There are some pretty significant ambiguities in the [Code Sec. 263] regulations. It’s important to get this resolved.”

■ **Comment.** The IRS issued final regs in 2003 on the capitalization of intangibles. “There’s been a ton of [IRS] exam activity in this area... these issues are highly fact-specific,” McElroy noted. “The ruling is also significant because it incorporates case law and IRS administrative rulings into the analysis of specific provisions of the transaction cost allocation regulations.”

### Background

Corporation B merged and became a subsidiary of a new corporation. Prior to the merger, a group of private equity funds that coordinated to effectuate the merger created Parent in a tax-free transfer. Parent owned newly-created Intermediate Company, which in turned owned Acquisition Company. Acquisition Co. merged into B, which became a wholly-owned subsidiary of Intermediate Co.

B, Acquisition Co. and Parent all incurred costs to initiate, investigate, plan and implement the merger transaction. All the companies paid legal and accounting fees, banking fees, and financing fees, among others.

### Allocation of transaction costs

The IRS determined that transaction costs can be allocated to either B or to Acquisition Co. based upon the entity which received the services or on whose behalf the services were provided. The Code Sec. 263 capitalization regs allow an amount paid on behalf of a party to be treated as paid by the party.

■ **Comment.** “It is significant that ... the tax deduction or capitalization” of one party’s costs can be taken by “the party for whose benefits these costs were incurred. The IRS looked to ... Section 162(a), and agreed that the taxpayer could use a facts and circumstances test to determine which party was entitled to the deduction,” McElroy indicated.

### Lump sum fees

The IRS concluded that the parties can allocate lump-sum service provider fees among deductible, amortizable and capitalizable expenses based on the scope of the services provided. Costs that facilitate the acquisition must be capitalized. Others may be deducted.

■ **Comment.** “The ruling confirms that an allocation of lump sum fees across a broad range of services” requires an inquiry into the underlying services and “documentation that substantiates such services were provided,” McElroy indicated.

### Investigatory costs

The IRS treated investigatory costs by B, the existing company, as deductible expenses because B was expanding its existing trade or business and the costs did not facilitate the merger. However, similar costs were start-up costs to Acquisition Co., a new company, and had to be amortized under Code Sec. 195. B would then step into the shoes of Acquisition and continue to amortize the start-up expenses after the merger.

■ **Comment.** “These rulings validate the position that business expansion costs and Section 195 costs are the same types of costs,” McElroy said. These conclusions also demonstrate the impact of Code Sec. 263 documentation requirements.

### Financing costs

The IRS looked at two categories of financing costs. Costs incurred to finance the transaction were amortizable under Code Sec. 263 over the period specified in Code Sec. 446 and its regs. Costs related to a securitization financing plan that was abandoned could be deducted as a loss under Code Sec. 165. A taxpayer that engages in multiple transactions can deduct costs allocated to abandoned transactions, even if other transactions are completed.

*References: FED ¶(to be reported); TRC BUSEXP: 9,104.20.*

## IRS Provides Sample Language For Inter Vivos And Testamentary Charitable Lead Unitrusts

◆ *Rev. Proc. 2008-45, Rev. Proc. 2008-46*

A pair of IRS revenue procedures describe sample and alternative declarations of trust for inter vivos and testamentary charitable lead unitrusts (CLUTs). Grantors, trusts and estates that follow the sample language generally will not need a ruling from the IRS and will qualify for income, estate and gift tax charitable deductions. The IRS also provided annotations explaining the trust provisions.

■ **CCH Take Away.** Providing sample language will reduce the demand on the IRS to issue letter rulings on these trusts, which have grown in popularity in recent years. The IRS indicated that it will not issue a letter ruling on whether a trust qualifies for income, estate or gift tax charitable deductions. However, it will issue rulings on the tax consequences of

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## IRS Issues Final, Temporary And Proposed Farm And Fishing Income Averaging Regs

◆ *T.D. 9417, NPRM REG-161695-04*

The IRS has released final, temporary and proposed regs under Code Sec. 1301 relating to the averaging of farm and fishing income in computing income tax liability. The regs provide guidance to individuals engaged in a farming or fishing business who elect to reduce their tax liability by treating all or a portion of the current tax year's farm or fishing income as if one-third of it had been earned in each of the prior three tax years.

■ **Comment.** The *American Jobs Creation Act of 2004 (2004 Jobs Act)*, amended Code Sec. 1301 to permit fishermen to make a farm income averaging election.

### Fishing business

The IRS defines a fishing business according to the definition provided in the *Magnuson-Stevens Fishery Conservation and Manage-*

*ment Act*. A fishing business includes catching, taking, or harvesting activities that result in the killing of fish or the bringing of live fish on board a vessel. However, a fishing business does not include the processing of fish.

### Lessors

A lessor of a vessel is engaged in a fishing business if the payment due to the lessor under the lease is based on a share of the lessee's catch (or a share of the proceeds from the sale of the catch) and the lease is a written agreement entered into before the lessee begins significant fishing activities resulting in the shared catch. A fixed lease payment is not eligible for income averaging.

