



FEDERAL TAX ALERT

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NEWS ITEMS

GAZING INTO THE EIGHT BALL:

TAX CHANGES THAT MAY BE LAW BY END OF FEBRUARY

We are in a brand new Congress — the 1st session of the 111th — and, in an almost unprecedented move, its new members are about to pass an enormous tax bill. Veteran tax watchers like myself (5 years at the Congressional Research Service and 20 years at Tax Analysts) are scratching our heads. We know that omnibus tax bills usually are enacted at the very end of a Congressional session, not at the beginning, particularly of the 1st session. But times are different. And Congress is in a frenzy to find ways to stop the steady U.S. economic decline, reported to the citizenry on a 24-hour basis. Enter the latest legislative beast, The American Recovery and Reinvestment Act of 2009.

Poli Sci 101: A “Congress” is made up of two sessions, each lasting one year. Calendar year 2009 is the first session of the 111th U.S. Congress. Year 2010 will be the second session of the 111th Congress. Public Law numbers indicate the Congress when a law was passed, not the year. For example, the first bank bailout bill, described in the October 2008 version of the *Federal Tax Alert*, is Public Law 110-343, indicating that it was the 343rd bill passed in the 110th Congress.

In late January 2009, the U.S. House of Representatives passed this bill as H.R. 1 by a 244-188 vote. No Republicans voted for

the bill, which contains a \$303.7 billion tax package. Meanwhile the Senate Finance Committee approved its own version of the new stimulus bill, with \$342 billion in tax provisions. Both bills were packaged with other economic measures, including titles dealing with unemployment insurance, workers' continued access to health insurance, boosts in information technology, and fiscal aid to states.

Note: Items unique in each version appear in red below.

Major House Provisions:

- **Making Work Pay income tax credit** of \$500 for individuals and \$1,000 for joint filers, with a phase-out for individuals with \$75,000 in AGI and joint filers with \$150,000 in AGI. The credit would be implemented through reduced paycheck withholding. **Note:** It has been estimated that it will take the Treasury Department until June 1 to give employers the necessary updated withholding schedules.
- Longer carryback period where businesses would be able to **deduct operating losses** incurred in tax years either beginning or ending in 2008 or 2009 from income earned up to five years earlier, enabling them to claim any resulting tax refunds.
- Increased eligibility for **child credit**.
- Waiver of the repayment requirement for the **first-time home buyer tax credit**.
- Increased **earned income tax credit** for 2009 and 2010.
- Modified HOPE scholarship credit to create a new **American opportunity tax credit**.
- Extends through 2009 increased

small-business expensing and bonus depreciation.

- Repeals withholding on government contractors set to otherwise take effect in 2011.
- Reduced AMT on tax-exempt bonds.
- Various **energy tax incentives**.
- **Losses in Mergers.** The bill also legislatively repeals **Notice 2008-83**, which was issued by the IRS in September and allows banks to use the **net operating losses** of failing institutions that they acquire. (See the December 2008 issue of the *Federal Tax Alert*, page 4, for an article on this Notice.)

Major Senate Provisions:

- **Making Work Pay income tax credit** similar to House provision but with a requirement that recipients provide a SSN.
- **Exclude from income tax the first \$2,400 of unemployment benefits in 2009.**
- **Net operating loss five-year carryback** as in House bill.
- New **American opportunity education tax credit**.
- Extend through 2009 increased **small-business expensing and bonus depreciation**.
- Increase the **earned income tax credit** for 2009 and 2010.
- One-year delay of withholding on government contractors.
- Increased eligibility for **child credit**.
- Waives the repayment requirement for the **first-time home buyer tax credit**.
- Extends and expands the new **markets tax credit**.
- Eliminates the **tax-exempt interest** on private activity bonds as a preference item for purposes of the AMT.
- Various **energy tax incentives**.
- Extends **Alternative Minimum Tax (AMT) patch** for one year.
- Delays the taxation of **income from cancelled debt for businesses**.

FROM THE EDITOR

The filing season rush is on, and we tax practitioners have our work cut out for us. With a huge new tax bill passed late in 2008 and another one on the table, even the IRS recognizes the difficulties facing us this filing season. As a result, it has released a number of guidance documents containing explanations of new provisions and reminders about available credits and deductions. The IRS also has announced that it is committed to helping financially distressed taxpayers, not only in filing taxes, minimizing taxes, and getting quick refunds, but also on the back end. The agency is implementing a number of hardship measures to give taxpayers some flexibility in paying taxes they owe when they are in financial difficulty. In addition to postponing collection actions and quicker release of levies, the IRS is prepared to help taxpayers who cannot pay their liability with their 2008 returns. See the lead article under IRS Action News in this issue for more detailed information.

As we struggle with compliance given the new penalty pressures on tax preparers, Treasury Secretary Timothy Geithner has been confirmed despite a serious compliance “error” on his own taxes. You probably have heard enough in the media coverage of his confirmation hearings, but I offer my own take on the controversy in this issue in the News section. More important is understanding Geithner’s priorities for the IRS and tax policy. He offers his vision in written testimony he submitted to the Senate in January, excerpted beginning on page 3.

Be careful how you promote your practice. The IRS has issued new rules on the ability of tax return preparers to disclose and use statistical compilations of anonymous tax return information data in support of their businesses. The guidance provides more flexibility than in the previous regulations, but still has strict limits on claims made in advertising.

Finally, each month it is a challenge to limit the court cases to a manageable number, given the very interesting fact patterns in so many cases. This month we look at cases involving a misapplication of tax payments by the IRS in an estate action, a brawl over an innocent spouse claim, and the liability of a major tax preparation company for its tax records being found, unshredded, in a dumpster.

The next issue will be the combined March/April 2009 FTA. Good luck for a prosperous filing season.

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FINANCIAL PLANNERS IDENTIFY END OF THE YEAR PROBLEMS RESULTING FROM AMT UNCERTAINTY

In a January 21, 2009 letter to the House Ways and Means Committee, the Financial Planning Association (FPA) urged that Congress quickly pass an interim alternative minimum tax (AMT) patch early this year as part of its economic recovery bill. Noting that the burden of the AMT now falls on the middle class, the group notes that taxpayers are frequently unaware they owe this tax until they file their returns. Thus, they have little or no time to plan for the financial consequences or to rearrange their finances to minimize the burden.

The group notes in their letter that an early fix would, “allow financial planners to better help their clients make tax-wise decisions and would provide a greater level of certainty in these uncertain economic times.”

Here’s a list of the specific issues taxpayers face when trying to plan for AMT liability, as identified by the FPA in its letter:

- * Whether to make 4th quarter estimated state and property taxes before or after the end of the year
- * Whether to make miscellaneous itemized deduction payments before or after the end of the year
- * When to make significant medical expense payments that would be deductible but adjusted for AMT purposes
- * Whether to accelerate income into 2009
- * Whether to defer income into 2010
- * The level of income above which the AMT exemption no longer phases out, which affects the desirable timing of completing large transactions that would generate capital gains such as diversifying concentrated stock or selling a small business
- * The impact of various personal expenses in 2009 versus 2010 that would be eligible for various nonrefundable tax credits, such as paying tuition in 2009 versus 2010, adoption expenses this year or next, etc.

TREASURY SECRETARY GEITHNER UNVEILED:

HIS TAX PROBLEM AND HIS PLANS FOR IRS

Former New York Federal Reserve Bank President Timothy Geithner is now President Obama’s new Treasury Secretary, after having been confirmed by the Senate Finance Committee in late January despite his earlier failure to pay self-employment taxes. As Treasury Secretary, Geithner will manage the IRS, along with numerous other offices and bureaus within the department. This article looks at his tax problem and also includes excerpts from his written testimony which explains his goals for the IRS as Treasury Secretary.

- **Broadband tax incentives.** (The House bill includes direct subsidies for development of broadband as opposed to tax incentives.)
- **Five-year carryback of general business credits.**
- **Increases the exclusion for individuals on the gain from the sale of small business stock held for more than five years from 50 percent to 75 percent.**

Pick and Choose:

Here’s my look at the top six tax changes that are the most likely to clear both houses and be enacted as part of the recovery bill.

- **Making Work Pay income tax credit.** (Plays well with constituents.)
- **Extend through 2009 increased small-business expensing and bonus depreciation.** (Help for this important employment sector.)
- **Net operating loss five-year carryback.** (Corporate break palatable to both parties.)
- **First-time home buyer tax credit expansion.** (A nod to housing market problems.)
- **Reduce AMT on tax-exempt bonds.** (Designed to help the states.)
- **Various energy tax incentives.** (The latest Congressional fad.)

The Tax Problem

In short, Geithner was employed by the International Monetary Fund (IMF) for several years in the early 2000s. The IMF does not withhold U.S. payroll tax, so U.S. employees are responsible for paying the tax on their own. The IMF grosses up their salaries to cover the tax liability and then makes each employee sign a “tax allowance application” acknowledging the obligation and agreeing to take responsibility for reporting and paying the tax.

Geithner signed these notices, but did not pay the taxes during the years in question. As a result, he owed \$34,000, which came to light in an IRS audit in 2006. He had prepared his own returns for 2001 and 2002 but used paid preparers in 2003 and 2004. As a result of the audit, Geithner filed amended returns for years 2004 through 2006 and paid back taxes for those years. Geithner was granted a waiver from penalties on those amounts by the IRS, for reasons which remain somewhat unclear.

The true controversy surrounds his returns for tax years 2001 and 2002. Geithner did not pay those taxes until after Obama’s transition team began looking at him as a possible nominee for Treasury Secretary. All of a sudden, in December, Geithner paid more than \$40,000 in back taxes and interest for 2001 and 2002, even though the IRS could not collect the taxes from those years because of the three-year statute of limitations for filed returns.

The media coverage of Geithner’s blunder was extensive, making it difficult to sort out the credibility of his argument regarding the inadvertence of his failure to pay. But two points are worth noting. Geithner claims he used a popular commercial tax preparation software to prepare his 2001 and 2002 returns. Thus, it is likely the software diagnostic “warned” him of a payroll tax discrepancy, depending on how he entered the income—as Schedule C income, W-2 income, or 1099 income. In addition, it is likely that he knew those years were closed, and this fact may have led him to disregard back payments at the time. The interesting issue which was never fully explored by the Finance Committee or the media was how and why his return preparers did not address the problem on his 2003 and 2004 returns. We may never know.

Secretary Geithner’s Goals for the IRS and Tax Policy

At a hearing in late January before the Senate Finance Committee, Treasury Secretary Geithner submitted 62 pages of written testimony regarding his goals for the IRS and

his plans for specific tax initiatives. Included as priorities were increasing e-filing, preparer competency standards, curbing offshore tax evasion, a permanent fix for the alternative minimum tax, and, a perennial favorite, simplifying the tax code. Set forth below are excerpts from his testimony dealing with the IRS and anticipated tax changes.

EXCERPTS FROM GEITHNER’S TESTIMONY REGARDING TAX POLICY AND IRS OPERATIONS

FINANCE COMMITTEE QUESTIONS FOR THE RECORD

United States Senate
Committee on Finance
Hearing on Confirmation of Mr. Timothy F. Geithner to be
Secretary of the U.S. Department of Treasury
January 21, 2009

ANSWERS TO QUESTIONS FROM CHAIRMAN BAUCUS

Question 1: [Offshore Tax Evasion]

Estimates of revenue lost because of offshore tax evasion range from \$50 to \$100 billion. The Finance Committee has had a number of hearings on the offshore tax evasion issue and I believe the next step is to pass legislation cracking down on offshore tax evaders, and I will be introducing a bill early in this session of Congress to address this problem.

