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New Law Expands NOL Carryback To All Businesses; Provides Reduced Homebuyer Credit To Long-Time Residents

◆ *Worker, Homeownership and Business Assistance Act of 2009, H.R. 3548*

The just-passed *Worker, Homeownership and Business Assistance Act*, which President Obama signed into law on November 6, provides all businesses with an expanded net operating loss (NOL) carryback and extends the first-time homebuyer credit. The new law also increases penalties for failure to file certain returns, delays worldwide allocation of interest, extends the temporary FUTA surtax, and more.

■ **CCH Take Away.** The new law is not a "second stimulus" but does extend two of the tax incentives in the first stimulus package, the *American Recovery and Reinvestment Act of 2009 (2009 Recovery Act)*. Waiting for possible enactment before year-end are an extensive package of extenders, an AMT patch, estate tax relief, COBRA premium assistance, and offshore account disclosure measures. While extensions of bonus depreciation and enhanced expensing at current levels are currently not on the front-burner, they are also possible contenders for year-end extension.

NOL carryback

The *2009 Recovery Act* allowed small businesses (generally taxpayers with average gross receipts of \$15 million or less) to elect to carry back 2008 NOLs for three, four or five years. Under the new law, all

businesses may elect to carry back an applicable 2008 or 2009 NOL for three, four or five years.

■ **Comment.** "Retailers are experiencing severe challenges to finding the cash they need to operate their businesses," Rachele Bernstein, tax counsel, National Retail Federation, Washington, D.C., told CCH. "The new law provides retailers with an important source of capital."

An applicable NOL is the taxpayer's NOL for a tax year ending after December 31, 2007 and beginning before January 1, 2010. However, the amount of any NOL that may be carried back to the fifth tax year preceding the tax year of the loss cannot exceed 50 percent of the taxpayer's taxable income.

A taxpayer can elect to take the expanded NOL treatment with respect to only one tax year (2008 or 2009). An eligible small business that carried back its 2008 NOL under the *2009 Recovery Act*, however, can make the election under the new law for its 2009 NOLs.

■ **Comment.** The fifth year 50 percent limitation does not apply to any loss of an eligible small business with respect to any election as in effect on the date before the date of enactment of the new law.

Additionally, the new law suspends the 90 percent income limitation on the use of NOLs for determining the AMT

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New Law Expands

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for an extended carryback year. The Act also provides a special carryback rule for insurance companies and generally prohibits taxpayers participating in the Troubled Asset Relief Program (TARP) from the expanded NOL treatment.

The irrevocable election under the new law must be made by the due date (including extensions) for the tax return filed for the taxpayer's last taxable year beginning in 2009. Fiscal year taxpayers can make the election for tax years beginning or ending in 2008 or 2009.

Homebuyer credit

A taxpayer who is a first-time homebuyer of a principal residence may claim a refundable credit equal to 10 percent of the purchase price of the residence (with a maximum credit of \$8,000 (\$4,000 for married couples filing separate returns)). The new law extends the credit for qualified taxpayers purchasing principal residences on or before April 30, 2010. If a taxpayer enters into a binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010, the new law treats the credit as not expiring until July 1, 2010. However, no credit is allowed if the purchase price of the principal residence exceeds \$800,000.

The new law also expands the credit to long-time homeowners who are buying replacement property but at a reduced amount. Individuals who have owned and used the same residence as their principal residence for any five consecutive year period during the eight year period ending on the date of the purchase of a subsequent principal residence may be eligible for a reduced credit of \$6,500 (\$3,250 for married couples filing separately). Phase-out of the credit begins under the new law at \$125,000 modified adjusted

gross income (MAGI) for single taxpayers (up from \$75,000) and at \$225,000 for married taxpayers filing joint returns (up from \$150,000).

■ **Comment.** It is unclear if the expanded credit will encourage current homeowners to sell, Phil Umansky, CPA, Ph.D., Virginia Union University, Richmond, Va., told CCH. Current homeowners will need to weigh the value of the credit against the cost of commissions to real estate agents, Umansky explained. "The credit may temporarily move up demand, which could drop after the credit expires."

■ **Planning Note.** The \$6,500 reduced credit, the higher MAGI levels and the \$800,000 cut-off are all effective for purchases after November 6, 2009.

The new law requires taxpayers to attach a copy of their settlement statement to their return. The Act also tightens the rules for intra-family transfers and generally disallows claims by individuals under age 18 with an exception if one spouse is 18 and the other spouse is not. Taxpayers may elect to treat a qualified purchase of a principal residence after December 31, 2008 as made on December 31 of the calendar year preceding the purchase.

The Act also gives the IRS math error authority over the credit. The math error authority is retroactive to returns for tax years ending on or after April 9, 2008.

Additionally, the new law incorporates provisions of a House-passed bill that provides members of the U.S. armed forces, foreign service and intelligence community additional time (generally one year) to claim the credit if they are serving on qualified official extended duty outside of the U.S. The Act also provides for waiver of repayment in certain circumstances for military personnel.

HAP program

The 2009 *Recovery Act* expanded the Department of Defense Homeowners Assistance Program (HAP) to assist military personnel required to permanently relocate during the home mortgage crisis, military and civilian personnel adversely impacted by base closings. The Act clarifies that payments made under the expansion of HAP in the 2009 *Recovery Act* are excluded from income.

Return preparation

The Act requires any individual income tax return prepared by a paid tax return preparer to be filed electronically unless the preparer reasonably expects to file fewer than 10 individual income tax returns during the calendar year. Under the new law, the term individual income tax return means any return imposed by subtitle A on individuals, estates or trusts. The provision is effective for returns filed after December 31, 2010.

Offsets

The new law extends unemployment insurance benefits by extending 0.20 percent FUTA surtax through June 30, 2011. The *Emergency Economic Stabilization Act of 2008* had extended the temporary surtax through December 31, 2009. The homebuyer, NOL and military relocation relief in the new law are paid for with a mix of revenue raisers.

■ **Penalties.** Effective for tax years beginning after December 31, 2009, the penalty for failure to file a partnership return or an S corp return increases from \$89 to \$195.

■ **Worldwide allocation of interest.** The effective date of worldwide allocation of interest, authorized by the *American Jobs Creation Act of 2004*, is delayed until tax years beginning after December 31, 2017.