### Eligible income

The IRS has clarified that the maximum amount of income that a taxpayer may elect to average is the total of the taxpayer's farm and fishing income and gains, reduced

by any farm and fishing deductions or losses allowed in computing taxable income. Therefore, a taxpayer engaged in both a farming business and a fishing business must combine income, gains, deductions, and losses from both the farming business and the fishing business to determine the maximum amount of income that is eligible for averaging.

■ **Comment.** The *2004 Jobs Act* also amended Code Sec. 55(c) to provide that the farm income averaging election is disregarded in computing the regular tax liability for purposes of calculating the alternative minimum tax (AMT). As a result, the reduction in regular tax liability resulting from a farm income averaging election will not be offset by a corresponding increase in the AMT.

*References: FED ¶49,822; TRC FARM: 3,302.*

## CLUTs

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other trust provisions not contained in the sample language.

■ **Comment.** The IRS issued sample language for inter vivos and testamentary CLATs in Revenue Procedures 2007-45 and 2007-46.

### Inter vivos CLUTs

A CLUT is a split-interest trust that pays income to one or more charitable beneficiaries for a term of years or the lives of specified persons living at the date of transfer. The remainder is then paid to one or more noncharitable beneficiaries. A unitrust interest is an irrevocable right to receive annual payments of a fixed percentage of the trust's fair market value. There is no specified minimum or maximum amount.

Rev. Proc. 2008-45 provides language for both grantor and nongrantor inter vivos trusts. The income tax consequences to the grantor vary, depending on whether the trust is a grantor or nongrantor trust. In contrast, a nongrantor trust is taxed as a separate entity. The generation-skipping

transfer (GST) tax may apply to an inter vivos trust, depending on the status of the noncharitable remainder beneficiary.

■ **Comment.** A grantor or nongrantor CLUT may, alternatively, define the unitrust as a varying percentage if the value is ascertainable when the trust is created.

### Nongrantor trusts

A nongrantor trust is taxed as a separate entity. If a nongrantor trust has terms substantially similar to the sample trust language, is a valid trust under local law, and operates in a manner consistent with its terms:

- The trust will be entitled to an income tax charitable deduction for amounts paid to charity;
- The grantor will not be entitled to an income tax charitable deduction for setting up the trust; and
- The grantor will qualify for a gift tax and/or estate tax charitable deduction for the present value of the charitable lead (unitrust) interest.

### Grantor trusts

A grantor trust is not a separate taxable entity. If the trust follows the sample

language, is a valid trust, and operates in accordance with its terms:

- The grantor will be entitled, when the trust is set up, to an income tax charitable deduction for the present value of the charitable lead interest;
- The grantor will qualify for a gift tax and/or estate tax charitable deduction for the present value of the charitable lead (unitrust) interest; and
- The grantor, not the trust, is taxable on the trust's income, deductions and credits.

A grantor trust may include a different power or provision to make the donor the owner of the entire CLUT.

### Testamentary CLUTs

A trust created at death trust is taxed as a separate entity. If the trust follows the sample language, is a valid trust, and operates in accordance with its terms:

- The estate will be entitled to an estate tax charitable deduction for the present value of the unitrust interest; and
- The trust will be entitled to an income tax charitable deduction for amounts paid to charity.

*Reference: TRC ESTGIFT: 45,302.10.*

## Final Regs On Roth Retirement Annuity Conversions Provide Three Valuation Methods

◆ *T.D. 9418*

The IRS has issued final regs on converting a non-Roth IRA annuity to a Roth IRA. The final regs generally reflect the proposed regs. However, in an important change, the final regs provide for three different methods of determining the fair market value of the annuities.

- **CCH Take Away.** The impact of these regs increase tremendously as tax planners prepare for 2010. For tax years beginning after December 31, 2009, a taxpayer can convert a traditional IRA to a Roth IRA without regard to the taxpayer's income. Taxpayers who convert in 2010 can elect to recognize the conversion income in 2010 or average it over the next two years. In deciding whether to convert a traditional IRA to a Roth IRA, a key factor is whether the taxpayer anticipates being in a higher or lower tax bracket after retirement.

### Roth IRA conversions

A traditional IRA allows for a deduction from income of the contributed amount, allowing for a pre-tax contribution, whereas a Roth

IRA allows only after-tax contributions. Consequently, distributions from traditional IRAs are taxed while distributions from Roth IRAs are tax-free. In Rev. Proc. 2006-13, the IRS provided safe harbor methods for determining fair market value of annuity contracts when calculating the amount includible in gross income resulting from a conversion from a traditional IRA to a Roth IRA.

### Distribution value

The final regs maintain the IRS's position on valuing the required taxable distribution. During a Roth IRA conversion, the taxpayer must recognize the fair market value of the annuity on the date of conversion as a distribution from the traditional IRA and include this amount in gross income.

- **Comment.** The IRS clarified the tax result when a taxpayer surrenders an annuity without retaining or transferring rights to the instrument. The final regs clarify that, should the taxpayer surrender the annuity for its cash value and reinvest the cash proceeds into a Roth IRA, the taxpayer will only have to recognize this cash value in gross

income, rather than the fair market value of the annuity.