Mr. Geithner, I hope you will take a close look at this legislation and help us to pass it from your new perch at the Treasury Department. Will you commit to setting aside time to help us develop a solution to this problem?

Yes, Senator Baucus, as soon as my tax team is fully in place, I look forward to setting aside time to review your forthcoming legislation and helping you, your staff, and other members of the Senate develop a solution to the problem of offshore tax evasion.

I share the President’s commitment to aggressively address the problem of offshore tax evasion and complement you and other members of the Senate for the work you’ve already done on this important issue. If confirmed, I will treat offshore tax evasion as a high priority issue and examine a wide range of policy options to address these abuses, including increasing IRS enforcement efforts, requiring greater disclosure and taxpayer accountability, and changing the presumption for transactions in tax-secrecy jurisdictions.

Question 5: [IRS Information Technology]

How will you make sure the IRS actually

updates its information technology and doesn’t squander IT funds on systems that don’t work, like it has in the past?

We must do a more effective job in planning and executing an information technology strategy for the Internal Revenue Service. Technology has the capacity to improve the speed and accuracy of tax administration. For this reason, improving IRS information systems must be an important priority. If we hope to make progress, it is important that we seek the opinion of the best technology experts in government and the private sector to develop a strategy going forward. If confirmed, I will work closely with the IRS Commissioner and other federal officials to achieve this goal.

How can the IRS workforce, especially senior leadership, be motivated to stay at the IRS and develop innovative ways to improve the organization?

There are critical workforce issues confronting the entire Federal government, including the IRS. The Federal government must do a better job in both recruiting and retaining employees, particularly senior leadership. The level of expected retirements at all ranks of our workforce must be considered as we formulate strategies to raise the attractiveness of government service. If confirmed, I will examine the workforce challenges confronting the IRS. As someone who has spent most of his professional career working for the Federal government, I know firsthand how important it is to attract top candidates to work in the public sector.

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Monday & Tuesday	9 AM — 5 PM ET
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Thursday	12 PM — 5 PM ET

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Question 7: [Funding for IRS Enforcement]

What can the IRS do to stem the tide of scams and schemes — offshore arrangements like UBS, and abuses like the Madoff Ponzi scheme — that result in folks hiding their income from Uncle Sam?

I share the President's commitment to closing down tax loopholes. I look forward, if confirmed, to working with the committee to examine this issue.

If confirmed, I will be a strong advocate for the Internal Revenue Service and its efforts to secure sufficient funding to carry out its mission successfully. Tax enforcement is a key priority for the IRS and I look forward to working with IRS Commissioner Doug Shulman to ensure that the compliance and enforcement mission of the IRS receives the necessary support and funding.

Question 8: [Preparer Competency Standards]

60% of individual returns are prepared by paid preparers. Do you support standard preparer competency standards in order to improve the quality of the returns they file?

A first objective is to seek ways to make the tax code more simple so that more taxpayers are able to complete their taxes without the additional financial burden of a paid preparer. However, there is little doubt that many taxpayers will continue to make use of paid preparers. For this reason, it is important that taxpayers have confidence that the advice they receive is competent. What steps we should take toward this objective I have not had an opportunity to study fully. I look forward to working with you and other members of the Committee to address this issue if I am confirmed.

Question 9: [Encouraging E-Filing]

In 1998, Congress set a goal of 80% electronically filed returns by 2007. In 2008, about 60% of returns were e-filed. What will you do to encourage e-filing so taxpayers get their refunds faster, errors are reduced, and the IRS can operate more efficiently?

I strongly support the President's promise to simplify the tax code. During the campaign, he outlined a proposal to develop a system that would dramatically simplify tax filings so that millions of Americans will be able to do their taxes in less than five minutes. If confirmed, I look forward to working with Congress on this and other ideas to simplify the tax code and increase the number of Americans that electronically file their tax returns.

Question 15: [Increasing Voluntary Compliance]

The IRS estimates the tax gap, the difference between the taxes legally owed and those paid on time, to be \$345 billion each year. In 2007, I asked Secretary Paulson to make a commitment to reach 90% voluntary tax compliance by 2017 -- ten years to raise the rate from its current 83.7%.

(i) Do I have your commitment that you will

work to achieve 90% voluntary compliance within 10 years?

I will work to improve the level of voluntary compliance and believe that, with adequate support from Congress, we can achieve 90% voluntary compliance within the next decade. The President is committed to implementing an effective program to close the tax gap and the Administration looks forward to working with you on this effort.

Question 20: [Complexity of Tax Code]

Mr. Geithner, on January 21, 2009, the New York Times ran an op-ed piece entitled "Questions for Mr. Geithner." The article posed the following questions, which I would like you to answer.

a. The American tax code is so complex that even Treasury secretary nominees can easily make mistakes on their returns. Furthermore, while income tax rates are 10 percent to 35 percent for individuals and 35 percent for corporations, because of the proliferation of deductions, credits, exclusions and loopholes, the revenue from income tax amounts to only 10 percent of gross domestic product. Should you give priority to simplifying the code and enforcing compliance before raising rates?

— CHARLES O. ROSSOTTI, the Commissioner of Internal Revenue from 1997 to 2002

[Former] IRS Commissioner Charles Rossotti is correct that our country should make tax simplification and compliance an important priority. The President shares his commitment to this objective, as is evidence by his proposal to allow millions of Americans to be able to do their taxes in less than five minutes.

[Expiring Tax Provisions]

f. Do you believe raising taxes on savings and investment, as would occur if the Bush tax cuts expire in 2010, will help or hurt our economy?

Our immediate priority is to work with Congress to provide substantial tax relief for families and businesses through an economic recovery plan. The President pledged to cut taxes for 95% of working Americans. For businesses, we propose to cut taxes for companies that are making job-creating investments. Beyond that, it is premature to speculate on the tax provisions that expire in 2010.

[Tax Fairness]

i. The income tax code favors those with employer-provided health insurance over those who buy their own health insurance or pay medical bills out of pocket. It also favors homeowners over renters, through the mortgage interest deduction. Is this tax treatment efficient or fair? Might you favor a more level playing field?

Measuring efficacy and fairness of the present U.S. tax code can only be undertaken in full view of the tradeoffs allowed or imposed by the Code on the wide range of beneficiaries and participants. I support the goal of fairness, and

look forward to working with the Congress in considering realistic steps that can be taken to improve both fairness and simplicity.

[Estate Tax]

j. President Obama supports the estate tax. Why should a person who leaves his money to his children pay more in taxes than another person with the same lifetime income who spends all his money on himself?

— N. GREGORY MANKIOW, a professor of economics at Harvard

During the campaign, President Obama proposed extending the rate and exemption level that will apply in 2009. However, I understand the strong emotions on both sides of this issue and I look forward to working with all of the Members of the Committee to develop a fiscally responsible solution that provides certainty to families and is consistent with President Obama's principle of restoring tax fairness. Additionally, I should note that President Obama wants to minimize the impact that the estate tax has on small businesses and family farms. His proposal to extend the rate and exemption level that will apply in 2009 ensures that less than 1% of small businesses and farms would be impacted by the estate tax.

QUESTIONS FROM SENATOR GRASSLEY

Question 8: [Withholding on Government Contractors]

Given your statement in today's hearing that you believe that third party information reporting can improve compliance, do you believe that repealing the 3% withholding requirement as passed by the House is a good proposal? Do you support this proposal.

I appreciate the opportunity to discuss with you measures that will improve tax compliance. If confirmed, I look forward to hearing from Commissioner Shulman and members of Congress on ways we can improve compliance. Recent steps taken to enhance information reporting have improved compliance and simplified tax filing and serve as a model for future action. With respect to the withholding provision, I have not had an opportunity to study this provision closely but, if confirmed, I will examine this proposal along with other ideas in this area.

Question 9: [IRS Private Debt Collection Program]

I understand that the current contracts with the collection agencies expire on March 1 and that the IRS must decide by February 1 whether the contracts will be extended. I understand that the IRS is studying the private debt collection program but that, as of an October briefing with my staff, the study was flawed. Since it is unlikely that I will be briefed on this study before February 1, I would like your commitment that Treasury will not terminate this

program until there has been a complete and thorough accounting of this program.

If confirmed, I will ask IRS Commissioner Shulman to provide me with a complete and thorough examination of this program before the approaching date for action in this area.

Editor's Note: More questions and testimony on a myriad of issues will follow on page 12.

IRS ACTION NEWS

IRS STARTS 2009 TAX SEASON WITH STEPS TO SPEED REFUNDS AND HELP FINANCIALLY DISTRESSED TAXPAYERS

Not surprisingly, the IRS kicked off the 2009 tax filing season by announcing new steps to help financially distressed taxpayers maximize their refunds and speed payments while providing help to taxpayers struggling to meet their tax obligations.

IRS encouraged taxpayers to take advantage of several new tax credits and deductions this filing season and to examine whether with less income, they are now eligible for tax breaks for which they did not qualify last year. The IRS reminded taxpayers of the following provisions they may qualify for:

First-Time Homebuyer Credit. Up to \$7,500 for qualified taxpayers. (See page 6 of this issue for an explanation of the rules for this credit.)

The Recovery Rebate Credit: This credit is figured like last year's Economic Stimulus Payment except that Recovery Rebate Credit amounts are based on tax year 2008 instead of 2007. Most people already received their full benefit in the form of the Economic Stimulus Payment. However, a taxpayer may qualify for the Recovery Rebate Credit, if, for example, he or she did not get an Economic Stimulus Payment, had a child in 2008 or had a change in income level.

Standard Deduction for Real Estate Taxes: Taxpayers can claim an additional standard deduction, based on the state or local real estate taxes paid in 2008. The maximum deduction is \$500, or \$1,000 for joint filers.

Mortgage Workouts and Foreclosures: Eligible homeowners can exclude debt forgiven on their principal residence if the balance of the loan was less than \$2 million. The limit is \$1 million for a married person filing a separate return.

Earned Income Tax Credit (EITC): Working families with incomes below \$41,646 and childless workers with incomes under \$15,880 often qualify for this credit.

Child Tax Credit: A taxpayer who has a dependent child under age 17 generally qualifies for the child tax credit. This credit, which can be up to \$1,000 per eligible child,

is in addition to the regular \$3,500 exemption claimed for each dependent. A change in the way the credit is figured means that more low and moderate-income families will qualify for the full credit on their 2008 returns.

Credit for Child and Dependent Care Expenses: An individual who pays for someone to care for a child so he or she can work or look for work qualifies for the child and dependent care credit for children under age 13 or disabled spouses or dependents. Normally, the child must be the taxpayer's dependent and under age 13. In most cases, the care provider's Social Security Number or taxpayer identification number must be obtained and entered on the return.

Education Credits: The Hope credit and the lifetime learning credit are available for a taxpayer's or dependent's college education expenses.

Saver's Credit: The saver's credit is designed to help low and moderate-income workers save for retirement. A taxpayer qualifies if his income is below certain limits and he contributes to an IRA or workplace retirement plan, such as a 401(k). Income limits for 2008 are:

- * \$26,500 for singles and married taxpayers filing separately
- * \$39,750 for heads of household and
- * \$53,000 for joint filers

Remember that 2008 IRA contributions can be made until April 15, 2009.