■ **Corporate estimated tax.** The Act increases the required corporate estimated tax payments factor for large corporations for payments due in July, August and September 2014 by 33 percentage points, up from an already increased level set by the *Corporate Estimated Tax Shift Act of 2009*.

For further details, see the Law, Explanation and Analysis of the new law on CCH's Intelliconnect and Tax Research Network and the special CCH Briefing also online.

Reference Key

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

House Passes Non-Inflation Adjusted Surtax To Pay For Health Care Reform

◆ *Affordable Health Care for America Act, H.R. 3962*

The *Affordable Health Care for America Act (H.R. 3962)*, passed by the House on November 7, imposes a new surtax on higher-income taxpayers to offset the cost of health care reform. The House also voted, 220-215, to place new limits on health flexible spending accounts (FSAs), mandate individual coverage, codify the economic substance doctrine, and more.

■ **CCH Take Away.** The estimated revenue raised by the surtax is coming under fire because the surtax is not indexed for inflation. If the surtax creeps into middle income taxpayers, Congress will be under great pressure to “patch” it as it has the AMT. Consequently, the surtax would not raise its projected revenues of \$460 billion over 10 years.

Surtax

Beginning for tax years after December 31, 2010, *H.R. 3962* would impose a surtax of 5.4 percent on married couples filing joint returns and surviving spouses with modified adjusted gross income (MAGI) that exceeds \$1 million. The same 5.4 percent rate would apply to other taxpayers with MAGI exceeding \$500,000, including estates and trusts.

■ **Comment.** The Senate is expected to approve a new excise tax on high-dollar health insurance to fund health care reform. The proposed thresholds for the excise tax, unlike the House surtax, would be indexed for inflation, Paul Van de Water, senior fellow, Center on Budget and Policy Priorities (CBPP), Washington, D.C., told CCH. “The proposed excise tax is based on the overall cost of the plan and is not purely tied to a person’s income,” Van de Water explained.

FSAs

H.R. 3962 would limit annual health FSA contributions under an employer sponsored cafeteria plan to \$2,500, indexed for inflation. Over-the-counter medications would be ineligible for health FSA dollars unless prescribed by a health care professional. Insulin, however, would be covered.

■ **Comment.** The House did not eliminate the “use it or lose it” rule for FSAs, Alan Kahn, CPA, chair, tax division oversight committee, New York State Society of CPAs, told CCH. “What it causes taxpayers to do is bunch up expenses.” The House-passed Act also does not recognize that in recent years many prescription-only medications have been made available over-the-counter, Kahn noted.

For more on H.R. 3962, see the special CCH Briefing on Intelliconnect and the Tax Research Network.

Sponsors Of Cash Balance Plans Get Deadline Reprieve On Interest Crediting Rates

◆ *Announcement 2009-82*

The IRS has announced relief for statutory hybrid plans, such as cash balance plans and pension equity plans, that must amend the interest rate credited under the plan to comply with the requirements of the *Pension Protection Act of 2006 (PPA)*. The *PPA* requires that the plans not have an interest crediting rate that exceeds a market rate of return. Admitting that there is no way for it to come out with comprehensive regs that define “market rate of return” in time for plans to comply by 2010, the IRS has effectively delayed the deadline until first plan years that begin on or after January 1, 2011.

■ **CCH Take Away.** A plan’s interest crediting rate must not be conditioned on current service and is the rate by which a participant’s account balance is increased under the terms of the plan. The increase

is called an interest credit regardless of how the amount is calculated.

Reg relief

The IRS has indicated that it will issue final and proposed regs in the near future that will interpret the requirement that a statutory hybrid plan have a rate that does not exceed a market rate of return. The announcement provides that the regs on permissible market rates will not go into effect before the first plan year that begins on or after January 1, 2011. Plans may rely on Announcement 2009-82 until the publication of the additional guidance.

Anti-cutback rules

If a statutory hybrid plan has an interest crediting rate that exceeds a market rate of return under the final regs, the IRS announced that it will allow a corrective amendment to the plan that will not violate the anti-cutback rules. The

amendment must be adopted prior to the final regs’ effective date and must reduce the future interest crediting rate to a permissible rate. The anti-cutback rules will not be violated, even though the amendment may be adopted after the safe harbor deadline in the *PPA* for amendments required to comply with the *PPA* and underlying regs.

204(h) notice

Announcement 2009-82 also anticipates a special timing rule for ERISA 204(h) notices on amendments that change a plan’s crediting rate adopted by the last day of the first plan year that begins on or after January 1, 2009, and after November 10, 2009. The required notice on such an amendment will be permitted to be provided as late as 30 days after the effective date of the amendment.

References: FED ¶(to be reported); TRC RETIRE: 39,058.20.

Assets Remain Subject To IRS Lien After Tax Liabilities Discharged In Bankruptcy

◆ *Prince, 133 TC No. 12*

The Tax Court has found that an IRS lien, in place before the taxpayer filed for bankruptcy, remained in effect despite the taxpayer's discharge from personal liability for his tax debts. The court also concluded that an IRS jeopardy assessment was proper since the taxpayer could have dissipated the assets.

■ **CCH Take Away.** After the completion of bankruptcy proceedings, property exempt from creditors under the Bankruptcy Code is subject to a pre-petition tax lien if the IRS properly filed notice of the lien. Having filed a Notice of Federal Tax Lien (NFTL) for the taxpayer's liabilities, the IRS could still reach the creditor's assets. The Tax Court likely elevated the profile of this decision to "regular opinion" status to underscore its adherence to this position on post-bankruptcy repercussion in light of the current economic downturn.

Background

The IRS determined that the taxpayer owed taxes for 1997-1999. The taxpayer

petitioned the Tax Court. In 2003, the Tax Court issued a decision upholding the IRS's determinations. While the case was pending, the police seized \$264,000 from the taxpayer on suspicion of illegal activities.

In April 2005, the IRS filed an NFTL for 1997-1999. In June 2005, the taxpayer filed for Chapter 7 bankruptcy. He did not list the funds held by the police as an asset. The bankruptcy court discharged the taxpayer from personal liability for his debts.

In 2007, the police notified the taxpayer that the money would be returned to him. The IRS immediately filed a jeopardy levy in the district attorney's office and sent a notice of the levy to the taxpayer. The IRS held a collection due process hearing and upheld the levy action.