### Fair market value calculation

The proposed regs used a method of determining the fair market value of an annuity similar to that found in gift tax regs. It was based on comparable contracts issued by the same company at or around the same time. Commentators recommended that the IRS clarify the methodology. The final regs include the gift tax method based on comparable contracts and two other methods:

- An approximation method where there are no comparable contracts; and
- An accumulation of premiums method based on Rev. Proc. 2006-13 and similar to a valuation method for qualified pension plans under Reg. §1.401(a)(9)-6.
- **Comment.** The final regs apply to any Roth IRA conversion where an annuity contract is distributed or treated as distributed from a traditional IRA on or after August 19, 2005.

*References: FED ¶(to be reported); TRC RETIRE: 66,760.10.*

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## Code Sec. 6015 Does Not Preempt State Community Property Law In Calculating Innocent Spouse Refunds, Ninth Circuit Finds

◆ *Ordlock, CA-9, July 24, 2008*

In a case of first impression, the Court of Appeals for the Ninth Circuit has held that a taxpayer in a community property state was not entitled to a Code Sec. 6015(g) refund of amounts from community property used to pay for the husband's tax understatements. Congress, in enacting Code Sec. 6015, did not intend to preempt community property law with respect to an innocent spouse's right to a refund, the court found.

- **CCH Take Away.** The taxpayer in this case resided in California, a community property state. The liability in this case arose before Congress enacted

Code Sec. 6015. However, Code Sec. 6015 applied because the liability remained unpaid on the date of enactment.

### Background

The taxpayer was granted innocent spouse relief under Code Sec. 6015(b) from joint and several liability for several years' tax debts attributable to her husband's understatements. Only \$2,500 of the \$160,000 in tax penalties and interest assessed by the IRS was made from the taxpayer's separate property. The IRS agreed that the taxpayer was entitled to a refund of the payments made from her separate property on the tax debt but asserted that she

was not entitled to a refund of payments that were made from the couple's community property. The taxpayer argued that Code Sec. 6015 requires that payments made from community property must be allocated between her and her husband, despite the continued existence of the marital community.

- **Comment.** Code Sec. 6015(a) provides a qualifying taxpayer, who has filed a joint return with his or her spouse, innocent spouse relief from joint and several liability in limited circumstances. The last sentence of Code Sec. 6015(a) provides that "any determination

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## IRS Rules Sale Of Royalty Income Share Not Lease Stripping Listed Transaction

◆ *LTR 200829011*

The IRS has ruled that a taxpayer, a consolidated group of corporations, was not engaging in a listed transaction when one of its subsidiaries licensed intellectual property to another group member and that member sold shares in the royalty revenue stream to third parties. While the transactions were accelerations of future income streams, requiring immediate inclusion into gross income, the IRS held that they were not the same as or similar to the lease stripping transaction described in Notice 2003-55.

■ **Comment.** While most suspected cases of lease stripping involve leasing of tangible property, IRS noted in Notice 2003-55, that the same rules could potentially apply to revenue streams flowing from intangible property. Reg. §1.61-8(b), the provision originally exploited by lease stripping transactions, requires both prepaid rent and royalties to be currently included in gross income.

### Background

Of all the members of the taxpayer's consolidated group, one subsidiary (technology subsidiary) owned the company's

intellectual property. The technology subsidiary licensed patents out to the taxpayer, its affiliated companies, and third parties; charging royalties based upon the number of products sold.

Because of this pricing model, the technology subsidiary's income varied greatly. To secure a more steady stream of income, the technology subsidiary entered into a swap transaction with one of the taxpayer's affiliated companies (affiliated subsidiary).

Both subsidiaries agreed to exchange the estimated amount of royalties the technology subsidiary was to receive from its licenses. However, the affiliated subsidiary would be responsible for additionally paying any estimated royalties the technology subsidiary did not receive. To even out the agreement, the affiliated subsidiary would also receive any excess royalties.

After entering into this swap transaction, the affiliated subsidiary subsequently entered into a separate agreement with two third parties to sell portions of the stream of payments it expected to receive from the technology subsidiary.

### Intellectual property licensing

The IRS determined that the affiliated subsidiary's transactions with the third

parties were accelerations of future income, causing the affiliated subsidiary to recognize ordinary income it received from the third parties. The swap agreement between the technology subsidiary and affiliated subsidiary was not intended to be an actual sale of the underlying intellectual property, only an exchange of a series of fixed cash flows for a series of variable cash flows.

The IRS pointed to the fact that, in the event the technology subsidiary were to declare bankruptcy, the swap agreement provided that the royalties would become assets in the technology subsidiary's bankruptcy estate, the affiliated subsidiary would become a creditor of the technology subsidiary, and the affiliated subsidiary would not have any claims to any cash flows under the licensing agreements. As a result, the third party acquisitions of shares in the technology subsidiary's royalty income stream also failed to qualify as sales of the underlying intellectual property. They were instead exchanges of cash flows.

*References: FED ¶(to be reported); TRC SALES 42,066.*

### Innocent Spouse

*Continued from page 353*

under this section shall be made without regard to community property laws."

### Court's analysis

The court agreed with the IRS that Code Sec. 6015 does not preempt the state's community property law with respect to an innocent spouse's entitlement to a refund for a community property payment on the non-innocent spouse's federal income tax liability. According to the court, the plain language of the "determination" provision of Code Sec. 6015(a) applies only to the IRS's initial

decision that a taxpayer is, or is not, an innocent spouse and thus entitled to relief from joint and several liability. It is this determination that is made without regard to state community property law. Whether that innocent spouse is then eligible for a refund is a separate question governed by state law.