Other Credits Available

- * District of Columbia first-time homebuyer credit, claimed on Form 8859
- * Foreign tax credit, claimed on Form 1040 Line 47
- * Credit for the elderly or the disabled, claimed on Form 1040 Schedule R
- * Adoption credit, claimed on Form 8839
- * Residential energy efficient property credit, claimed on Form 5695
- * Alternative motor vehicle (including hybrids) credit, claimed on Form 8910
- * Credit for prior year minimum tax, claimed on Form 8801

Free File, E-File, E-Pay and Direct Deposit

The IRS also has announced a major enhancement to the Free File program that will allow nearly all taxpayers to e-file for free and accelerate their refunds. According to the IRS, taxpayers who e-file and choose direct deposit for their refunds will get their refunds in as few as 10 days. That compares to approximately six weeks for people who file a paper return and get a traditional paper check.

Anyone with an adjusted gross income up to \$56,000 can use the standard Free File options this year, which this year offers a standardized set of electronic forms that are most frequently used by Free File-eligible taxpayers. The IRS and its partners also are offering a new option, Free File Fillable Tax Forms, that opens up Free File to even those whose incomes exceed \$56,000.

The new **Free File Fillable Tax Form** option allows taxpayers to fill out and file their tax forms electronically, just as they would on paper. This option does not include an "interview" process like the other Free File offerings, but it does allow taxpayers to enter their tax data, perform basic math calculations, sign electronically, print their returns for recordkeeping and e-file their returns.

Help for People Who Owe Taxes

With many people facing financial difficulties, the IRS is taking steps to help people who owe back taxes, first by giving IRS employees the flexibility to work with struggling taxpayers. Depending on the circumstances, taxpayers in hardship situations may be able to adjust payments for back taxes, avoid defaulting on payment agreements or possibly defer collection action. The IRS has said it will consider the following actions to help distressed taxpayers:

Postponement of Collection Actions: IRS employees will have greater authority to suspend collection actions in certain hardship cases where taxpayers are unable to pay. This includes instances when the taxpayer has recently lost a job, is relying solely on Social Security or welfare income or is facing devastating illness or significant medical bills.

Added Flexibility for Missed Payments: The IRS is allowing more flexibility for previously compliant taxpayers paying under existing Installment Agreements who have difficulty making payments because of a job loss or other financial hardship. The IRS may allow a skipped payment or a reduced monthly payment amount without automatically suspending the Installment Agreement.

Additional Review for Offers in Compromise on Home Values: Although an Offer in Compromise (OIC), may be a viable option for taxpayers experiencing economic difficulties, the equity taxpayers have in real property can be a barrier to an OIC being accepted. With the uncertainty in the housing market, the IRS recognizes that the real-estate valuations used to assess ability to pay may not be accurate. So in instances where the accuracy of local real-estate valuations is in question or other unusual hardships exist, the IRS is creating a new second review of the information to determine if accepting an offer is appropriate.

Prevention of Offer in Compromise Defaults: Taxpayers who are unable to meet the periodic payment terms of an accepted OIC will be able to contact the IRS office handling the offer for available options to help them avoid default.

Expedited Levy Releases: The IRS will speed the delivery of levy releases by easing requirements on taxpayers who request expedited levy releases for hardship reasons. Taxpayers seeking expedited releases for levies to an employer or bank should contact

the IRS number shown on the notice of levy to discuss available options. When calling, taxpayers requesting a levy release due to hardship should be prepared to provide the IRS with the fax number of the bank or employer processing the levy.

Inability to Pay When Filing for 2008: Taxpayers with financial problems who discover they cannot pay when they file their 2008 tax returns also have options available. The IRS website at www.irs.gov has a list of "What If?" scenarios that deal with payment and other financial problems. These scenarios, in question-and-answer format, provide information on specific actions taxpayers can take. Taxpayers unable to pay in full can likewise contact the IRS to discuss additional options to pay.

GUIDANCE ON HOW TO ALLOCATE HOMEBUYER CREDIT BETWEEN UNMARRIED TAXPAYERS

The IRS has issued guidance on how to allocate the new first-time homebuyer credit between unmarried taxpayers who purchase a principal residence together either as tenants in common or joint tenants. The guidance restates the basic rules for the credit and provides examples of acceptable allocations, shown below.

Credit Basics: The credit, enacted last year, allows a 10 percent credit up to \$7,500 of the purchase price of a principal residence by a first-time homebuyer. To qualify as a first-time homebuyer, the taxpayer must not have owned a principal residence during the past three years. The taxpayer also cannot have purchased the property from a related person, and the property has to be purchased after April 9, 2008 and before July 1, 2009. The credit begins to phase out for a taxpayer whose modified adjusted gross income (MAGI) is \$75,000 (\$150,000 for married taxpayers filing a joint return). The credit is completely phased out for a taxpayer whose MAGI is \$95,000 (\$170,000 for married taxpayers filing a joint return). Finally, those claiming the credit must repay it in 15 equal annual installments beginning with the second taxable year after the taxable year in which the taxpayer claims the credit, although some versions of the new stimulus bill would drop the repayment requirement. (See page 1 of this issue for an article on the proposed stimulus provisions.)

Allocation Methods. The first-time homebuyer credit may be allocated between the unmarried taxpayers using any reasonable method. Reasonable methods include allocating the credit based on either the taxpayers' contributions towards the purchase price of the residence as tenants in common or joint tenants or based on the taxpayers' relative ownership interests in a residence as tenants in common. Of course, the total credit allocated between the taxpayers cannot exceed the \$7,500 limitation.

IRS EXAMPLES

The examples below illustrate how the first-time homebuyer credit may be allocated when A and B purchase a principal residence as tenants in common. The rules illustrated in the examples also apply in a similar manner to taxpayers who purchase a principal residence as joint tenants. Unless otherwise indicated, assume that A and B in each example (i) purchase a principal residence on May 1, 2008, (ii) are not married to each other, (iii) do not have MAGI in excess of the MAGI threshold, and (iv) are first-time homebuyers who otherwise satisfy the requirements of § 36.

Example 1.

A contributes \$45,000 and B contributes \$15,000 towards the \$60,000 purchase price of a residence. Each owns a one-half interest in the residence as tenants in common. Under § 36(a), the allowable credit is limited to 10 percent of the purchase price, or \$6,000. A and B may allocate the allowable \$6,000 credit three-fourths to A and one-fourth to B based on their contributions toward the purchase price of the residence, one-half to each based on their ownership interests in the residence, or using any other reasonable method (for example, the entire credit to A or B because both A and B are eligible to claim the entire allowable credit).

Example 2.

A contributes \$10,000 for a down payment towards the \$100,000 purchase price of a residence, and A and B obtain and are jointly liable for a \$90,000 mortgage for the remainder of the purchase price. Each owns a one-half interest in the residence as tenants in common. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. A and B may allocate the allowable \$7,500 credit 55 percent to A and 45 percent to B based on their contributions toward the purchase price, one-half to each based on their ownership interests in the residence, or using any other reasonable method (for example, the entire credit to A or B because both A and B are eligible to claim the entire allowable credit).

Example 3.

On April 15, 2008, A pays the entire \$100,000 purchase price of a residence and is the sole owner. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. On May 12, 2008, A transfers a one-half interest in the residence to B as a tenant in common for \$10,000. A may claim the entire allowable \$7,500 credit. Because B acquired B's interest in the residence from A in part by gift, B's basis in the residence is determined under § 1015 by reference to A's basis in the residence. Therefore, B did not purchase an interest in the residence within the meaning

of § 36(c)(3), and no portion of the credit may be allocated to B because B is not eligible to claim any portion of the credit.

Example 4.

A and B each contributes \$50,000 toward the \$100,000 purchase price of a residence and owns a one-half interest in the residence as tenants in common. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. However, B is not a first-time homebuyer within the meaning of § 36(c)(1). Therefore, no portion of the credit may be allocated to B because B is not eligible to claim any portion of the credit. A may claim the entire allowable \$7,500 credit.

Example 5.

A contributes \$75,000 and B contributes \$25,000 toward the \$100,000 purchase price of a residence, and each owns a one-half interest in the residence as tenants in common. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. A's MAGI is \$100,000 and B's MAGI is \$60,000. Because A's MAGI exceeds the \$95,000 MAGI cap, any portion of the credit allocated to A would be reduced to \$0. A and B may allocate the entire allowable \$7,500 credit to B because B's MAGI is less than the \$75,000 MAGI threshold and, therefore, B is eligible to claim the entire allowable credit.

Example 6.

A and B each contribute \$50,000 toward the \$100,000 purchase price of a residence and owns a one-half interest in the residence as tenants in common. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. A's MAGI is \$80,000 and B's MAGI is \$60,000. Because A's MAGI exceeds the \$75,000 MAGI threshold by \$5,000, any portion of the allowable credit allocated to A will be reduced by one-quarter, \$5,000 (MAGI in excess of \$75,000) / \$20,000. A and B may allocate the allowable \$7,500 credit one-half to A and one-half to B (\$3,750 each) based on their contributions toward the purchase price of the residence or their ownership interests in the residence. However, A's \$3,750 portion of the credit is limited by § 36(b)(2) and is reduced by one-quarter ($\$3,750 \times .25 = \937.50) to \$2,812.50 ($\$3,750 - \937.50). Alternatively, A and B may allocate the allowable \$7,500 credit using any other reasonable method (for example, the entire credit to B because B's MAGI is less than the \$75,000 MAGI threshold and, therefore, B is eligible to claim the entire allowable credit).

Example 7.

A and B, who are sisters, each contribute \$50,000 toward the \$100,000 purchase price of a residence and each owns a one-half interest

as tenants in common. Under § 36(b)(1)(A), the allowable credit is not \$10,000 (10 percent of the purchase price) but is limited to \$7,500. A and B purchase the residence from their cousin, C. A, B, and C are not related persons within the meaning of § 36(c)(5). Therefore, A and B may allocate the allowable \$7,500 credit one-half to A and one-half to B based on their contributions toward the purchase price of the residence or their ownership interests in the residence. Alternatively, A and B may allocate the allowable \$7,500 credit using any other reasonable method (for example, the entire credit to A or B because both A and B are eligible to claim the entire allowable credit).

How to Claim the Credit on Form 5405: For eligible purchases in 2008, a taxpayer claims the credit by attaching Form 5405, "First-Time Homebuyer Credit," to the taxpayer's 2008 tax return. For eligible purchases in 2009, a taxpayer may elect to claim the credit for 2008 or 2009 by attaching Form 5405 to the taxpayer's original or amended 2008 tax return or 2009 tax return.

PRIMER ON "TENANTS IN COMMON" VERSUS "JOINT TENANTS"

Tenancy in common

Tenants in common own separate shares of property and have no right to each other's interest upon the death of the other tenant.

Joint tenancy

In joint tenancies with survivorship, when two people own property as joint tenants and one owner dies, the other owner automatically gets the deceased owner's share.

It is said that tenants in common own by the part but not by the whole, whereas joint tenants own by the whole, but not by the part.

IRS ISSUES NOTICE ON PREPARER PENALTIES FOR UNREASONABLE POSITIONS

The IRS has issued guidance in the form of a Notice (2009-5) to supplement the final regulations on the implementation of the tax return preparer penalty under section 6694 as amended by the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. (See page 1 of the November 2008 *Federal Tax Alert* for an article on the new reporting standard for tax return preparers and see page 6 of the January 2009 *Federal Tax Alert* for an article on the new regulations.) The IRS also has issued a revenue procedure (Rev. Proc. 2009-11) that identifies the returns and refund claims that are subject to the penalties for understatement of a taxpayer's liability by a tax return preparer and for the return preparer's failure to sign the return or refund claim.