Assets available

The court upheld the IRS's right to the funds. The bankruptcy discharge relieved the taxpayer of personal liability for his unpaid tax liabilities. But the court concluded that a valid tax lien survives bankruptcy and that the lien continues to attach to pre-bankruptcy property.

The court cited two of its decisions, *Bus-sell, 130 T.C. 222 (2008)*, and *Iannone,*

122 T.C. 287 (2004). The lien on the funds seized by the police survived because it was filed before the bankruptcy petition was filed. The court also noted that the taxpayer did not include the funds in his schedule of assets filed with the bankruptcy court.

Jeopardy levy proper

The court concluded that the jeopardy levy was appropriate because the IRS determined that collection of the tax was in jeopardy. The IRS levy was limited to the pre-bankruptcy assets subject to the lien. If not levied upon, the funds could be dissipated and the IRS would be unable to collect the tax liabilities.

Other arguments rejected

The court rejected taxpayer's argument that the funds did not belong to the taxpayer. The Tax Court said that the issue had to be raised by the parties claiming to be the owners of the funds. The court also found that the taxpayer received timely notice of the jeopardy levy, and it rejected taxpayer's argument that the Appeals Officer was biased.

References: CCH Dec. 57,977; TRC IRS: 51,158.25.

IRS Determines Rebate On Fundraiser "Scrip" Excluded From Buyer's Income

◆ *LTR 200945022*

Rebate of "scrip" purchased from a charitable organization that a taxpayer can receive in cash or allow the charity to retain is not included in the taxpayer's gross income, the IRS has determined. If the taxpayer elects to permit the charity to keep the rebate, the taxpayer would still be able to claim a charitable contribution.

■ **CCH Take Away.** A scrip program is a fundraiser where merchants issue gift cards at a discount to charities. The purchase price that a charity pays for the scrip is a certain percentage below the face value of the scrip. The charity sells the scrip at face value. The difference

between the discounted purchase price and the face value of the scrip represents a charity's proceeds from the fund-raising program.

Background

A charitable organization purchases scrip at a discount. The charitable organization subsequently sells the scrip at face value. When a taxpayer purchases scrip from the charitable organization, it may choose to receive in cash a portion of the difference between the face value of the scrip and the charity's cost for the scrip. Alternatively, the taxpayer may allow the charity to retain that portion.

The taxpayer asked the IRS if the rebate would constitute an adjustment to the pur-

chase price of the scrip and, consequently, would be included in the taxpayer's income. If the charitable organization retains the rebate, the taxpayer inquired if its purchase of the scrip would constitute a charitable donation.

Excluded from income

Under Code Sec. 61, gross income means all income from whatever source derived. A rebate, the IRS noted, received by a buyer from the party to whom the buyer directly or indirectly paid the purchase price for an item is an adjustment in purchase price. A rebate is not an accession to wealth. A rebate is not included in the buyer's gross income.

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Taxpayer Granted Equitable Innocent Spouse Relief For Ex-Spouse's Share Of Taxes

◆ *Bruen, TC Memo. 2009-249*

The Tax Court has granted equitable innocent spouse relief to a divorced wife for her ex-husband's half of their joint tax liabilities for 2002 and 2003. However, the court denied relief to the wife for her own half of the couple's joint tax liabilities. The Tax Court again rejected the IRS's argument that the proper standard of review in such cases is abuse of discretion, not de novo. Additionally, the court determined that evidence may be introduced at trial that was not included in the administrative record.

■ **CCH Take Away.** The IRS Chief Counsel continues to argue for an abuse of discretion standard, based solely on the administrative record, for litigating cases involving Code Sec. 6015(f) innocent spouse relief. See *CC-2009-021, July, 2009*.

Background

A divorce decree provided that the taxpayer and her ex-husband would file joint returns for 2002 and 2003, and would each be liable for half of their 2003 federal income tax. It did not cover their 2002 liability, apparently assuming that the liability had been paid. The amended returns for 2002 and 2003 showed a balance of tax due attributable solely to the ex-husband's income.

The taxpayer filed for equitable innocent spouse relief under Code Sec. 6015(f) with respect to the 2002 and 2003 tax liabilities. The IRS asserted she had knowledge or reason to know that her ex-husband would not pay his share of the joint liabilities and denied her request.

Tax liabilities

The Tax Court determined that the taxpayer was entitled to equitable relief for her ex-husband's share of the 2002 and 2003 tax liabilities. The taxpayer demonstrated that she did not know or have reason to know her ex-husband would not pay his portion.

However, she remained liable for her half of the liabilities. The court determined that factors weighing in favor of relief, such as abuse or economic hardship, were absent. Factors weighing against relief weighed "very heavily and [were] decisive." The taxpayer was the principal tax return preparer for the cou-

ple while they were married, for almost 30 years, and she understood she would be liable for half of the tax liabilities under the divorce decree.

■ **Comment.** Despite the divorce decree's failure to assign half of the 2002 liability to each spouse, the Tax Court determined that the same analysis applied to their 2002 liability as well as their 2003 liability. The taxpayer was liable for half of the taxes and was entitled to relief for half of the 2002 liabilities.

References: CCH Dec. ¶57,980(M); TRC INDIV: 18,058.

Code Sec. 529 College Savings Plan Held Subject To Bankruptcy Proceedings

A federal bankruptcy court recently awarded the funds of a debtor's Code Sec. 529 college education account to a Chapter 7 bankruptcy trustee, over the debtor's argument that it was excluded from the bankruptcy estate. The account met the definition of property includible in the estate under Sec. 541 of the U.S. Bankruptcy Code. Further, the account did not meet any applicable exceptions under that Section.

Educational accounts covered. The court explained that the account fell within the debtor's bankruptcy estate because the funds belonged to the debtor, not the designated beneficiary of the account. He owned most of the contributions and earnings credited to the account. Additionally, since he had the power to terminate the account, he would receive a distribution of the account balance upon termination.

Inapplicable education exception. The court did acknowledge that a protection against bankruptcy exists for educational accounts. However, for this exception to apply, the taxpayer must have (1) contributed to the Code Sec. 529 account at least a year before the bankruptcy filing and under certain monetary caps or (2) contributed to the account more than two years before the filing with no monetary limit. The debtor in this case contributed funds to the account within two weeks of filing for bankruptcy.