■ **Comment.** A divided Tax Court (126 T.C. No. 4) rejected the taxpayer's argument that she was entitled to a refund from her and her husband's community property. However, one dissent noted that under the plain language of Code Sec. 6015(a) community property laws are not applicable. The dissenting judge further asserted that because

the term "determination" is not defined in the statute, it should be read to include refunds.

■ **Comment.** The Ninth Circuit also rejected the taxpayer's argument that "notwithstanding" language of Code Sec. 6015(g)(1) mandates preempting the operation of community laws in making refunds. "It is far more likely that Congress meant to avoid certain bars to refund eligibility while still respecting others, and used the expansive notwithstanding any law or rule of law language to achieve that goal," the court found.

*References: FED ¶(to be reported); TRC IRS: 33,102.*

# Tax Briefs

## Internal Revenue Service

The IRS has released the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests in such buildings during the period January through September 2008.

*Rev. Rul. 2008-36, FED ¶46,526;*  
*TRC BUSEXP: 54,222.*

## International

The IRS has announced updated specifications for electronically filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding. The procedure will be reproduced as the current revision of Publication 1187, Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically.

*Rev. Proc. 2008-44, FED ¶46,527;*  
*TRC EXPAT: 15,056.05.*

## Jurisdiction

A federal district court abused its discretion by dismissing a couple's complaint for lack of subject matter jurisdiction and for failure to prosecute. The couple's mere failure to respond to the government's motion to dismiss or to appear at a pretrial conference was insufficient to justify a dismissal with prejudice.

*Watson, CA-5, 2008-2 USTC ¶50,446;*  
*TRC LITIG: 9,252.05.*

Jurisdiction was lacking over an individual's complaint seeking return of monies withdrawn by the IRS from her savings account because she did not establish that she had filed an administrative claim for a refund.

*Artuso, FedCl, 2008-2 USTC ¶50,442;*  
*TRC LITIG: 9,056.*

The U.S. Court of Federal Claims lacked subject matter jurisdiction over a complaint regarding a whistleblower claim. Claims based on Code Sec. 7623(b)(1) are within the exclusive jurisdiction of the Tax Court. Furthermore, the informants did not establish the existence of an implied-in-fact contract

or show that they had negotiated with the IRS to receive a specific reward amount.

*DaCosta, FedCl, 2008-2 USTC ¶50,444;*  
*TRC IRS: 63,060.05.*

## Summons

IRS summonses seeking to determine an estate's estate and gift tax liabilities were not quashed, and enforcement was properly ordered. The government established a *prima facie* case for enforcement, and the summoned parties did not show that the summonses were issued for an improper purpose or in bad faith.

*Adamowicz, CA-2, 2008-2 USTC ¶50,441;*  
*TRC IRS: 21,108.*

## Income

Payments from the federal and state (Georgia) governments to a local telephone company under a universal service support program intended to fund the extension of telecommunications infrastructure into rural and other high-cost areas were income, not contributions to capital under Code Sec. 118. The mechanisms used to calculate and distribute the payments indicated that the payments constituted supplements to general revenue, rather than specific capital contributions. Because payments were based on a broad range

of operational expenses and investment return, they were not solely for capital purposes.

*Coastal Utilities, Inc., CA-11, 2008-2 USTC ¶50,447;*  
*TRC CCORP: 3,254.*

## Frivolous Arguments

A federal district court's dismissal of an individual's suit to quiet title to his wages was affirmed because his arguments on appeal were rejected as frivolous. The IRS's tax assessments were made in proper form and proven through appropriate documentation.

*Samuelson, CA-10, 2008-2 USTC ¶50,445;*  
*TRC IRS: 27,218.*

Frivolous documents filed by an individual who attempted to assert a claim or lien against various government officials were declared null and void, and the individual was permanently enjoined from filing similar documents in the future.

*Muncy, DC Ark., 2008-2 USTC ¶50,449;*  
*TRC LITIG: 9,256.*

The government was entitled to summary judgment with respect to a taxpayer's frivolous suit where all administrative procedures were properly followed. Moreover, despite receiving several admonitions with regard to her

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## Doctors Hit With 40 Percent Penalty For Overvaluation Of Stock To Tax-Exempt PSC

The Tax Court recently found that doctors who donated stock in their medical practice to a newly formed tax-exempt professional services corporation (PSC) were only entitled to a small portion of the charitable contribution deductions they claimed and accuracy-related penalties were imposed. The value of the donated stock, as determined by the taxpayers' expert, was too high. Based on trial testimony and other evidence, it was clear that the medical group was going to be consolidated into the PSC and should not have been valued as a going concern.

In addition, each taxpayer was liable for the 40 percent accuracy-related penalty for gross valuation misstatement, if their underpayment exceeded \$5,000, because they did not act in good faith and did not make a good-faith investigation as to the value of the donated stock. Despite the taxpayers' claimed reliance on appraisers and advisors, the taxpayers were well-educated and should have been aware of the problems in valuing the stock at so high a price when it was unlikely that the medical group would continue as an operating entity.