The IRS explained that the Notice provides interim guidance on the penalty for knowingly filing a return or refund claim that shows an understatement of liability due to an "unreasonable position." The Notice focuses on the definition of "substantial authority" and interim penalty compliance rules for tax shelter transactions.

Definition of Substantial Authority

Until further guidance is issued, "substantial authority" has the same meaning as in the accuracy-related penalty regulations. The authorities considered in determining whether there is substantial authority for a position are those that come from primary source or government documents, such as IRS administrative pronouncements or court opinions. Also, in the case of a tax return preparer, a written determination with a misstatement or omission of material fact is substantial authority unless the tax return preparer knew or should have known of the misstatement or omission of material fact when the return or claim for refund was filed. There also is substantial authority for a position if the position is supported by controlling precedent of a United States Court of Appeals to which the taxpayer has a right of appeal with respect to the position. Finally, substantial authority for a position must exist on the date the return or claim for refund is deemed prepared or on the last day of the taxable year to which the return relates.

Conclusions reached in treatises, periodicals, legal opinions, or opinions rendered by tax professionals (including tax return preparers) are not authority. A tax return preparer nevertheless will be considered to have met the standard if the tax return preparer relies in good faith and without verification on the advice of another advisor, another tax return preparer, or other party.

Interim Penalty Compliance Rules for Tax Shelter Transactions

A position on a tax shelter will not be deemed an "unreasonable position" if there is substantial authority for the position and the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer in the event that the transaction is deemed to have a significant purpose of Federal tax avoidance or evasion. This advice to the taxpayer must explain that, if the position has a significant purpose of tax avoidance or evasion, then there needs to be a minimum substantial authority for the position, the taxpayer must possess a reasonable belief that the tax treatment was more likely than not the proper treatment in order to avoid a penalty and will not protect the taxpayer from assessment of an accuracy-related penalty. The tax return preparer must contemporaneously document the advice in the tax return preparer's files.

If a nonsigning tax return preparer provides advice to another tax return preparer regarding a position with respect to a tax shelter the position will not be deemed an "unreasonable position" if there is substantial authority for the position and the nonsigning tax return preparer provides a statement to the other tax return preparer about the penalty standards applicable to the tax return preparer under section 6694.

Contemporaneously prepared documentation in the nonsigning tax return preparer's files is sufficient to establish that the statement was given to the other tax return preparer. If a nonsigning tax return preparer and other tax return preparer are employed by the same firm, then documentation of advice provided by any tax return preparer in that firm to the taxpayer regarding applicable penalty standards also is sufficient to establish that the statement was given by a nonsigning tax return preparer to the other tax return preparers within the firm.

Observation: The complexity of the numerous guidance documents released on this issue and the volume of comments is daunting. Watch future issues for an analysis of the comments received by the IRS.

Also note: The "substantial authority" standard, which has replaced the "more likely than not" standard, is still a higher standard than the pre-May 26, 2008 "realistic possibility" standard.

IRS SETS MAXIMUM VALUES FOR EMPLOYER-PROVIDED VEHICLES IN 2009

The IRS has established maximum vehicle values for 2009 that taxpayers need to determine the value of personal use of an employer-provided vehicle under the special valuation rules. These values are indexed annually for inflation.

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2009 for which the vehicle cents-per-mile valuation may be applicable is \$15,000 for a passenger automobile and \$15,200 for a truck or van;

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2009 for which the fleet-average valuation rule may be applicable is \$19,900 for a passenger automobile and \$19,900 for a truck or van.

2009 RULES FOR OBTAINING LETTER RULINGS, TECHNICAL ADVICE

The IRS has issued its yearly voluminous Revenue Procedure on how to obtain letter rulings and information letters. **Revenue Procedure 2009-1.** Included in the same issue of the Internal Revenue Bulletin (IRB 2009-1) is **Revenue Procedure 2009-2**, which explains when and how the IRS will issue technical

advice memoranda to a director or an Appeals Area Director. It also explains the rights a taxpayer has when a field office requests a TAM regarding a tax matter. Finally, **Revenue Procedure 2009-3** lists areas in which rulings will not be issued on domestic tax matters. To retrieve these documents from the IRS website, enter "2009-1" in the search box for Other Official Tax Guidance, Complete IRB, under the Tax Professionals, Code, Regs & Guidance tab.

IRS MAKES PREFILING AGREEMENT PROGRAM PERMANENT

The IRS has made permanent its prefilling agreement program. Under this program, large and midsize businesses are able to resolve tax issues for the current tax year and up to four future tax years before they file a return.

HOW FINANCIAL INSTITUTIONS ARE TO REPORT 2009 REQUIRED MINIMUM DISTRIBUTIONS FROM RETIREMENT PLANS

The IRS has issued guidance to financial institutions on reporting required minimum distributions (RMDs) from tax-qualified retirements plans given the waiver of RMDs for 2009 enacted by Congress in 2008. That law waives any required minimum distributions (RMDs) for 2009 from retirement plans such as 401(k) plans, 403(b)s and 457(b)s and also waives any RMD for 2009 from an Individual Retirement Arrangement (IRA). Thus, most participants and beneficiaries otherwise required to take minimum distributions from these types of accounts are not required to withdraw any amount in 2009.

The Act does not waive any 2008 RMDs, even for individuals who were eligible and chose to delay taking their 2008 RMD until April 1, 2009 (e.g., retired employees and IRA owners who turned 70 1/2 in 2008). These individuals must still take their full 2008 RMD by April 1, 2009. The 2009 RMD waiver under the Act does apply to individuals who may be eligible to postpone taking their 2009 RMD until April 1, 2010 (generally, retired employees and IRA owners who attain age 70 1/2 in 2009). However, the Act does not waive any RMDs for 2010.

Also, if a beneficiary is receiving distributions over a 5-year period, he or she can now waive the distribution for 2009, effectively taking distributions over a 6-year rather than a 5-year period.

Instructions for Form 5498: Issuers of the 2008 Form 5498, IRA Contribution Information, should not put a check in Box 11. However, in recognition of the short amount of time to make programming changes, if a financial institution issues a 2008 Form 5498 with a check in Box 11, the IRS will not consider such form issued incorrectly solely because of the check in Box 11, provided the IRA owner is notified by the finan-

cial institution no later than March 31, 2009, that no RMD is required for 2009.

In addition, the required yearly RMD information need not be sent to IRA owners for 2009. If a financial institution sends a separate RMD statement to an IRA owner, either initially or in response to the owner's request for the financial institution to calculate the RMD for 2009, the financial institution must show the RMD for 2009 as zero (0). Alternatively, the financial institution may send the IRA owner a statement showing the RMD that would have been required but for the waiver of RMDs for 2009, along with an explanation of the waiver for 2009.

Important: In the Notice, the IRS encourages all financial institutions to inform IRA owners who delayed taking their 2008 RMD until April 1, 2009, that they are still required to take that distribution. Be prepared for questions from your clients on this issue. The guidance is clear. No break for delayed 2008 RMDs.

IRS ISSUES GUIDANCE FOR ELECTING RESEARCH, AMT CREDITS IN LIEU OF BONUS DEPRECIATION

In a recent Revenue Procedure, the IRS has provided additional information on how corporations may elect to increase their business credit limitation or their alternative minimum tax (AMT) credit limitation instead of claiming their "stimulus" or 50 percent bonus depreciation under the 2008 Housing Act. The election is allowed for new property acquired after March 31, 2008 and placed in service before January 1, 2009. (For prior coverage, see page 7 of the December 2008 *Federal Tax Alert*.)

The supplemental guidance contains detailed rules on the time and manner for making the election, the allocation of credit increases between controlled group members, and the effect of an election on partnership whose corporate members have made the election. Procedures also are given for the application of the election option for S corporations and rules for elections by certain automotive partnerships.

For more information, see Revenue Procedure 2009-16, available on the IRS website.

IRS PUBLISHES 2009 TABLES SHOWING AMOUNTS EXEMPT FROM LEVY

FOR DELINQUENT TAX

In Notice 2008-114, the IRS has published tables from Publication 1494 for figuring the amount exempt from levy on wages, salary, and other income. Amounts exempt for each pay period are shown in five tables covering each possible filing status, including single, unmarried head of household, married

filing jointly, married filing separately, and an additional exemption for blind taxpayers and taxpayers over 65 years of age. Amounts are provided for each different type of pay period, including daily, weekly, biweekly, semimonthly and monthly and are based on the number of exemptions claimed. IRS also gives examples illustrating how to read the tables.

To view the tables, enter "2008-114" in the search box on the homepage of the IRS website.

IRS HOLDS HEARING ON CHARITABLE CONTRIBUTION REPORTING RULES

The IRS took testimony on January 23rd on proposed rules for appraisal of charitable contributions under the substantiation and reporting requirements for cash and noncash charitable contribution deductions. The regulations, issued in August 2008, reflect the enactment of provisions of the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006 and provide guidance to individuals, partnerships, and corporations that make charitable contributions. Many appraiser groups have been weighing in on the proposed rules, most praising the requirement as not too burdensome. With that level of practitioner support, you can expect that the IRS will finalize the rules soon, with some minor changes for valuing noncash contributions.

COURT OPINIONS

Misapplication of Tax Payment by IRS: ESTATE OF LEONARD ROSEN v. COMMISSIONER 131 T.C. No. 8 (2008)

Issue: Whether the IRS can recharacterize an estate tax payment to satisfy the income tax liability of the decedent after the period for assessment on the income tax return has expired.

Facts: This case involves the final 1040 filing of a deceased person and his estate's Federal Estate Tax Return (Form 706). In June 2001, the estate administrator filed Rosen's final income tax return for the year of his death, 2000. The estate included with decedent's final income tax return a check in the amount of \$1,073,654. In August 2001, the IRS processed the payment made with Rosen's final income tax return and refunded to the estate \$499,757 (plus interest of \$1,316) as an overpayment of Rosen's 2000 income tax through a check payable to the estate in the amount of \$501,073.

After the estate had received the refund check, an accountant for the estate notified the IRS that the estate believed that IRS had mistakenly not taken into account the interest owed from excess foreign passive investment company income.

Approximately one week later, the estate marked the refund check void and sent it back to the IRS with a letter stating that the funds reflected in that check were apparently for the interest connected with decedent's final income tax return. The IRS reapplied the funds to the 2000 taxes as an overpayment. Then, the estate later learned from the IRS that the excess funds had been applied to the estate's liability for estate tax. In November 2005, after the 3-year period of limitations had expired as to the decedent's 2000 income tax, the IRS recharacterized the funds as an income tax payment and decreased the estate tax payment by a similar amount.

Analysis and Conclusion: The IRS argued that its treatment of the disputed funds as a payment of decedent's 2000 income tax carried out the estate's intent in tendering those funds in the first place. The Tax Court disagreed, noting that the IRS unilaterally changed its records to apply the funds to the income tax after the expiration of the three-year period of limitations for assessment for decedent's 2000 Federal income tax. Given the timing of that change, the IRS was bound by its mistake, and it was too late for the IRS to use the funds to satisfy any increased income tax liability. Rather, the funds represented estate tax payments.

Comment: The timing of IRS deficiency assessments are limited by the statute of limitations, three years under normal circumstances when a return has been filed. In this case, the IRS's assessment period had expired, so IRS attempted to get around it by unilaterally recharacterizing a payment they had applied to the estate tax as an income tax payment.