■ **Comment.** This case is a reminder that, while contributions to qualified Code Sec. 529 tuition programs are excluded from Federal income tax under the Internal Revenue Code, they are not necessarily exempt from Federal bankruptcy laws.

In re C.H. Bourguignon, BC-DC Ida., Sept. 23, 2009, 2009-2 USTC ¶50,717; TRC INDIV: 60,204.05.

Fundraiser

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Here, the taxpayer purchased scrip from the charity and had the option to receive a cash rebate. The rebate is an adjustment to the purchase price and would not be included in the taxpayer's gross income. The IRS came to the same conclusion if

the taxpayer elects to allow the charitable organization to retain the rebate.

Charitable contribution

The IRS noted that the taxpayer's election to receive the rebate in cash or allow the charity to retain the rebate is voluntary. Consequently, the taxpayer would be

treated as making a charitable contribution if it chooses to allow the charity to keep the rebate. The charitable contributions would be deductible only if all other requirements under Code 170 are satisfied, the IRS added.

References: FED ¶(to be reported); TRC INDIV: 33,556.

Tax Court Nixes CARDS Transaction For Lack Of Economic Substance

◆ *Country Pine Finance LLC, T.C. Memo 2009-251*

The Tax Court has found that a custom adjustable rate debt structure (CARDS) transaction lacked economic substance. The investors engaged in the transaction to create a tax loss, which would remain even if the investment vehicle could potentially earn a profit.

■ **Comment.** The House-passed health care reform bill, the *Affordable Health Care for America Act (H.R. 3962)*, includes codification of the economic substance doctrine as a revenue raiser.

Background

The investors were involved in several business ventures, including an insurance brokerage and an office park. Eventually, the investors decided to sell their business. The investors received stock and cash in exchange for their share. The investors

recognized gain on the exchange of their stock and reported it on their individual Forms 1040 for tax year 2001.

The investors sought to offset their gains through the CARDS transaction. They organized a limited liability company (LLC) to effectuate the transaction. The LLC engaged in a complex transaction including a cross-currency swap. The IRS eventually disallowed the purported losses.

Court's analysis

The court agreed with the IRS and held that the transaction lacked economic substance. In applying the objective prong of the test, the court held that the CARDS transaction consisted of predetermined steps; pointing to the fact that it was created only to produce tax benefits. Additionally, the transaction had no profit potential.

Under the subjective prong, the court held that the investors did not have a non-tax business purpose for entering into the

CARDS transaction. The investors argued that the purpose of the CARDS transaction was to finance a real estate investment. They would purchase real estate and use the real estate as collateral. If the investment was profitable, earnings from the real estate would exceed the costs of the CARDS transaction.

The court found that real estate was never substituted as collateral. Even if it was, the artificial loss would remain. The court found that it must look at the transaction giving rise to the tax loss in dispute and not at a hypothetical legitimate transaction.

■ **Comment.** Some of the investors testified that they had not read the transaction documents and had no knowledge of CARDS. This lack of due diligence, the court found, showed that the investors were doing nothing more than purchasing a tax loss.

References: CCH Dec. 57,982(M); TRC PART: 60,056.

Federal Circuit Affirms "Indirect Notice" That Short Sale Would Trigger Code Sec. 752 Liability

◆ *Marriott International, Resorts, L.P., CA-FC, October 28, 2009*

The U.S. Court of Appeals for the Federal Circuit has affirmed the Claims Court's decision that a partnership that took part in a Son of BOSS transaction was required to reduce the basis of certain mortgage notes it received by the obligation to cover a short sale of U.S. Treasury securities. The Federal Circuit, in a per curiam opinion, adopted without change the Claims Court's summary judgment opinion issued in 2008.

■ **Comment.** Courts have struggled to decide whether to retroactively apply Reg. §1.752-1, which treats all short sale obligations as Code Sec. 752 partnership liabilities. Since the partnership's transaction occurred in 1994, it predated the effective date of that regulation and Rev. Rul. 95-26,

IRS guidance that also declared the position of Reg. §1.752-1.

Background

The partnership engaged in a transaction to negate the taxable gains anticipated on its upcoming sale of mortgage notes. The partnership obtained mortgage notes from its business of selling timeshare interests in resort properties. It expected a substantial tax gain from the sale of those mortgages to an unrelated third-party. The partnership used the transaction to erase the tax owed on this sale and, even further, claim a purported \$71 million loss on the sale. The partnership used several short sales of five-year Treasury securities to artificially inflate the basis of the mortgage notes within the possession of the partnership.

In two notices of final partnership administrative adjustment (FPAA), the IRS reduced the basis of mortgage notes in the

hands of the partnership by the amount of the obligation to close the short sales. It also recharacterized the reported tax loss as a tax gain on the sale of the mortgages.

Indirect notice

The Federal Circuit affirmed that the IRS had provided "indirect" notice to the partnership that short sale obligations were Code Sec. 752 partnership liabilities in Rev. Rul. 88-77, which was effective for 1994. The taxpayer had indirect notice at the time the transaction was structured that the obligation to close a short sale might well give rise to a liability under Code Sec. 752.

The Federal Circuit further affirmed that the FPAA was correct. The IRS properly adjusted the outside basis of the partners to reflect the partnership's obligation to return the borrowed Treasury notes.

References: 2009-2 USTC ¶50,719; TRC SALES: 45,100.

Leasing Of Aircraft Fails Business Use Test; Planes Not Eligible For Accelerated Depreciation

◆ TAM 200945037

The IRS has concluded in a technical advice memorandum that taxpayers who owned and leased several aircraft did not regularly engage in the leasing business and did not satisfy a business use test for the aircraft. Consequently, the taxpayers could not claim accelerated depreciation, bonus depreciation, or expensing for the aircraft.

■ **CCH Take Away.** Many taxpayers are aware that there are depreciation limits on luxury cars used for business. There also are depreciation restrictions on excessive personal use of other “listed” property also used for business, such as aircraft. Congress did not want the incentive of accelerated depreciation to subsidize the purchase of personal property used incidentally or occasionally for business. In the TAM, the IRS determined that the taxpayer’s personal use of several aircraft was excessive and that the taxpayers must use straight-line depreciation.