*Bergquist, 131 T.C. No. 2, CCH Dec. 57,492; TRC PAYROLL: 6,106.*

## Tax Briefs

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use of frivolous tax-protester arguments, the taxpayer continued to advance such claims. As a result, the Court imposed Code Sec. 6673 delay penalties totalling \$15,000.

*Homza, T.C., CCH Dec. 57,494(M), FED ¶48,107(M); TRC PENALTY: 3,260.15.*

### *Liens and Levies*

Federal tax liens were foreclosed against a married couple's property with respect to unpaid taxes that were self-assessed because the limitations period had not expired. The IRS was not required to file notices of deficiency for those taxes and the suit was timely filed. However, tax liens with respect to additional taxes assessed for two other tax years were not foreclosed because the couple had not waived their right to receive notices of deficiency.

*Hoklin, DC Minn., 2008-2 USTC ¶50,439; TRC IRS: 27,212.*

### *Collection Due Process*

The IRS's determination to proceed with collection of a married couple's unpaid tax liabilities was not an abuse of discretion. The taxpayer did not dispute the existence or amounts of the unpaid tax liabilities but offered numerous irrelevant and immaterial statements and arguments in response to the IRS's motion for summary judgment. Moreover, although the taxpayer instituted and maintained the case primarily for delay, the frivolous argument penalty was not imposed.

*Williams, T.C., CCH Dec. 57,493(M), FED ¶48,107(M); TRC IRS: 51,056.25.*

### *Tax Assessments*

The government was entitled to reduce an individual's unpaid tax liability to judgment because the individual failed to prove that the government's tax assessments were erroneous. The assessments were presumptively correct and properly reflected the taxes owed and the payments made by the individual.

*Walton, Jr., DC Mo., 2008-2 USTC ¶50,440; TRC IRS: 45,158.*

The IRS's tax assessments with respect to a couple's unpaid taxes, interest and penalties were presumptively correct because they were not arbitrary. However, summary judgment was not granted because a genuine issue

of material fact existed regarding the amount of deficiency and whether the IRS mailed a notice and demand to the couple.

*Cochran, DC Ind., 2008-2 USTC ¶50,443; TRC IRS: 27,200.*

### *Deficiencies and Penalties*

A married couple who deducted a possible contingent liability and received corresponding tax refunds, but who had to return the refunds after the liability was not realized, were liable for the accuracy-related penalty for substantial income understatement. The couple did not adequately disclose their tax position and, moreover, their position was reasonable.

*Wadsworth, T.C., CCH Dec. 57,490(M), FED ¶48,104(M); TRC PENALTY: 3,108.*

The IRS correctly determined that a married couple had unreported cancellation of debt income arising from a settlement of a credit card debt judgment. The notice of deficiency was presumed correct and the taxpayers have not argued that any of Code Sec. 108 cancellation of debt exception applies.

*Winn, T.C., CCH Dec. 57,491(M), FED ¶48,105(M); TRC SALES: 12,150.*

A petition seeking redetermination of the taxpayers' tax deficiency was dismissed for lack of jurisdiction because it was filed after the 90-day filing period had elapsed. The envelope containing the taxpayers' petition was postmarked four days after the end of the filing period and the taxpayers had altered the copy of the notice of deficiency so that it appeared to be timely filed. A \$1,500 penalty

was imposed under Code Sec. 6673(a) since merely dismissing the petition would reward the taxpayers' dishonesty.

*Samaniego, T.C., CCH Dec. 57,495(M), FED ¶48,109(M); TRC LITIG: 6,202.*

### *Bankruptcy*

The IRS's freeze of a married couple's account, which prevented the automatic issuance of their income tax refund, was not a violation of the bankruptcy code's automatic stay and a six-month delay in issuing the debtor's refund was not unreasonable in the circumstances.

*In re Harchar, BC-DC Ohio, 2008-2 USTC ¶50,448; TRC IRS: 57,054.05.*

### *Claims for Damages*

An individual's claims for damages for wrongful disclosure of his income tax return information in the course of IRS collection activities was dismissed. Code Sec. 7433 provides the exclusive damages remedy and the individual did not exhaust his administrative remedies prior to filing suit. Moreover, no *Bivens* action was available.

*Bosset, DC Fla., 2008-2 USTC ¶50,438; TRC IRS: 9,352.*

### *Tax-Exempt Status*

An organization that promoted public safety in a particular business area, through the promulgation of specific uniform safety codes, did not qualify as a tax-exempt business league, under Code Sec. 501(c)(6), but did qualify for exempt status as a civic organization, under Code Sec. 501(c)(4).

*TAM 200829029 FED ¶47,422; TRC EXEMPT: 9,100.*

## **IRS Issues Guidance To Kansas Disaster Area For Electing Bonus Depreciation**

The IRS has issued procedures for claiming the 50 percent Kansas Disaster Area additional first-year depreciation authorized by the *Food, Conservation, and Energy Act of 2008* for qualified Recovery Assistance property (RA property) placed in service by the taxpayer on or after May 5, 2007. The guidance also explains how a taxpayer may elect not to deduct the Kansas additional first-year depreciation for RA property.

For a taxpayer that has yet to file a federal tax return for the tax year that includes May 5, 2007, the taxpayer may claim the depreciation on line 14 of Form 4562, Depreciation and Amortization, for the federal tax return for the tax year that includes May 5, 2007. If a taxpayer timely filed its federal tax return for the tax year that includes May 5, 2007, and did not claim the Kansas additional first-year depreciation for RA property, but wants to do so, the IRS has provided special procedures by which the taxpayer can claim the bonus depreciation (provided that the taxpayer did not elect not to deduct the bonus depreciation).