(Also note the recent problems of Treasury Secretary Geithner where he was not liable for deficiencies not caught by the IRS within this three-year time frame. Geithner paid the underpayment only after his nomination to the Cabinet, but was not legally obligated to do so. See page 2 of this issue.)

Innocent Spouse signing Under Duress:

D'RE I. STERGIOS v. COMMISSIONER TC Memo 2009-15

Issue: Whether the Petitioner is an innocent spouse when she had some knowledge of income omission but signed the returns under duress.

Facts: This case arises from a couple's 2000 and 2001 tax returns, both of which greatly understated the tax due, mainly from unreported stock sales. James Murray and his former wife, D'Re Inge Stergios, were each issued a notice of deficiency for the last two full years of their marriage, and the former wife petitioned for innocent spouse status. She did not contest the amount of the deficiency, but pled as an affirmative defense that she qualified as an innocent spouse. The IRS agreed with her, but her ex-husband intervened to

challenge the innocent spouse designation.

Murray had graduated from the University of Arizona with a degree in economics and was working as a stockbroker at Merrill Lynch. Murray's employment gave him considerable financial expertise, but he disputed any inference that his wife, Stergios, did not understand the family's financial affairs. Arguing that his wife was not an innocent spouse, he claimed that she knew about all of his transactions and about the investment accounts in her name. The former spouses' stories diverge on almost every detail. Stergios blamed Murray for unethical trades that he made with her family's accounts. Stergios also claimed that Murray routinely forged signatures, and that she had signed the 2001 return, but only under extreme pressure from her then-separated husband. The record showed that the couple had been involved in numerous physical altercations.

Analysis and Conclusion: The Court noted that spouses who file joint returns are jointly and severally liable for the tax owed; however, there are some circumstances that allow the Commissioner to exempt a spouse from liability under the "innocent spouse" regulations. This case is complicated by the fact that the husband alleges that his ex-wife had knowledge of their financial transactions and their deficient filing. Both parties were extremely contentious and blamed the other for the deficiency. Disregarding the testimony of both former spouses, the Court decided that neither party was credible and that the case would be decided on who persuaded them by a preponderance of the evidence.

The Court applied the tests for deciding whether Stergios signed under duress. Stergios met the first part of that test because she would not be expected to resist the threats of a man who is 6 feet 4 inches tall and weighed around 250 pounds, especially given that the couple had a history of violence. Stergios also met the second part because a letter to Murray showed she would not have signed the return if it were not for his threats. The Court concluded that it was more likely than not that Stergios signed the 2001 return under duress and thus she was not liable for that year's arrearage.

As for tax year 2000, the Commissioner proposed several adjustments to the 2000 return, and the Court found each was attributable to Murray without Stergios' knowledge. Therefore, only Murray was liable for those deficiencies.

Observation: Interestingly, the Court completely discounted the testimony of both ex-spouses, finding them equally suspect. Instead the Court focused on other tangible evidence of the wife's actual knowledge of the couple's financial affairs, as well as the intimidation factor—the ex-husband's physical dominance.

Damages for Mishandling of Tax Returns by Return Preparers:

PINERO v. JACKSON HEWITT TAX SERVICE INC. et al. NO. 2:08-CV-03535 (JANUARY 7, 2009)

UNITED STATES DISTRICT COURT EASTERN DISTRICT OF LOUISIANA

Issue: Whether a tax service is liable under state law and the IRC Sec. 6103 confidentiality rules for discarding intact tax returns in a public dumpster.

Facts: This case arises out of Defendants' alleged mishandling of Plaintiff's confidential personal information. In 2006, Plaintiff visited Defendant Crescent City Tax Service, Inc. in Metairie, Louisiana to have her 2005 federal and state tax returns prepared and e-filed. Crescent City Tax Service is a franchisee of Defendant Jackson Hewitt Tax Service ("Jackson Hewitt"). During her visit Plaintiff provided confidential information, including her social security number, date of birth, and driver's license number, to Crescent City. Plaintiff signed Jackson Hewitt's privacy policy, which stated that Defendants had policies and procedures in place, including physical, electronic, and procedural safeguards, to protect customers' private information. Plaintiff alleges that she relied on this statement in her decision to turn over her information.

In early 2008, Defendants disposed of her 2005 federal and state tax returns in a public dumpster. A Good Samaritan found the returns and contacted a news station and the sheriff's office. The returns were still in readable form and were not burned, shredded, or pulverized. The news station contacted Plaintiff and returned the tax returns to her. Crescent City later issued a public statement asserting that the documents were stolen and maintaining that it takes customer privacy seriously.

Plaintiff sued for damages under a number of different theories and statutes, including state law claims of fraud, breach of contract, negligence, invasion of privacy, violation of the Louisiana Database Security Breach Notification Law (LDSBNA), and violation of the Louisiana Unfair Trade Practices Act (LUTPA). Plaintiff also maintained that Defendant was in violation of Section 6103 of the Internal Revenue Code, which prohibits disclosure of confidential tax return information by the IRS and other governmental entities and by certain other non-governmental entities who receive return information in the course of public business.

The Plaintiff alleged a number of emotional problems relating to the disclosure, including fear, panic, anxiety,

sleeplessness, nightmares, embarrassment, hassle, anger, lost time, loss of consortium, and other emotional and physical distress. Plaintiff also sought special damages for credit monitoring, credit insurance, reimbursement for all out-of-pocket expenses related to notifying creditors of the improper disclosure, and reimbursement for all out-of-pocket expenses related to identity theft. Finally, Plaintiff made a motion for class certification of her claims to get permission of the court to start a class action suit against Defendant. The case came to the District Court in New Orleans on a Motion to Dismiss by Defendants.

Analysis and Conclusion: The Court granted in part and denied in part the Defendant's motion to dismiss. The Court dismissed the negligence, fraud, and other state law claims against Jackson Hewitt, but allowed an invasion of privacy claim. The Court also held that Jackson was not guilty of violating Section 6103 of the Code because that section only applies to disclosures by the IRS. That subsection provides that an action may be brought only against non-governmental entities that fit into certain narrow categories. The Court specifically found that this last category does not include commercial tax preparers. The Court also denied Plaintiff's motion for class certification as premature.

The Court's reasoning was that Plaintiff's damages were mostly speculative, noting that Plaintiff did not allege that any third party accessed her information or stole her identity. The Court found that Plaintiff's request for credit monitoring was not related to actual damages, but was in anticipation of future injury, and not recoverable under Louisiana law. Further, Louisiana law does not allow recovery for emotional damage absent physical injury. On the breach of contract claim, the Court found that there was no intentional breach on the part of the Defendants and there was no loss sustained by Plaintiff for defective performance under the contract.

The Court found that Plaintiff had made sufficient allegations to state a claim for public disclosure of private facts to allow that issue to move forward.

Observation: Although we take it on faith that protection of client records is absolutely required for tax professionals, this Plaintiff was caught between a number of applicable statutes, with her claim not fitting neatly into any one of them. Note that state bar associations and accounting associations have their own rules about non-disclosure, which may be stricter than state privacy laws. Despite the outcome in this case, prudent return preparers should always shred or otherwise destroy all tax records before disposing of them.

ETHICS CORNER

IRS EXPANDS ABILITY OF TAX PREPARERS TO USE COMPILATIONS OF RETURN INFORMATION

In January 2008, the IRS issued final regulations prohibiting tax preparers from disclosing statistical compilations of tax return information except in very limited circumstances involving compliance with regulatory reporting requirements or in conjunction with the sale of a tax return business. Those regulations became effective on January 1, 2009. Recognizing that those rules may be too strict, the IRS has released a Notice clarifying and expanding permissible uses of tax return data for 2009 and soliciting comments from practitioners on the appropriate level of confidentiality.

Specifically, the new Notice provides interim guidance on the ability of a tax return preparer to disclose and use statistical compilations of **anonymous tax return information** data in support of its tax return preparation business without taxpayer consent. **Important:** This notice **does not** apply to disclosure of return information which contains any information which could identify a taxpayer. That situation is still governed by the recently-effective final regulations. The interim guidance applies to disclosures of anonymous statistical compilations of tax return information occurring after February 8, 2009 and expires on the earlier of the date that it is superseded or December 31, 2009.

DEFINITION OF TAX PREPARER

Under the existing regulations, the term "tax return preparer" means:

- A. Any person who is engaged in the business of preparing or assisting in preparing tax returns;
- B. Any person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns, including a person who develops software that is used to prepare or file a tax return and any Authorized IRS e-file Provider;
- C. Any person who is otherwise compensated for preparing, or assisting in preparing, a tax return for any other person; or
- D. Any individual who, as part of their duties of employment with any person described in A-C above, performs services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

DEFINITION OF TAX RETURN INFORMATION

The post-2008 final regulations also expanded the definition of "tax return information" to include information the tax return preparer derives or generates from tax return information in connection with the preparation of a taxpayer's return. The rules also cover anonymous statistical compilations of tax return information in a form that cannot be associated with, or otherwise identifies, directly or indirectly, a particular taxpayer.

Reasons for the Change

The IRS observed that some disclosures may provide benefits to taxpayers generally or to the public as a whole, citing the fact that statistical data could assist taxpayers in making informed choices about filing options and tax return preparers. Moreover, the availability of anonymous statistical data can be useful from a public policy perspective, because the availability of such data can assist lawmakers, academics, non-profit organizations and other agencies in tax policy analysis and regulatory decisions. Finally, volunteer tax return preparers that provide free tax return preparation services to low and moderate-income taxpayers and families need to be able to demonstrate the impact of their efforts through service statistics in order to obtain the funding necessary for their continued operations.

The New Standard

Tax return preparers may use and disclose, without taxpayer consent, statistical compilations of tax return information to support the tax return preparer's tax return preparation business. The purpose and use of the statistical compilation must relate directly to the internal management or support of the tax return preparer's tax return preparation business. However, any disclosure of a statistical compilation must be in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. To this end, the Notice prohibits the disclosure of statistical compilations with cells containing data from fewer than twenty-five tax returns. In addition, the sale of anonymous statistical compilations is prohibited except if the sale occurs in conjunction with the transfer of assets in a sale or other disposition of the tax return preparer's business.

Advertising and Marketing Limitations

The Notice emphasizes that any use of anonymous statistical compilations of average refund, credit, or rebate amounts for purposes of advertising or marketing continue to be prohibited. The IRS has expressed concern that claims of high refund and credit percentages could create

inaccurate expectations on the part of taxpayers and improper incentives on the part of tax return preparers at the expense of compliance and accuracy. Marketing and advertising will be considered to be in direct support of the tax return preparer's tax return preparation business as long as the marketing and advertising makes no prohibited refund or credit claims and is not false, misleading, or unduly influential.

VITA Programs

Fundraising activities conducted by Volunteer Income Tax Assistance programs and similar organizations in direct support of their tax return preparation services are not considered marketing and advertising under the new guidance. Thus, these organizations have broader ability to use statistical compilations to demonstrate their need and their effectiveness.

EXAMPLES

The new rules are illustrated by the following examples contained in the Notice:

Example 1. Preparer A is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In 2008, A used tax return information to produce a statistical compilation of data for both internal management purposes and to support A's tax return preparation business. The statistical compilation included a cell containing the information that A prepared thirty-two S corporation tax returns in 2008. In 2009, A decides to embark upon a new marketing campaign emphasizing its experience preparing small business tax returns. In the campaign, A discloses the cell containing the number of S corporation tax returns prepared in 2008. A's disclosure does not include any information that can be associated with or that can identify any specific taxpayers. A may disclose the anonymous statistical compilation without taxpayer consent because it complies with the interim guidance described in the notice.