Background

The taxpayers were two companies that purchased and leased aircraft. Company A never owned more than two aircraft. Company B had owned one aircraft and more recently owned no planes. A married couple owned the two companies.

Company A leased an airplane to Lessee, an S corp. Because it was owned by the husband, wife, and wife’s grantor trust, Lessee was a related party to Company A. The husband used the plane for personal and business travel, and Lessee used the plane for business travel. The plane was also flown to transport lobbyists, for entertainment, and for maintenance. Company A took accelerated depreciation on the aircraft.

Company B also leased an airplane to Lessee. The plane was used for personal travel, business travel, and maintenance. Company B took accelerated depreciation and bonus depreciation on the plane.

Business use required

If any listed property is not “predominantly used” in a trade or business in a taxable year, the property is limited to straight-line depreciation for that year and subsequent years. The business use percentage must exceed 50 percent, excluding certain specified uses.

The excluded uses include leasing property to a five-percent owner or to a person related to the property’s owner or lessee. However, this use does not have to be excluded if at least 25 percent of the total use of the aircraft is other qualified business use.

■ **Comment.** The regs clarify that the excluded use is not just the leasing of the property but the actual use of the property by a related person or five-percent owner.

The depreciation restrictions do not apply to listed property owned by any person regularly engaged in the business of leasing the property. Being “regularly engaged” requires that the business enter into leasing contracts frequently over a continuous period of time. Occasional

activity, such as leasing one car per year, is not sufficient.

Leasing not regular

The IRS determined that the taxpayers were not regularly engaged in the business of leasing. They only leased aircraft to related parties. Because they engaged in multi-year leases, they leased the aircraft infrequently, and they leased no more than one or two planes at a time. The husband and wife retained significant personal control over the use of the aircraft, despite the ownership and leasing arrangements.

Business use not predominant

The taxpayers did not satisfy the more than 50-percent use test. Fundamentally, they did not satisfy the 25-percent test for other business use that would have allowed them to count the business use by the related parties. Because a share of maintenance flights must be allocated to personal use, the personal flights with a five-percent owner or related person on board accounted for more than 75 percent of the use of each aircraft.

References: FED ¶(to be reported);
TRC DEPR: 3,510.25.

Surrender Of Life Insurance Policy Triggers Ordinary Income; Penalties Due For Failure To Report Income

The Tax Court has found that, upon surrender of a life insurance policy, the taxpayer received ordinary income of \$135,500 rather than capital gain on the \$11,500 net amount received. The distribution included amounts that offset policy loans.

Background. The taxpayer, an attorney, was the owner and beneficiary of a life insurance policy taken out by his mother in 1980 to pay her potential estate taxes. He paid most of the policy premiums by borrowing against the policy’s cash value. When he surrendered the policy in 2005, he had invested \$225,390 in the policy and realized taxable gains of \$135,963, as reported on Form 1099-R. He did not include any of the income on his 2005 tax return.

Surrender triggers ordinary income. The Tax Court determined that the satisfaction of the loans had the effect of a pro tanto payment of policy proceeds to the taxpayer and was income. The taxpayer was thus taxable under Code Sec. 72(e) on the amount reported by the insurance company on Form 1099-R. Moreover, the surrender of the insurance policy was not the sale or exchange of a capital asset. The court considered it settled law that the gain is ordinary income; there was no transfer of the policy or other circumstances to justify treatment as a capital asset.

The taxpayer was also liable for the accuracy-related penalty. His failure to report income shown on the Form 1099-R did not stem from reasonable cause and good faith.

Barr, TC Memo. 2009-250, CCH Dec. 57,981(M); TRC INDIV: 30,100.

Tax Briefs



Internal Revenue Service

The IRS has released the corporate bond weighted average interest rate, the permissible range of interest rates used to calculate current plan liability for plan years beginning in November 2009, and to determine the required contribution under Code Sec. 412(l) for plan years through 2009, and the current corporate bond yield curve and related segment rates for the purpose of establishing a plan's funding target under Code Sec. 430(h)(2).

*Notice 2009-88, FED ¶46,524;
TRC RETIRE: 15,304.05.*

Summons

An IRS third-party summons, issued to a financial corporation and requesting the production of records relating to its financial transactions with an individual in order to determine her tax liability, was not quashed. The government established a *prima facie* case for good faith issuance which was not rebutted.

*White, DC Mo., 2009-2 USTC ¶50,720;
TRC IRS: 21,106.*

Refund Claims

A married couple was entitled to a refund of an amount erroneously abated by the government because the tax was not reinstated before the statute of limitations expired. The IRS itself had concluded that the erroneous abatement was not the product of a clerical error, specifically rejecting its agent's contention to the contrary; therefore, the tax had actually been abated.

*Fowler, DC La., 2009-2 USTC ¶50,718;
TRC IRS: 45,162.*

Abatements

Although the IRS granted an individual taxpayer's interest abatement request with respect to a five-month and a six-month period occurring during the multi-year examination of his income tax return, the Tax Court's review of the administrative record found additional periods during which interest abatement was appropriate because the IRS, without explanation, took

no action whatsoever or failed to perform required administrative acts.

*Bucaro, TC, CCH Dec. 57,978(M),
FED ¶48,205(M); TRC IRS: 33,400.*

Deficiencies and Penalties

Summary judgment was denied with respect to a trust fund recovery penalty assessed against an individual. The individual, who was a 50-percent shareholder of a company, rebutted the presumption of validity of the IRS's penalty assessment by raising factual issues as to whether she had significant control over the financial affairs of the company, intentionally preferred other creditors over the government or acted with reckless disregard.

*Wells, DC N.J., 2009-2 USTC ¶50,721;
TRC PAYROLL: 6,256.*

An individual was liable for additions to tax for failure to file a return on the date prescribed under Code Sec. 6651(a)(1). However, he was not liable for an addition to tax under Code Sec. 6654(a) because the IRS failed to show that the individual filed a return for the preceding tax year and, the amount shown on that return. However, he was liable for a \$25,000 penalty under Code Sec. 6673(a)(1) for presenting frivolous arguments.