*Notice 2008-67, FED ¶46,525; TRC DEPR: 3,700.*

# Practitioners' Corner

## Sample Client Letter On Housing And Economic Recovery Act Of 2008

*Congress has just passed, and President Bush is expected to sign, a \$300 billion housing bill to help restore confidence in the housing market. The new law includes more than \$15 billion in tax incentives as well as some important revenue raisers. Practitioners can send or email this letter to clients to alert them about the new law, invite them to discuss the tax incentives and develop a tax strategy.*

### Dear Client:

The downward spiral in home sales and home values has many Americans worried. Home sales have hit a 10-year low, gasoline prices are still high, and easy credit, which fuels the economy, is drying up. While the news is troubling, there is a bright spot. Congress has passed a sweeping housing bill (the *Housing and Economic Recovery Act of 2008, H.R. 3221*). The new law includes more than \$15 billion in tax incentives. Let's take a look at some of the major incentives – and revenue raisers – in the housing act. As always, please call or email us if you have any questions.

### Tax incentives

**First-time homebuyer tax credit.** One tax incentive in the new law, the first-time homebuyer tax credit, has been getting a lot of attention in the news but be careful. The credit, while generous, is essentially an interest-free loan from the government. Taxpayers who take the credit, which equals 10 percent of the purchase price (up to \$7,500 for single individuals and married couples filing jointly; \$3,750 for married individuals filing separate returns), must repay the credit. They will have 15 years to repay the credit in equal amounts. If a taxpayer sells his or her home before the end of the 15-year period, he or she will likely have to immediately repay any outstanding balance. Important income thresholds also apply. Additionally, the credit is temporary and applies to homes purchased on or after April 9, 2008 and before July 1,

2009. There are also complex rules about who can take it, when they can claim it and so on. Please contact our office if you have any questions about this potentially valuable but complicated new credit.

advantage of bonus depreciation because they do not have any taxable income against which to take the deductions. The housing act allows taxpayers (corporations) to use accumulated alternative minimum tax (AMT)

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**“The new law includes more than \$15 billion in tax incentives.”**

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**Property deduction for non-itemizers.** Significantly less complicated is a new standard property tax deduction for taxpayers who do not itemize deductions. Before the new law, only itemizers could deduct state and local property taxes. The housing act gives non-itemizers a limited deduction for state and local property taxes by increasing the amount of their standard deduction by the amount of property taxes they paid or \$500 (\$1,000 for a married couple filing jointly). If you have paid off your mortgage and no longer itemize, you might benefit from this new deduction. As now written, however, this is a one-year shot in the arm, available only for taxes paid in 2008.

**Borrowers.** Many homeowners are trying to refinance mortgages that offered low teaser rates but whose rates have now skyrocketed. The new law authorizes states to issue \$11 billion more in mortgage revenue bonds for 2008 and allows qualifying subprime borrowers to use their state's mortgage revenue bond program to refinance into a loan with a more favorable rate. The housing bill also creates a new program called “HOPE for Homeowners” to help homeowners refinance their mortgages. Both provisions are temporary.

**Businesses.** The *Economic Stimulus Act of 2008* included bonus depreciation to encourage businesses to increase investment. However, companies in a loss position cannot take

credits as well as research and development (R&D) tax credits to make investments that would qualify for bonus depreciation, if the taxpayers were profitable. The new law also dramatically changes the information reporting requirements of banks and other processors of merchant payment card transactions. Starting in 2011, they will be required to report a merchant's annual gross payment card receipts to the IRS and the merchant. Congress believes that enhanced information reporting will help close the \$300 billion tax gap, the difference between what taxpayers owe and what they actually pay.

**Home sale exclusion.** The home sale exclusion is one of the most popular tax breaks in the Tax Code. A married couple filing jointly can generally exclude up to \$500,000 in gain (single individuals up to \$250,000). Before the new law, if a second home becomes a principal residence, after two years the owner could sell it and exclude up to \$250,000 in gain from their income or up to \$500,000 for couples filing jointly. The housing act closes what some call a “loop hole.” The new law pro-rates the exclusion between the time that a home is used as a principal residence and the total length of ownership, which includes any “non-qualifying” use as a rental or vacation property. As good news to those who have already owned property for a while and have seen it appreciate, non-qualifying use

*Continued on page 359*

# Washington Report

by the CCH Washington News Bureau



## Stimulus package a factor in larger deficit

The fiscal year (FY) 2009 federal budget deficit is expected to increase to \$482 billion, or 3.3 percent of gross domestic product (GDP), primarily due to the economic stimulus package that was enacted in February and the slowdown in the U.S. economy, according to the Bush administration's Mid-Session Review released on July 28. "We believe these deficits are temporary and manageable if we keep spending in check, the tax burden low and the economy growing," White House Press Secretary Dana Perino asserted at a press briefing on July 28.

For FY 2008, the budget deficit is estimated to be \$389 billion, which is \$21 billion lower than the February estimate. However, OMB Director Jim Nussle told reporters the FY 2008 deficit could grow larger because the mid-session report does not take into account Medicare legislation and the housing package that Bush is expected to sign once he receives them (*see details on page 349 of this issue*).