Example 2. Preparer B is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In 2009, in support of B's tax preparation business, B advertises that the average tax refund obtained for its clients in 2008 was \$2,800. B may not disclose this information because it contains a statistical compilation reflecting average refund amounts.

Example 3. Preparer C is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A) and is a Volunteer Income Tax Assistance preparer. In 2009, in support of C's tax preparation business, C makes a grant request to a charitable foundation to fund C's operations providing free tax preparation services to low and moderate-income families. In support of C's request, C includes anonymous statistical data showing that, in 2008, C provided services to 500 taxpayers, that 95% of the taxpayer population served by C received the Earned Income Tax Credit (EITC), and that the average amount of

the EITC received was \$3,300. C may disclose this information because it contains an anonymous statistical compilation, is in direct support of their tax return preparation services, and is consistent with this interim guidance.

Example 4. Preparer D is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In December 2007 D produced an anonymous statistical compilation of tax return information obtained during the 2007 filing season. In 2009, D discloses portions of the anonymous statistical compilation in connection with the marketing of its financial advisory and asset planning services. D is required to receive taxpayer consent under § 301.7216-3 before disclosing the tax return information contained in the anonymous statistical compilation because the disclosure is not being made in support of the tax return preparation business.

Request for Comments on Notice 2009-13

The IRS is seeking practitioner input as to whether the interim guidance should be adopted by regulations or further modified. If you are interested in weighing in on this issue, you may submit comments on this notice by May 10, 2009. Comments should be submitted to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2009-13), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Comments may also be submitted electronically via the following e-mail address: Notice.Comments@irs.counsel.treas.gov. Please include Notice in the subject line of any electronic submission.

Observation: Despite the ban on using refund and credit statistics to promote your tax return preparation business, the large tax preparation companies manage to walk the fine line in their advertising. A recent, prominent TV ad by one firm states something to the effect that "most of our clients get refunds..." Also, remember that IRS authorization of use or disclosure does not affect legal or ethical rules which prohibit professionals such as attorneys and accountants from using or disclosing information to their own advantage or their clients' disadvantage.

Requirements for Taxpayer Consents under Section 7216

In a Revenue Procedure issued in conjunction with the disclosure regulations, the IRS provides specific rules for obtaining consents to disclose and consents to use taxpayer data in both the paper and electronic environments. Generally, tax preparers must obtain the signed consent of the taxpayer on paper or electronically before they can disclose taxpayer return information to anyone or use it for any purpose other than in the context of preparing and filing the return. Separate consents are required for disclosure and use.

Form of Consents: Consents must be in 12-point type on 8 1/2 by 11 inch paper. Electronic consents must be in the same type as the web site's standard text; must contain the taxpayer's affirmative consent (as opposed to an "opt-out" clause); and must be signed and dated by the taxpayer.

Required Content. Taxpayer consents must:

1. Identify the intended purpose of the disclosure or use;
2. Identify the recipient(s) and describe the particular authorized information to be disclosed or used;
3. Include the name of the tax return preparer and the name of the taxpayer;
4. Include mandatory language that informs the taxpayer that he is not required to sign the consent and if he signs the consent, he can set a time period for the duration of that consent;
5. Include mandatory language that refers the taxpayer to the Treasury Inspector General for Tax Administration if he believes that his tax return information has been disclosed or used improperly.
6. Include the appropriate language informing the taxpayer that his tax return information may be disclosed to a tax return preparer located outside the U.S., if applicable;

Violations of these rules could result in imprisonment for up to one year, a fine of not more than \$1,000, or both, for each violation.

ET CETERA

LIMOUSINE LIBERAL?

As the Geithner tax controversy recedes, more high profile Obama nominees emerge with tax problems.

Tom Daschle was the leader of the Democrats in the Senate when a few years ago he was targeted by the Republicans and barely lost his Senate seat. Since then he has made millions in the private sector. He became one of President Obama's first major supporters and helped guide Obama's strategy in the election, including providing Obama with key personnel that had been on his leadership staff on the Hill. So, it was natural that the new President wanted Daschle near him in the new administration, nominating him not only to the cabinet post for Health and Human Services, but also naming him his "Health Czar" with an office in the White House.

Then came the vetting. Some minor tax omissions were uncovered. He underestimated a charitable deduction...some dispute over whether he had received the proper documentation from the charity...no big deal. But then it turns out he also was provided with a limousine and driver, 80% of it for personal use. Daschle received no Form 1099 reporting the income from personal use of the vehicle, so he didn't pay his tax on it. Evasion or mistake? Depends on whom you talk to. The *Wall Street Journal* and the *New York Times*, in a rare moment of agreement, said he should remove his name from consideration. The *Washington Post* editorialized that he should hang in there. He withdrew quietly and quickly!

NANNY TAX WOES DERAIL OBAMA APPOINTMENT

President Obama's idea to install a "chief performance officer" for the federal government was dealt a set-back recently when his pick, Nancy Killefer, withdrew her nomination after earlier failing to pay D.C. unemployment tax on household employees. Killefer, who served as Assistant Treasury Secretary for Management in the Clinton Administration, led the modernization effort of the IRS. More recently, she served as an executive with the consulting firm of McKinsey & Co. In her new position, she was to work with economic officials to increase efficiencies and eliminate waste in government spending.

After her nomination, the Associated Press disclosed that she had a lien placed on her home in 2005 by the District of Columbia government for nonpayment of approximately \$1,000 in unemployment tax for a household employee. The lien was released five months later when she resolved the issue.

Comment: Two nominees are now gone, and the lesson is clear: If you're going to go into government service, your taxes better be squeaky clean.

SNOW DAY

President Barack Obama recently was heard complaining to reporters that his children's new school in Washington, D.C. had cancelled classes one day last week, over what was no more than a dusting of snow. "I'm from Chicago," he reminded them, and "my daughter pointed out that they NEVER cancel school in Chicago, no matter how high the snow."

Well, it's a good thing he made it out of Chicago. This year they may need a dog sled (pulled by Shasha and Malia's new puppy, maybe) had they stayed at home in Chicago. Due to budgetary restraints caused by falling tax revenues, the City will stop plowing snow on side streets, except during "union day hours" according to Mayor Richard M. Daley. His Honor noted that just an inch or so of snow

ended up in half a million bucks in overtime.

The citizens aren't happy. "I expect for the streets to be cleaned for my tax money," said Chicago resident Sarah Lockhart.

IMPORTANT NOTICE TO SMOKERS

There is a way to afford smoking these days, short of growing your own tobacco. It's simple. All you have to do is to get appointed ambassador to just about any country. The Bush Administration established a rule on January 14, 2009, that allows foreign diplomats in this country to enjoy their tobacco tax-free—that is free from all federal, state, or local tax. Cigars, cigarettes, and pipes. In exchange, American diplomats posted abroad will receive reciprocal treatment. Such exemptions are granted under diplomatic protocol.

Continue from page 5

QUESTIONS FROM SENATOR GRASSLEY, CONTINUED:

Question 28: [Losses of Target Companies]

Section 382 of the Internal Revenue Code limits the ability of acquiring companies that acquire target companies to offset the taxable income of the acquiring company with the Net Operating Losses of the target. This provision was not enacted lightly by Congress, but rather after extensive scholarly reflection by the staffs of the Senate Finance Committee and the Joint Committee on Taxation, as well as after reflection by the House Ways & Means Committee. It has been an established part of the law ever since 1986.

This law was changed when Treasury issued Notice 2008-83. Many tax law scholars have opined that Treasury simply did not have authority to make this change. The respected law firm of Jones Day, one of the country's largest law firms, at one point estimated that this Treasury Department waiver of this act of Congress could cost the US Treasury \$140 billion dollars in taxes that would have otherwise been paid. It is troubling to me that this Notice was issued on September 30, 2008 the Treasury virtually waived section 382, the day after the House said no to the first bail-out bill and two days before Wells Fargo acquired Wachovia on October 2, 2008.

A. How do we re-establish the rule of law?

If confirmed, I will respect the constitutional limits on the Treasury Department's authority, as will all those who work for me. I understand there is a high level of concern on Capitol Hill about this issue, specifically within the Finance Committee. I am aware that legislation has been introduced and that Senator Grassley has called for an Inspector General's report on this issue. I look forward to reviewing that report when it is completed. I realize that this is a complex issue that raises concerns

about Treasury's authority, differential treatment of the financial services industry, and budgetary transparency. I promise to more closely examine the issue and work with the Committee if I am confirmed.

Question 29: [Penalty for Failure to Report Reportable or Listed Transaction]

Chief Counsel Korb has made public comments about the need to change the strict liability standard under IRC section 6707(A). However, I have not seen any proposals from Treasury to amend this statute. Do you agree that the standard must be changed? If yes, explain why you think this must be changed and provide suggestions for change.

I have been advised that proposed and temporary regulations under this statute were published this past autumn. If confirmed, I and my staff will work with the IRS to review the statute, regulations and comments to those regulations in order to identify any changes that should be made or proposed.

[Taxation of Corporation Debt v. Equity]

(2) Tax reform. The leading macro contributor to our financial downturn was an overleveraged economy. There are numerous policy areas that brought us to an overleveraged state. One of them is the Tax Code, which allows corporations to deduct interest while subjecting corporate profits to tax. In other words, our Tax Code has a bias for debt financing over equity financing. As the Senate's tax-writing panel, should the Finance Committee eliminate this bias for debt financing? How should we go about doing so?

I think this is an issue that needs to be examined in detail, particularly in the context of tax reform. Today, the tax code gives preferential treatment to debt, and taxpayers go to great lengths to characterize certain transactions as debt deals, even though they look a lot more like equity deals. This is done solely to get tax benefits and the steps taken are not always economically efficient. That is an issue that deserves study, perhaps clarifying how the tax code defines debt and equity.

ANSWER TO QUESTION FROM SENATOR CANTWELL

[Savings Bond Purchase Option on Federal Tax Returns]

1. ... The annual federal income tax refund that many low-income families receive, bolstered by the Earned Income Tax Credit (EITC) and the child tax and other credits, is often very large relative to their overall income. When the individual receives that refund, there is a window of opportunity for the individual to save and for the government to encourage that savings. Enabling taxpayers to check a box right on the federal tax return form and set aside some of that refund in a U.S. Savings Bond is a simple policy for encouraging savings among a broad

spectrum of the population that otherwise has trouble building wealth.

U.S. Savings Bonds have a 75-year history of helping Americans save, especially smaller-balance and first-time savers. During the 1960s, you could buy a savings bond by checking a box on your tax refund, using Form 1040. Yet recent changes by the Bureau of Public Debt have accelerated a trend to de-emphasize the savings bond program.

Mr. Geithner, what is your view of the role savings plays in our national recovery and savings bonds in particular? Would you support a call to re-introduce the savings bond purchase option to the annual federal tax filing process?"