*Davenport, TC, CCH Dec. 57,979(M),
FED ¶48,206(M); TRC FILEIND: 15,208.*

Supreme Court Docket

Petitions Filed

An individual's offer of proof was insufficient to support his theory that corporate distributions to him were a nontaxable return of capital. His proffered evidence only referenced corporate earnings, without any proof that the distribution was with respect to stock, or that any nexus existed between the distribution and his stock ownership.

M.H. Boulware, CA-9, 2009-1 USTC ¶50,289.

Petitions Denied

Limited partners' statute of limitations and penalty interest claims involved partnership items that could only be litigated in partnership-level proceedings. The partners' refund claim was based on their contention that the IRS issued Final Partnership Administrative Adjustments (FPAAs) after the applicable period of limitations had expired; however, the statute of limitations issue was a challenge to a partnership item that required litigation in partnership-level proceedings. Reg. §301.6231(a)(3)-1(b) implicitly included the statute of limitations determination within the definition of partnership items.

K.C. Keener, et al., CA-FC, 2009-1 USTC ¶50,152.

A criminal defense attorney was not entitled to a charitable contribution deduction for the donation of discovery material to a public university. Because the discovery material was not a capital asset and the taxpayer's basis in the property was zero, the ordinary income from its hypothetical sale reduced the deduction to zero.

S. Jones, CA-10, 2009-1 USTC ¶50,316.

An individual was not entitled to a jury instruction contending that his failure to pay over employee payroll taxes was not willful because he did not have money to pay the taxes. In order to establish willfulness, the government was not required to prove that the individual had the ability to meet his tax obligations. Instead, the failure to pay was willful because the individual knew that he owed taxes and did not pay them.

J. Easterday, CA-9, 2008-2 USTC ¶50,512.

Practitioners' Corner

Client Letter on New Law's Change To Homebuyer Credit, NOL Carrybacks, And More

On November 6, 2009, President Obama signed into law the Worker, Homeownership, and Business Assistance Act of 2009. Practitioners can e-mail or send the following letter to clients to highlight the tax incentives and revenue raisers in the new law.

Dear Client:

We are contacting you today to alert you to some of the details in the recently passed *Worker, Homeownership, and Business Assistance Act of 2009*. Especially as the close of the current tax year approaches, you may want to take certain steps to maximize your tax savings under the new law. We are here to assist you and answer your questions.

Two popular tax breaks – the first-time homebuyer credit and the expanded net operating loss (NOL) carryback – are extended in the new law. Some non-first-time homebuyers may be eligible for a reduced credit. Additionally, the expanded NOL carryback is now available to all businesses, not just for small businesses. Along with these incentives, the new law also extends the FUTA (unemployment) surtax, increases corporate estimated tax payments for part of 2014, delays application of worldwide allocation of interest, increases penalties for failure to file partnership or S corporation returns, expands electronic return filing by paid preparers, and excludes some special payments to military personnel from income.

First-time homebuyer credit. The first-time homebuyer credit is one of the most popular tax incentives in recent years. However, it is not a permanent tax break. It is temporary. Its originally scheduled expiration date of November 30, 2009 prompted Congress to extend and expand it.

Originally, the credit was limited to \$7,500 (\$3,750 for a married taxpayer filing separately) and the credit acted like

a loan. Taxpayers had to repay it in equal installments over 15 years. The repayment requirement appeared to discourage

and claim the credit when you file your 2010 return in 2011. This election needs to be reviewed carefully. Our office can

“Especially as the close of the current tax year approaches, you may want to take certain steps to maximize your tax savings under the new law.”

taxpayers from taking the credit and Congress removed it last year in most cases. Congress also raised the maximum credit to \$8,000 (\$4,000 for a married taxpayer filing separately).

The new law extends the credit for principal residences purchased on or before April 30, 2010. If a taxpayer enters into a binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010, the new law treats the credit as not expiring until July 1, 2010. Members of the U.S. armed forces, foreign service and intelligence community may have additional time to claim the credit if they are serving on qualified official extended duty outside of the U.S.

The new law also extends a special rule that could boost your expected tax refund. Eligible taxpayers can elect to treat a qualified purchase of a principal residence after December 31, 2008 as made on December 31 of the calendar year preceding the purchase. For example, if you purchase a qualified principal residence on March 2, 2010 and you are eligible for the credit, you can elect to treat the purchase as made on December 31, 2009 and claim the credit on your 2009 return. This treatment could result in a larger refund in 2010 depending on your personal tax situation. Otherwise, you could wait

help you decide when to claim the credit to maximize your tax savings.

Until now, the credit was limited to first-time homebuyers. The full credit (the \$8,000 credit) is still limited to first-time homebuyers. However, some long-time residents of the same principal residence may be eligible for a reduced credit of \$6,500. Generally, you must have owned and used the same residence as your principal residence for any five consecutive year period during the eight year period ending on the date of the purchase of a subsequent principal residence. This provision is intended to help younger homeowners who are trading up and seniors who may be looking to downsize.

Another notable change in the new law enables many more taxpayers to take advantage of the credit. Congress raised the income phase-outs for the credit. Previously, the credit phased out for single individuals with modified adjusted gross income (MAGI) between \$75,000 and \$95,000 and for married couples filing joint returns with MAGI between \$150,000 and \$170,000. Under the new law, phase out starts for single individuals with MAGI at \$125,000 and for married couples filing joint returns with MAGI at \$225,000.

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Washington Report

by the CCH Washington News Bureau

President signs homebuyer credit, NOL carryback and unemployment benefits legislation

On November 6, President Obama signed the *Worker, Homeownership, and Business Assistance Act of 2009 (H.R. 3548)*, extending unemployment insurance benefits, the first-time homebuyer tax credit, and the five-year carryback of net operating losses (NOLs). Not only does the new law extend the \$8,000 homebuyer credit, it also enhances the credit as well, making it available to higher-income individuals and providing a modified credit of up to \$6,500 to “long-time” homeowners looking to make their next home purchase. Congress also imposed new documentation requirements to claim the credit. Additionally, the new law extends the five-year NOL carryback election to all U.S. businesses, and provides an extension of unemployment insurance benefits for an additional 14 weeks.

“The legislation builds on the successes of the *American Recovery and Reinvestment Act* to help spur job creation and help struggling workers. It is fiscally responsible,” a White House spokesperson said.