When asked why corporate tax receipts are lower each year from FY 2008 to 2011, Nussle said the decline is largely the result of a softening economy. While acknowledging it would be a challenge to achieve, he maintained that the president's budget blueprint remains on track to achieve balance with surpluses of \$58 billion in 2012, and \$29 billion in 2013.

## Equalizing preparer/taxpayer penalty standards AICPA's legislative priority

Equalizing the preparer and taxpayer penalty standards at substantial authority for undisclosed nonabusive return positions is the "top legislative priority" for the American Institute of Certified Public Accountants (AICPA), Barry Melancon, president and CEO of the 350,000 member organization, told CCH on July 23. However, AICPA supported legislation (the *Renewable Energy*

and *Job Creation Bill of 2008 (H.R. 6049)*) appears stalled in the Senate. Melancon also called for the banning of tax strategy patents and greater certainty and stability in the Tax Code. Melancon spoke to reporters of the accounting/tax press in Washington, D.C.

The AICPA has been working to equalize the preparer and taxpayer standards since Congress passed the *Small Business and Work Opportunity Tax Act of 2007 (2007 Small Business Tax Act)*. The 2007 *Small Business Tax Act* replaced the old "realistic possibility of success" standard for undisclosed nonabusive positions with a reasonable belief that the position would more likely than not be sustained on its merits. However, the 2007 *Small Business Tax Act* did not change the taxpayer standard of substantial authority for undisclosed nonabusive positions. "The difference puts the preparer and the taxpayer at a different level of confidence," Melancon explained.

"Our members are very worried about this (the difference between the preparer and taxpayer standards)," Melancon said. The AICPA has cautioned that the more-likely-than-not standard could require a preparer to disclose a return position that a taxpayer, under the substantial authority standard, might not be inclined to disclose, setting the stage for preparer/client conflict.

## Finance panel examines tax evasion in Cayman Islands

Senate Finance Committee Chairman Max Baucus, D-Mont., on July 24 pushed a panel of witnesses on the findings of a Government Accountability Office (GAO) investigation of the Uglan House, an alleged tax haven in the Cayman Islands. Baucus said the problem might require financial firms to file information reports to the IRS when they facilitate transfers of client funds offshore as a method of enabling the IRS to better track tax evaders by matching that report with filed returns. "I think requiring individuals and companies to be more

forthcoming about their offshore holdings in places like the Caymans will go a long way," said Baucus.

The Finance Committee also sought input on six legislative recommendations, including modifying the rules for the Foreign Bank Account Report (FBAR), which facilitates information collection by the IRS. The proposals would reinforce the role of the IRS in levying penalties against individuals who fail to file an FBAR, increase the statute of limitations for FBAR violations, require that FBARs be filed with tax returns and strengthen rules on the disclosure of the identity of individuals who make money from offshore financial transactions.

## DOJ litigator promotes tax shelter penalties

The "sea change" of tax shelter activity that took place since the 1990s created a current need for stringent tax shelter prosecution, according to Dennis Donohue, chief senior litigation counsel, Department of Justice Tax Division. Donohue stated at a roundtable in Washington, D.C. on July 25 that not only are tax shelter penalties appropriate, but that the Department Justice may need even stronger tools in combating sophisticated tax shelter marketers, despite evidence in other areas that harsh government efforts may actually weaken tax enforcement.

Donohue maintained that diehard tax shelter promoters will never simply give up their activities and move on. Instead, he explained, they will continue their attempts to distinguish their positions from those IRS has deemed abusive. No amount of current regulation, he stated, can deter this behavior. When asked about which alternatives would succeed, Donohue responded, "raising the bar for those who promote these programs from civil to criminal, I think, is going to send alarm bells throughout our respective professions. What remains to be seen is what is going to happen when it does."

# IRS Denies Restricted Management Account Discounts

◆ *Rev. Rul. 2008-35*

In a highly-anticipated ruling, the IRS has determined that the fair market value of a restricted management account (RMA) for federal estate and gift tax purposes is based on the value of the assets in the account without any reduction or discounts. Restrictions imposed by an RMA agreement do not reduce the value of the assets in the account for federal estate and gift tax purposes.

## Background

Code Sec. 2036(a) provides that a decedent's gross estate includes transfers under which he or she retained the right to the possession or enjoyment of, or the right to income from, the transferred property. Further, Code Sec. 2037(a)(2) provides that, subject to exception, for federal estate, gift and generation-skipping transfer (GST) tax purposes, the value of any property is determined

without regard to any restriction on the right to sell or use the property.

## RMA

An individual deposited marketable securities and cash into an RMA for a term of five years. During this time, a bank had complete discretion regarding investments; the individual retained full property rights in the account's assets, however. All dividends, interest and other earned income were reinvested in the RMA. Distributions were not permitted unless allowed by the RMA agreement. After one year of the term, the individual assigned one-sixth of his interest in the RMA to a second RMA for the individual's child. Under the RMA agreement, the RMA was extended to seven years after the third year of the account's term. In the fourth year, however, the individual died. At the expiration of the RMA's term, the assets were to be paid over to the individual, or the individual's representative if the individual was no longer alive.