The President has proposed several ideas that would give all American workers the opportunity to save. Half of the American workforce has no 401(k) or other employer-based retirement plan. To address this problem, the President has proposed the adoption of automatic workplace IRAs and expanded tax credits for saving. In the months ahead, if confirmed, I look forward to working with you on consideration of these ideas as well as other savings incentives, such as the savings bond proposal that you raise. You correctly note that an important time to highlight the role of savings in a family's overall economic health is upon receipt of their tax refund. For those receiving the Earned Income Tax Credit, greater awareness of savings opportunities might be particularly useful. You have suggested that our Savings Bond program should be promoted more broadly in connection with tax filings. This sounds like a useful idea that deserves careful consideration. I hope to have the opportunity to talk further with you on the President's suggestions as well as the full range of savings ideas.

QUESTIONS FROM SENATOR CRAPO

7. The tax policies included in the economic recovery package should be designed to provide an immediate, short-term stimulus to companies in need of money to run their business and employ American workers. Most of the proposals under consideration will not help many businesses impacted by the depressed economy because they do not have current earnings. Specifically, many of these companies cannot use additional credits or deductions because they do not have current tax liability. What are your thoughts on innovative proposals designed to allow taxpayers to borrow against their future tax savings? For example, should we include in the package proposals that allow taxpayers to temporarily monetize their own tax assets like AMT credits, R&D credits or net operating losses (NOLs)? Please explain.

President Obama's economic recovery proposals are designed, in part, to explore ways of increasing capital available for busi-

nesses to invest in people and other resources to generate economic activity. In particular, his net operating loss carry back recommendation would allow companies to balance recent losses against gains booked in the past five years. As members of Congress add their ideas to the President's plan, a necessary aspect of the legislative process, the Obama administration's economic team will continue to discuss the merits of various ideas and work with Congress to enact much needed legislation to stimulate the economy. I look forward to working with you on the tax ideas you and others have brought to our attention, many of which are included in the President's program.

Question 2 [High US Corporate Tax Rate]

As you know, the U.S. has the second-highest nominal corporate income tax rate in the world. With an eye toward attracting investment, many countries around the world are lowering their corporate tax rates. The reason is simple -- lower tax rates and simplified tax codes help to generate greater investment, jobs, and growth. Shouldn't the United States be leading the charge to enact lower corporate tax rates?

The competitiveness of U.S. companies depends on many factors such as labor costs, health care costs, research and development, technology investment, and worker education. U.S. tax rates are a factor as well. However, I believe the rate that matters to U.S. companies is the effective tax rate — that is, the rate that companies pay after deductions and credits.

Nevertheless, let me be clear. I share the President's strong desire to encourage U.S. companies to invest in research and development and to create jobs here in America. I believe the ability of companies to develop new products through research and development is vital to our long-term competitiveness and a key driver of job growth.

I also share the President's desire to help small businesses. They are an important part of our economy and a critical source of new jobs. And, unlike some large businesses that have capital reserves to ride out economic downturns, small businesses are particularly vulnerable during tough economic times such as these.

I look forward to working with you to ensure the competitiveness of American businesses, large and small, during this challenging economic period and far into the future.

Question 8 [Extending Bush Tax Cuts]

Very soon the bipartisan 2001 and 2003 tax relief will expire. I believe that much of this tax relief stimulated the economy and that we should extend relief into the future. Allowing tax relief to expire will force a massive tax increase on American families, seniors, and small businesses at the worst possible time. Do you think we should extend those cuts for individuals on a longer-term basis?

Our immediate priority is to work with

Congress to provide substantial tax relief for families and businesses through an economic recovery plan. For families, our plan makes a down payment on the President's commitment to cutting taxes for 95% of working Americans. For businesses, we propose to cut taxes for companies that are making investments and creating jobs.

The President has instructed his economic team to draw on the best ideas from all quarters and avoid ideological solutions. For this reason, the plan includes both investments and tax cuts to create 3.5 million jobs, raise incomes, and promote recovery.

Over the longer term, the important thing to recognize is that the President's plan is a net tax cut intended to boost long-term economic growth. It provides tax cuts to relieve the squeeze on middle class families and to help them afford things like college, health care and a secure and dignified retirement. His plan also advances the goal of restoring fairness to our tax system.

Question 11 [IRS Creation of its Own Free-File Web Portal]

The IRS has implemented a Free File Program for the past six years and the private sector participants in that program have done a good job in serving those of our citizens who need support and assistance like the working poor, the elderly, and other disadvantaged citizens. Unfortunately, some have suggested that the IRS should design and build its own tax Web Portal to replace the current Free File Program. I oppose this effort. The government should not be competing against private sector participants in the tax software preparation market. What will you do to discourage the IRS from wasting money on such counter-productive efforts?

I strongly support the President's goal of simplifying the tax code and the tax preparation process. During the campaign, he outlined a proposal to develop a system that would dramatically simplify tax filings so that millions of Americans would be able to do their taxes in less than five minutes. Estimates of this proposal suggest that it could save Americans millions of hours and billions in preparer fees. I am eager to hear your views about the best way to achieve this important objective, leveraging the Free File experience and both public and private sector advantages for optimal quality and efficiency. The IRS already receives most Americans' financial information directly from employers and banks. President Obama has proposed for the IRS to use this information to give taxpayers the option of pre-filled tax forms to verify, sign, and return to the IRS or online. Experts estimate that the Obama proposal will save Americans up to 200 million total hours of work and aggravation and up to \$2 billion in tax preparer fees -- allowing families to keep

more of their hard earned dollars, which is particularly important during these tough economic times when every penny counts. If confirmed, I look forward to working with you on this project to ensure the IRS does not waste money or engage in counter-productive efforts and that we are achieving effective tax simplification in a safe, fair and efficient way.

Question 12 [Tax on Repatriated Earnings]

Recently, Dr. Robert Shapiro, chair of the New Democrat Network's Globalization Initiative, wrote an article where he described a way to find a "free" \$420 billion to stimulate the economy. The money is held by our own companies outside the U.S., but current tax law strongly discourages firms from bringing capital back to the U.S. In fact, several years ago, Congress passed a temporary law allowing firms to repatriate capital from their foreign affiliates at much lower tax rates. The result of the temporary change to a lower rate resulted in \$34 billion in additional revenues to the Treasury and \$312 billion of capital into the U.S. Given that more than ever we need to add capital to our market, do you agree that it makes sense to remove once again this self-imposed tax barrier? Lowering the tax on repatriation would be cheaper to the taxpayer and would actually increase money to the Treasury again.

I can appreciate that some economists believe the immediate stimulative effects of a repatriation tax holiday outweigh the costs in incentives for offshore production and potentially deteriorating the federal tax base. I would be happy to discuss with you the evidence that leads you to support a repatriation holiday and to share the contrary evidence that leads me to be more skeptical. For one thing, the previous "one time" tax relief for repatriated dividends appears not to have demonstrably created new jobs despite the promises of beneficiary firms to do so. For another thing, several economists believe the repatriation tax holiday actually increased incentives to shift profits offshore, encouraging the very behavior it was intended to reduce.

I know this is an issue that is important to you and I'm eager to better understand your position and the empirical data and experience that has helped you reach the conclusion that you have. If confirmed, I will work with you on the issue of the competitiveness of U.S. firms, including tax issues such as repatriation.

Question 13 [Cancellation of Indebtedness Income]

The original purposes of the TARP was to get distressed debt off of the books of financial institutions, so they would clean up their balance sheets and continue to provide credit. You have stated that this remains a goal. Did you know that U.S. tax law strongly discourages firms from renegotiating their indebtedness with holders of that debt, because the IRS will send a

tax bill for the amount of debt cancelled? I have suggested temporarily changing the tax law to allow firms to renegotiate their debts without triggering additional taxation. Doesn't it make sense to allow businesses to handle their debt problem in this way, especially when they can do so without taxpayer money?

I am in favor of simplifying the tax code such that businesses and individuals get the most out of their tax dollars, particularly at a time when our economy faces nearly unprecedented challenges. If confirmed, I look forward to working with you and other members of this committee to develop proposals that would make tax law work in favor of middle class families and enable our businesses to remain competitive, globally.

QUESTIONS FROM SENATOR HATCH

Question 1: [Fundamental Tax Reform]

Do you think that fundamental and wholesale reform of the tax code is politically possible during this new administration? Or, do you believe that it might make more sense from a practicality standpoint for the Administration and Congress to pursue a series of incremental reforms that simplify the code and improve the incentives for both households and firms?

Determining the best strategy to reform the tax code is something that can only be accomplished with close consultation and work with you and other members of Congress. I share the President's support for simplifying the tax code, restoring fairness, and encouraging pro-growth, pro-job tax policies. I also share his desire to provide middle-class tax relief and find ways to help American companies create jobs and be globally competitive. At the same time, there is a lot of work that needs to be done to eliminate unnecessary tax shelters and loopholes. We also must find ways to increase compliance and close the tax gap. If confirmed, I will work with you to improve our tax system. I believe our most urgent tax priorities are to find ways to create jobs, encourage business investment through the adoption of the economic recovery plan, and provide for long-term economic growth.

Question 2: [Permanent Research Credit]

As you may know, Chairman Baucus and I have sponsored legislation for many years to make the research credit permanent. In 2001, we were able to get a permanent research credit passed in the Senate as part of the big tax cut bill we passed that year. Unfortunately, the permanent provision fell out in conference with the House. It seems to me that we have an extraordinary opportunity to make this vital provision permanent by including it in the stimulus bill Congress is now working on. Can you tell me if you see a better opportunity to make the research credit permanent down the road?

I share the President's desire to encourage U.S. companies to invest in research and devel-

opment. The ability of companies to develop new products through research and development is vital to our long-term competitiveness and a key driver of job growth.

The President supports making the R&D tax credit permanent and I look forward to working with you and the rest of the Committee to accomplish this goal.

Question 6: [Make Work Pay Credit, Expensing, Capital Gains Rate]

Would a refundable "make work pay" credit (even a permanent one) encourage capital formation, make workers more productive, and raise pre-tax wages? How about a cut in the corporate tax rate? Expensing of plant and equipment? Indexed depreciation allowances? Lower tax rates (extended permanently) on capital gains?

I believe that the competitiveness of U.S. companies depends on many factors such as labor costs, health care costs, research and development, technology investment, and worker education. U.S. tax rates are a factor, as well. I believe, moreover, that the rate that matters to U.S. companies is the effective tax rate, that is, the rate that companies pay after deduction and credits.

With respect both to lowering tax rates on capital gains and to refundable tax credits, I believe that investment, work and savings, and their relationship to productivity, are critical to the economic future of the country. Any option in this area needs to be evaluated against multiple criteria, including its impact on economic growth, job creation, work incentives, the promotion of our standard of living, and the tax principle of fairness. The President has said that the refundable tax credits should be available only to those Americans who work. We also need to evaluate proposals based on the requirement of being fiscally responsible and maintaining an adequate tax base.

ANSWERS TO QUESTIONS FROM SENATOR KYL

CORPORATE FINANCE

[Capital Gains and Dividends Tax Rate]

According to CBO, the tax rate on debt-financed corporate investment is a negative 6.4 percent and the rate on equity-financed investment is 36.1 percent, a difference of 42.5 percent. Most economists believe this differential distorts the efficient allocation of capital, causes companies to take on relatively more debt and become more susceptible to bankruptcy. Increasing the capital gains tax rate would increase the tax rate on equity-financed investment further.

1. Wouldn't eliminating or reducing this distortion have a positive impact on the economy?

In general, reducing distortions in business investment and financing decisions attributable to the tax system would have positive economic effects. However, many factors affect investment and financing decisions,

including especially the proper functioning of credit and equity markets. In the current economic environment, our focus needs to be on restoring markets.