The new law includes a number of revenue raisers, including an acceleration of corporate estimated tax payments, and an increase in penalties for failure to file partnership and S corporation returns. The effective date for several of the key provisions is November 6, 2009, the date of enactment of the new law. *For more details on the new law, see the lead article on page 529 of this newsletter.*

House passes health care bill

Late on November 7, the House passed, 220-to-215, its health care reform bill, the *Affordable Health Care for America Act (H.R. 3962)*. The largest revenue raiser in the House’s bill is the controversial 5.4 surtax on higher income individuals and families, which is estimated to raise more

than \$400 billion over 10 years. The 5.4 percent surtax would apply to individuals with adjusted gross income (AGI) in excess of \$500,000, and to families with AGI in excess of \$1 million. The surtax is not indexed for inflation. In addition to the surtax on high-income individuals, the House bill includes new treaty benefit limitations, new information reporting requirements on payments to corporations, new restrictions on the biofuel credit, and codification of the economic substance doctrine. The Act also places new limits on health flexible spending accounts (FSAs), revises the penalties on nonqualified distributions from HSAs, imposes an excise tax on medical devices, and includes a public option.

The House bill will face a battle in the Senate, which is still struggling to merge two versions of health care reform: one bill passed by the Senate Finance Committee and another passed by the Senate Health, Education, Labor and Pensions Committee. The Senate must then pass its health care reform bill. Thereafter, the House and Senate versions must be merged in conference.

The House-passed surtax is particularly unpopular in the Senate. “With this small business surtax, a family of four in the top bracket will pay a marginal tax rate of 46.4 percent in 2011. This tax change would result in an increase of the marginal tax rate by 33 percent,” Sen. Charles Grassley, R-Iowa, predicted. Sen. Joseph Lieberman, I-Conn., has indicated he will not support the House’s public option. “If a government plan is part of the deal, I will not allow this bill to come to a final vote.”

\$123.5 million in refund checks undeliverable

A combined total of \$123.5 million in undeliverable refund checks are owed to approximately 108,000 taxpayers, according to the IRS. The refund checks were returned due to mailing address errors. The average refund check amount is \$1,148. As soon as

the IRS updates the mailing addresses, the checks will be resent. According to the IRS, the easiest way to update a mailing address or check the status of a refund is to access the IRS web site, www.irs.gov, and use the “Where’s My Refund?” tool.

Taxpayers erroneously claim health coverage tax credit

On November 5, the Treasury Inspector General for Tax Administration (TIGTA) reported that large numbers of taxpayers are incorrectly claiming the Health Coverage Tax Credit (HCTC). According to TIGTA, on the 2007 returns that it sampled, it identified 1,260 individuals who erroneously claimed approximately \$1.8 million in HCTCs. From a statistical sample of 82 individual tax returns claiming the HCTC on their 2006 returns, TIGTA found that 59 returns (72 percent) did not have the required documentation attached for claiming the credit.

TIGTA also noted that the percentage of eligible individuals that actually participate in the HCTC program is “extremely low.” For example, TIGTA found that during the 2007 tax year, of roughly 356,000 individuals identified as potentially eligible for the credit, only eight percent participated in the program to receive the credit.

SFC grills nominee for assistant Treasury secretary for tax policy

On November 4, the Senate Finance Committee (SFC) conducted a hearing on the nomination of Michael Mundaca to serve as assistant Treasury secretary for tax policy. Mundaca testified that the current income tax system fails in the areas of simplicity, fairness and promotion of growth in tax revenue. Mundaca praised the Obama administration’s budget proposals for increasing domestic and cross-border compliance as well as its coordination with the international organizations, such as the Organisation for Economic Co-operation and Development (OECD).

Practitioners' Corner

Continued from page 537

While the homebuyer credit can be very valuable, it is also very complex. In addition to the provisions we have described, there are special rules for repayment, new documentation requirements, a purchase price cap, and more. Please contact our office for more details about the credit.

NOL carryback. In what is very welcomed news for many businesses buffeted by the recession, the new law not only extends special NOL carryback rules, it makes all businesses eligible for the expanded carryback first made available under the *American Recovery and Reinvestment Act of 2009 (2009 Recovery Act)*. NOL carrybacks are valuable when taxpayers are operating at a loss. A taxpayer can use an NOL to obtain a refund for taxes paid in prior or future years when they have an operating gain. Under normal circumstances, the carryback period is two years. The new law more than doubles that period, allowing up to a five-year carryback of NOLs.

Under the *2009 Recovery Act*, a qualified small business could elect to carry back 2008 NOLs for three, four or five years rather than the standard two years. The *2009 Recovery Act* generally limited this special treatment to small businesses with average gross receipts of \$15 million or less. Since Congress enacted the *2009 Recovery Act*, many business groups have lobbied for expanding the enhanced carryback to all businesses. The new law does just that. All businesses may elect to carry back 2008 or 2009 NOLs for up to five prior years, but with a 50 percent income limit on NOL carrybacks in the fifth year. A taxpayer can take the new expanded election for NOLs incurred in either 2008 or 2009, but not for both years.

There is a special rule for a qualified small business that elected under the *2009 Recovery Act* to carry back 2008 NOLs. The qualified small business may make the election for an additional year. Consequently, an eligible small business may be able to carry back NOLs from both 2008 and 2009 for up to five years.

More favorably, the 50 percent limitation does not apply to a qualified small business that elected to carry back its 2008 NOLs under the *2009 Recovery Act*. However, the 50 percent limitation does apply to the qualified small business's 2009 NOLs.

The election under the new law must be made by the due date (including extensions) for the tax return filed for the taxpayer's last taxable year beginning in 2009. Keep in mind that the election is irrevocable. Fiscal year taxpayers can make the election for tax years beginning or ending in 2008 or 2009.

The new law also includes special NOL provisions for insurance companies and businesses that received funds under the federal government's Troubled Asset Relief Program. Additionally, the new law suspends the 90 percent income limitation on the use of NOLs for determining the AMT of an extended carryback year.

Our office encourages small businesses to contact us about expanded NOL carrybacks. Moreover, because of the new law, all businesses need to review their NOL carrybacks. Please contact our office for more information.