## No discounts

The IRS determined that the assets remaining in the individual's RMA were includible in his gross estate under Code Sec. 2036(a). Notwithstanding the bank's complete discretion regarding the account's investments and the restrictions on withdrawal, termination and transfer of an interest in the RMA, the individual remained the sole and outright owner of the RMA's assets. Any contractual restrictions imposed by the RMA on the ability to withdraw account assets, terminate the agreement or transfer RMA interests do not affect the FMV of the assets. Under Code Sec. 2703(a)(2), the restrictions on the sale or use of the property were disregarded for federal estate and gift tax valuation purposes. As such, the FMV of the gift to the individual's child for federal estate and gift tax purposes is the value of the assets in the RMA.

*Reference: TRC VALUE: 1,050.*

## Practitioners' Corner

*Continued from page 357*

before the January 1, 2009 effective date of the provision is not used in the calculation; neither are periods after a qualified use of the property or temporary absences of less than two years.

**Real estate investment trusts.** A real estate investment trust (REIT) holds passive investments in real property equity and mortgages. Like the rules for tax-exempt bonds and the LIHTC, the rules for REITs are complex. If a REIT violates these rules, the tax consequences can be severe. The housing act clarifies some of the rules, such as allowing REITs to treat certain foreign currency gains as qualified income for purposes of income tests. Congress also clarified other aspects of the income tests and authorized the IRS to determine if other items should be treated as qualified income for purposes of the income tests, among other changes.

**Down payment assistance.** Seller-funded down-payment-assistance programs provide cash assistance to homebuyers who cannot afford to make the minimum down payment

or pay the closing costs involved in obtaining a mortgage. Despite their popularity, these programs have been criticized for helping to inflate home prices. In 2006, the IRS ruled that organizations that provide seller-funded down-payment assistance to home buyers do not qualify as tax-exempt charities. The new law bans seller-funded down payment assistance programs.

**Military personnel.** The housing bill includes many provisions to help military personnel on active duty and veterans avoid foreclosure. Under the new law, service members and veterans are protected from foreclosure for nine months following a period of military service (rather than the current 90 days). Congress also made the VA home loan program more attractive and provided funding for disabled veterans to make accommodations in their homes for their disabilities.

**Affordable housing.** Tax-exempt housing bonds and the low-income housing tax credit (LIHTC) help to fund the construction of affordable housing units. The rules for tax-exempt housing bonds and the LIHTC are extremely technical. The housing act simplifies these rules and makes other changes,

such as excluding tax-exempt interest on certain housing bonds from being a preference item for AMT purposes. The housing act also allows taxpayers to use the LIHTC and the rehabilitation tax credit to offset AMT liability. Congress also enhanced the rehabilitation tax credit and some special tax breaks for taxpayers in the Gulf Opportunity Zone.

## More provisions

The housing act completely overhauls government regulation of Fannie Mae and Freddie Mac, creating a new regulator for these entities, which own or guarantee nearly half of all U.S. mortgages. Congress also authorized the U.S. Treasury to help fund Fannie Mae and Freddie Mac if needed. Additionally, the new law sets minimum standards for mortgage brokers, strengthens the *Truth in Lending Act* and funds foreclosure prevention counseling.

As you can see, the housing bill really is mammoth in scope. If you have any questions about the new law, please contact our office.

**Sincerely,**

# Compliance Calendar

## ■ August 1

Employers deposit Social Security, Medicare, and withheld income tax for July 26, 27, 28, and 29.

## ■ August 6

Employers deposit Social Security, Medicare, and withheld income tax for July 30, 31, and August 1.

## ■ August 8

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

## ■ August 11

Employees who received \$20 or more in tips during July must report them to their employer using Form 4070.

File Form 941 for the second quarter of 2008. This due date applies only if you deposited the tax for the quarter in full and on time.

## ■ August 13

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

## ■ August 15

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

# Monthly Quizzer

The following questions (with answers at the bottom of the column) will help you review some of the important developments in CCH Federal Tax Weekly during the past month.

**Q** 1. IRS Chief Counsel recently determined that the agency may reconsider a refund claim for which it has already issued a notice of disallowance. *True or False?*

**Q** 2. Under relief from the deferred compensation rules provided to teachers paid over 12 months, the IRS:

- (a) Will not accelerate the taxation of a teacher's annual compensation.
- (b) Will tax amounts as they are paid to the teacher.
- (c) All of the above.
- (d) None of the above.

**Q** 3. The National Taxpayer Advocate views identity theft, indebtedness income and outsourcing of tax collection as the IRS's most significant challenges. *True or False?*

**Q** 4. The IRS responded to rising gas prices by:

- (a) Raising the charitable standard mileage rate from 14 cents-per-mile to 22 cents-per-mile.
- (b) Raising the business standard mileage reimbursement rate from 50.5 cents-per-mile to 58.5 cents per mile.
- (c) Raising the standard mileage rate for medical and moving expenses from 19 cents-per-mile to 58.5 cents-per-mile
- (d) All of the above.

## Answers

**Q1.** True, See Issue #29, page 339.

**Q2.** (c), See Issue #27, page 314.

**Q3.** True, See Issue #28, page 331.

**Q4.** (b), See Issue #36, page 301.

# 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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