2. *Doesn't that suggest a need to keep capital gains and dividends tax rates low?*

In general, reducing tax distortions has positive economic effects. Under current law, at the end of 2010, the maximum tax rate on capital gains will increase to 20 percent and the maximum tax rate on dividends will increase to 39.6 percent. Without a change to current law, the differential between the effective tax rate on debt and equity will increase. President Obama has proposed limiting the capital gains tax rate to 15 percent for taxpayers with incomes below \$250,000. He has also proposed continuing to tax dividends at the same rate as capital gains. President Obama's proposal thus would reduce the differential between the effective tax rate on debt and equity that under current law would otherwise result.

REBATE CHECKS

[Effectiveness of Last Year's Stimulus Payments]

About this same time last year, Congress was contemplating stimulating the economy by providing individuals and families with rebate checks. At the time, I argued that past experience suggested these checks would be largely ineffective because individuals would save most of the money. Marty Feldstein, who initially supported the idea of sending people rebate checks, wrote in an August Wall Street Journal editorial, "recent government statistics show that only between 10 percent and 20 percent of the rebate dollars were spent. The rebates added nearly \$80 billion to the permanent national debt but less than \$20 billion to consumer spending."

1. *With that in mind, it's pretty hard to argue that last year's rebate checks were a successful stimulus; so if last year's stimulus bill failed to prevent our nation from entering a recession, how will the economic stimulus bill the new Administration is proposing do any better?*

Our view is that the American Recovery and Reinvestment Plan is designed in a way that will help improve the prospects that a larger portion of the tax benefit is actually spent. The two reasons for this is that:

- a. It is an initial down payment on a reform that President Obama would like to both make permanent and to pay for. Our hope is that this is going to be an enduring change in withholding tax treatment for Americans that are eligible and, thus, would have a more powerful effect on spending than the last round of rebates, and
- b. This proposal is designed in a way that, as opposed to the last rebate proposal where it was a one-time check, the American

people will see a change in withholding statements every week. And they will have a reasonable expectation that it will be continued. We believe that this proposal will have more impact on spending behavior and have more effectiveness.

[Tax Cuts v. Direct Spending]

4. *...Should the proposed stimulus bill rely more heavily on reductions in revenue than increases in spending?*

President Obama has put forward an economic recovery plan that includes strategic investments that are based on what yields the highest rate of return for the economy. In some cases, the highest rate of return can be realized through direct government spending.

In other cases, a high rate of return can be made in some tax cut proposals. For this reason, we have proposed a mixture of both tax cuts and direct spending to comprise his proposal.

5. *How can you argue that many provisions of the stimulus bill will have any appreciable stimulative effect? Which ones?*

A key measure of President Obama's American Recovery and Reinvestment Plan is that it should save or create at least 3 million American jobs by the end of 2010. Proposals that create and save jobs have a definite stimulative effect.

The elements of the President's proposal that are related to such items as school repair, infrastructure and energy will likely have job growth in the manufacturing and construction industries. Proposals, such as the middle-class tax cut and fiscal relief to states are likely to help save or create jobs in all sectors of the economy.

When then-President-elect Obama met with the bipartisan Congressional leadership, he said he wanted 40% of the "stimulus" package to be tax relief. The package unveiled by the House allocates only 32% to tax cuts. And even there, a big portion of the tax cuts are really spending -- and will be scored as such by Congress -- because they provide money through the tax code to people who do not pay income taxes. These are the "refundable credits."

What portion of the "stimulus" package will be dedicated to actual tax cuts, i.e., revenue reductions?

The answer partly depends upon the legislative process. As you know, there are currently two bills that are moving through the Congress. At this point, it is unclear what the final product will be. President Obama has proposed both spending and revenue proposals that he feels provides the right combination to bring growth back to this economy. Of course, if confirmed, I look forward to working with the Committee as these bills proceed.

7. *Will you work with the Senate Finance Committee to increase the tax relief portion to equal 40% of the package?*

It is important to consider the totality of the plan. As you know, President Obama has proposed significant tax reductions. If confirmed, I will work with you and the entire Finance Committee to find the optimal mix of spending and revenue provisions that provide the needed growth and recovery to the economy.

ANSWERS TO QUESTIONS FROM SEN. SNOWE

Question 8 [Retroactive and Extended Relief from Retirement Plan Required Minimum Distributions]

Under current law, individuals who have reached age 70.5 generally must begin to withdraw funds from their IRAs or defined contribution retirement plans, including 401(k), 403(b), 457, and TSP plans. Failure to take a required minimum distribution may result in a 50 percent excise tax on the difference between what must be withdrawn and the amount actually distributed. As you know, Congress rightly suspended required minimum distribution rules for 2009 as part of the Worker, Retiree, and Employer Recovery Act of 2008. Unfortunately, Congress has not suspended the rules for 2008 or 2010, as I, joined by Senator Lincoln, proposed in the Retirement Account Distribution Improvement Act of 2009.

After a year in which the Dow lost 34 percent and with the American Association of Retired Persons having said that retirement accounts may have lost as much as \$2.3 trillion between September 30, 2007, and October 16, 2008, I believe that both retroactive and forward-looking relief is absolutely vital. Retirees should be able to recontribute 2008 withdrawals and should not have to make any withdrawals in 2010 given that it will take several years to recoup their staggering losses.

Mr. Geithner, as you know, President Obama has expressed sympathy for this issue on the campaign trail. But would you and President Obama agree with me that additional relief is warranted?

Our country is facing a set of economic challenges that rival any that have come before. We are witnessing a severe recession, historic declines in housing prices, growing job loss and a concern that these negative trends are accelerating. Most Americans are all too aware of the difficult economic challenges we face. However, Senator, you are correct, individuals near retirement or in retirement are among those hardest hit by the economic decline we have witnessed for more than a year. The President has pledged to identify ways to assist these individuals, including ways that our system of savings might be adjusted. Steps taken last year were a critical beginning. If confirmed, I look forward to working with Congress on this important topic.

Question 9 [Excluding Unemployment Benefits from Income]

As President Obama and Congress work together to develop stimulus legislation, I could not help but notice that I share many of the priorities that the President expressed support for on the campaign trail. In particular, I have, with Senator Lincoln and Bunning, introduced the Unemployment Benefit Tax Suspension Act of 2009 to exempt unemployment compensation from tax in 2008 and 2009. There is no reason why we should be taxing unemployment benefits, which so many Americans are relying on to put food on the table and a roof over their heads.

Would you agree with me that this proposal should be part of any stimulus package sent to the White House? Why or why not?

Far too many Americans have lost their jobs over the past year. As I said today in the hearing, it is imperative that we aggressively pursue a full range of measures to help restore our economic health, both in the financial sector and in the broader economy. In the meantime, there is no question that our system of unemployment compensation is a vital linchpin for many Americans who have lost their jobs and far too often their economic well being. If confirmed, I look forward to working with you on measures that will restore our economic health and on the things we can do in the meantime to assist those in who have lost their job. Your idea is one of several we should seriously consider.

Question 10 [New Markets Tax Credit]

As you may know, the New Markets Tax Credit has had a very successful history in promoting development in distressed urban and rural communities. In fact, the Treasury Department reports that the incentive has helped to develop or rehabilitate over 68 million square feet of real estate and create 210,000 construction jobs and 45,000 new full-time jobs.

With the stiff competition for Credits, the Community Development Financial Institutions Fund, which administers the incentive, indicates that it has at least \$1.5 billion in qualified applications on hand and that it can allocate any additional Credit authority within 90 days of enactment. The New Markets Tax Credit Coalition research shows that based on the program's track record, this would generate 11,000 permanent jobs and 3,500 construction jobs.

Wouldn't you agree that the New Markets Tax Credit should be part of a stimulus package? Why or why not?

The downturn we have witnessed in our financial markets and in the broader economy over the past year has particularly impacted our most distressed communities and neighborhoods. While I have not had an opportunity to study the New Markets Tax Credit program in great detail, I am aware that the program enjoys a wide range of support.

It is viewed by many as an important revitalization tool for our distressed cities and rural areas. If confirmed, I look forward to studying this issue more fully. Tools such as the NMTC should be examined as we consider the best ways to help our cities and rural communities.

Question 13 [Permanent Solution to Alternative Minimum Tax]

Mr. Geithner, one of the most frustrating taxes we have to address each year is the alternative minimum tax (AMT). Every year, we are forced to pass a so-called patch so that millions of Americans are not ensnared by this onerous levy. Indeed, if we do not pass another patch in 2009, 30 million will face this onerous levy up from approximately 4 million in 2008. Although all of us agree that the AMT should not be allowed to ensnare this nation's middle-class taxpayers, the problem is that it is extremely expensive to address. In fact, CBO and the Joint Committee on Taxation estimate that it would cost \$763 billion to index the AMT for inflation over the next 10 years. It will cost hundreds of billions more to fix the AMT if we extend even just President Bush's tax cuts for the middle class.

How do you plan to address the AMT over the long term while recognizing that the nation already faces a baseline deficit of over \$3.1 trillion? How do you plan to ensure that America's middle class will not get stuck having to compute their taxes twice — once under the regular system and once under the AMT — only to find out that they owe hundreds of dollars more than they first thought they would have to pay?

The AMT is clearly broken and needs to be fixed. The AMT exists for an important reason -to prevent people with very high incomes from exploiting deductions and loopholes to completely avoid paying income taxes. Over the years, it has migrated far from its original intention and is now affecting millions of middle-class families. If confirmed, I look forward to working with Congress on the President's commitment to fixing the AMT in order to reduce complexity for ordinary taxpayers in a single fiscally responsible way.

ANSWERS TO QUESTIONS FROM SENATOR STABENOW

[Manufacturing Tax Credit]

5. There are a number of renewable industries that are looking for reasons to remain here in the United States to produce their products instead of going overseas. Implementing certain tax policies would encourage those companies further down the supply chain. A manufacturing tax credit could act as a force multiplier and would stimulate job creation in our country. What are your thoughts on such a tax policy?

Our country is facing a set of economic conditions that rival any that we have seen

before. The President has said that we need to be aggressive in our approach to restoring economic health. As a part of our strategy, the Administration has said that we should pursue tax policies in our economic recovery plan that work and provide an immediate jolt to sectors of the economy that will make the best use of the assistance while also establishing a framework for long-term growth.

There is no question that among the tax policies we pursue an important sector of the economy we must consider our manufacturing base. If confirmed, I look forward to working with you on ways to ensure that our manufacturing sector is both vibrant and competitive.

QUOTES

"These were careless mistakes, they were avoidable mistakes, but they were unintentional."

—**Treasury Secretary Timothy Geithner, remarking on his nonpayment of payroll taxes, at his confirmation hearing before the Senate Finance Committee in January.**

"It is incomprehensible to me that you didn't immediately realize that you had done it wrong for the entire time you were at the IMF."

—**Senate Finance Committee Member Jon Kyl, (R-Arizona) at Geithner's confirmation hearing.**

"A business that makes nothing but money is a poor business."

—**Henry Ford**

"We need to ensure that we balance our responsibility to enforce the law with the economic realities facing many American citizens today," Shulman said. "We want to go the extra mile to help taxpayers, especially those who've done the right thing in the past and are facing unusual hardships."

—**IRS Commissioner Douglas Shulman, upon kicking off the 2009 tax filing season.**

"Balanced budget requirements seem more likely to produce accounting ingenuity than genuinely balanced budgets."

—**Thomas Sowell, Economist**



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