FUTA. In 1976, Congress imposed a temporary 0.20 percent surtax on top of the regular 6.0 percent federal unemployment tax (FUTA). The surtax was most recently renewed in 2008. The new law extends the surtax through June 30, 2011.

Penalties. The IRS imposes penalties on taxpayers that fail to file returns. The new law increases two of those penalties. Effective for tax years beginning after December 31, 2009, the penalty for failure to file a partnership return increases from \$89 to \$195. The penalty for failure to file an S corporation return also increases from \$89 to \$195, effective for tax years beginning after December 31, 2009.

Military exclusion. The Department of Defense Homeowners Assistance Program (HAP) compensates eligible military personnel and civilian employees for adverse effects on housing values. These payments are generally excluded from income. The *2009 Recovery Act* expanded HAP to assist military personnel

who are wounded, injured, or become ill when deployed; surviving spouses of service members or DOD employees killed or who died of wounds while deployed; military personnel member and civilian employees assigned to base realignment organizations; and military personnel required to permanently relocate during the home mortgage crisis. The new law clarifies that the *2009 Recovery Act* HAP provisions are excluded from income.

Corporate estimated tax. In July 2009, Congress passed the *Corporate Estimated Tax Shift Act*. The *Corporate Estimated Tax Shift Act* increased estimated tax payments for large corporations to 100.25 percent for estimated taxes due in July, August and September 2014. The new law increases the required corporate estimated tax payments factor for these large corporations for payments due in July, August, and September 2014 by 33 percentage points.

Return preparation. The new law requires any individual income tax return prepared by a tax return preparer to be filed electronically unless the preparer reasonably expects to file fewer than 10 individual income tax returns during the calendar year. Under the new law, the term individual income tax return means any return imposed by subtitle A on individuals, estates or trusts.

Worldwide allocation of interest. In 2004, Congress authorized a worldwide affiliated group to make a one-time election to determine the foreign source taxable income of the group by allocating and apportioning the domestic members' interest expense on a worldwide basis, as if all members of the group were a single corporation. The new law delays the effective date of this provision until tax years beginning after December 31, 2017.

As you may have gathered from what has been only a summary of the new tax law, there is a considerable degree of complexity involved both in taking full advantage of the tax benefits and in avoiding pitfalls. Please do not hesitate to contact our office if you have any questions about the *Worker, Homeownership and Business Assistance Act of 2009*.

Sincerely yours,

Compliance Calendar

■ November 16

Monthly depositors must pay Social Security, Medicare, and withheld income tax for October.

Employers deposit Social Security, Medicare, and withheld income tax for November 7, 8, 9, and 10.

Deadline for taxpayers to perfect or modify election to defer cancellation of debt on repurchased debt under Rev. Proc. 2009-37

■ November 18

Employers deposit Social Security, Medicare, and withheld income tax for November 11, 12, and 13.

■ November 20

Employers deposit Social Security, Medicare, and withheld income tax for November 14, 15, 16, and 17.

■ November 25

Employers deposit Social Security, Medicare, and withheld income tax for November 18, 19, and 20.

■ November 30

Employers deposit Social Security, Medicare, and withheld income tax for November 21, 22, 23, and 24.

■ December 2

Employers deposit Social Security, Medicare, and withheld income tax for November 25, 26, and 27.

■ December 4

Employers deposit Social Security, Medicare, and withheld income tax for November 28, 29, 30, and December 1.

■ December 9

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

■ December 10

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

From the Helpline

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

Q Taxpayers may file an amended return in order to claim a Net Operating Loss carryback that was missed. Rev Proc 2009-26 appears to suggest this is possible within six months, while IR-2009-79 appears to state that an amended return may be filed up to the end of the tax year. Which is correct?

A The six month rule is correct. The election must be made within 6 months after the due date of the original return. The December 31 deadline mentioned in IR 2009-79 is not the deadline for making the election. December 31 is the deadline for making the actual refund claim on a Form 1045 (individuals) or Form 1139 (corporations), assuming that an election is made by a taxpayer by attaching an election statement to its original income tax return by the September 15 or October 15 due date for calendar year corporations and individuals. See *TRC NOL: 12,103; Rev. Proc. 2009-26*.

Q What forms must a taxpayer file when two C corporations merge?

A Both the acquiring corporation and target corporation in a merger must file a statement with their returns for the tax year of the merger to report certain information about the transaction. See *Reg. §1.368-3(a); TRC CCORP: 39,306*.

Certain shareholders and security holders of the target corporation are also required to file an information statement with their returns. Generally, the reporting requirements apply to target shareholders who receive stock or securities in the merger and, immediately before the exchange, owned at least five percent of the target's total outstanding stock that is publicly traded, or at least one percent of the total outstanding stock that is not publicly traded. Security holders who owned securities in the target corporation with a basis of \$1,000,000 or more immediately before the transaction and receive stock or securities in the exchange must also file a statement. See *Reg. §1.368-3(b) and (c); TRC CCORP: 39,258*.

TRC Text Reference Table

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

BUSEXP 39,106	523	IRS 21,106	536	LITIG 3,050	523
CCORP 3,250	523	IRS 21,300	523	LITIG 3,152	523
COMPEN 18,352	521	IRS 27,156	511	LITIG 3,156	523
DEPR 3,510.25	535	IRS 27,218	523	LITIG 6,456.35	523
FILEBUS 12,102.05	522	IRS 33,400	536	PART 3,102	523
FILEIND 15,208	536	IRS 36,052.05	512	PART 48,154	522
FILEBUS 15,052.054	523	IRS 36,052.05	523	PART 60,056	534
INDIV 6,052	523	IRS 39,058.05	523	PAYROLL 3,352.05	523
INDIV 6,056	509	IRS 45,160	523	PAYROLL 6,256	536
INDIV 18,058	533	IRS 45,162	536	PAYROLL 9,058	520
INDIV 21,206	511	IRS 51,056.25	523	PENALTY 3,106.20	523
INDIV 30,100	535	IRS 51,158.25	532	RETIRE 15,056	521
INDIV 33,556	532	IRS 66,152.25	523	RETIRE 15,304.05	536
INDIV 57,800	519	IRS 66,154	511	RETIRE 39,058.20	531
INDIV 60,204.05	533	IRS 66,154	523	SALES 45,100	534
IRS 21,104	523	LITIG 3,050	511	SCORP 404.10	519