

# Federal Tax Weekly

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## More Reductions In IRS Services Likely Due To Funding Cuts, Koskinen Predicts

◆ *IRS Commissioner John Koskinen, August 21, 2014*

Taxpayers should expect more reductions in IRS services because of budget cuts, Commissioner John Koskinen recently cautioned. Koskinen's warning comes as the IRS prepares for year-end tax legislation as well as implementing its voluntary return preparer education program and combatting tax-related identity theft.

■ **CCH Take Away.** Employee training is one area where the IRS has reduced funding in response to budget cuts. "The training budget of IRS personnel is down by 83 percent," Fred Slater, CPA, partner, MS 1040 LLC, New York, told CCH. "I challenge the IRS to make positive changes toward better service," Slater said.

### Background

The IRS's funding level for FY 2014 is \$11.29 billion, or about \$850 million below FY 2010 funding. In July, the House approved a \$10.9 billion FY 2015 budget for the IRS, reflecting a \$341 million drop from FY 2014 funding. The Senate is expected to maintain funding at FY 2014 levels, possibly with a slight increase. Additionally, the *Budget Control Act of 2011* imposed sequestration (across-the-board spending cuts) on many federal agencies, including the IRS.

■ **Comment.** The IRS will "play the hand we are dealt" when it comes to funding, Koskinen said,

but he warned that the agency cannot do more with less. "You cannot continue to reduce our resources and ask us to do more things. We are no longer going to pretend that cutting funding makes no difference," Koskinen said.

### Service and enforcement

Reduced funding has had a direct impact on customer service, Koskinen said. The IRS cut 5,200 call center employees because of lack of funding. Wait times to speak with the IRS will increase, he predicted. Overall, the agency's total employment is down approximately 10,000 full-time employees compared to 2010.

■ **Comment.** The IRS's level of customer service for the 2014 filing season was around 70 percent, meaning that about 70 percent of taxpayers who called this filing season got through to the IRS. This could drop into the 50s, Koskinen said.

Funding cuts have also impacted enforcement activities. The IRS will perform 100,000 fewer individual audits. The government could lose some \$3 billion in revenue as a result, Koskinen cautioned.

■ **Comment.** Voluntary compliance has been the keystone of the federal tax system. "If voluntary compliance with the tax code drops by one percent, it costs the U.S. government \$30 billion per year," Koskinen said.

*Continued on page 406*

## IRS Directs Timely Action, Debriefing Of Whistleblower Claims

◆ *Whistleblower Memorandum, August 20, 2014*

Timely action on whistleblower claims is essential, IRS Deputy Commissioner John Dalrymple said in a just-released review of the agency's whistleblower program. Dalrymple also emphasized that the agency will take all necessary steps to protect the existence and identity of the whistleblower from disclosure.

■ **CCH Take Away.** "Looking to the future, the IRS must do everything possible to strengthen the whistleblower program and build on the progress already made in implementing the law, while remaining mindful of the need to protect taxpayer rights," IRS Commissioner John Koskinen said in a statement. "I am committed to expanding the program's reach and improving communications with existing and potential whistleblowers."

### Background

Code Sec. 7623(b) provides that if the taxes, penalties, interest and other amounts in dispute exceed \$2 million, the IRS will pay 15 percent to 30 percent of the amount col-

lected. If the case deals with an individual, his or her annual gross income must be more than \$200,000. Final determinations under Code Sec. 7623(b) may be appealed to the Tax Court.

If a whistleblower submission does not meet the criteria for an award under Code Sec. 7623(b), the IRS may make a discretionary award under Code Sec. 7623(a). Decisions under Code Sec. 7623(a) may not be appealed to the Tax Court.

■ **Comment.** The IRS issued final comprehensive whistleblower regs in early August (*see the August 14, 2014 issue of this newsletter for details*). The final regs clarify the filing of claims, eligibility for awards, collected proceeds, and more.

### Whistleblower leads

Whistleblowers provide valuable leads and often offer unique insights, Dalrymple said. When the information can be corroborated, the IRS will act on specific and credible information regarding tax compliance issues. "The decision on whether to conduct an audit should be based on the quality of the information provided, its relevance to IRS tax enforcement priorities, and available resources," he said.

### Time frames

Dalrymple emphasized that substantive review of whistleblower information needs to be a priority. Whistleblower claims should be initially evaluated within 90 days, he said. Operating divisions and Criminal Investigation should complete their review within 90 days of receipt. Whistleblowers should be notified of an award decision within 90 days after collected proceeds can be finally determined.

### Debriefing

Dalrymple called debriefing of the whistleblower an "invaluable and crucial component" of the evaluation of his or her information. Debriefing can take place in-person or by telephone. Debriefing, Dalrymple indicated, should take place before a decision is made whether to refer the information for further investigation.

All whistleblower claims referred to review in the Large Business and International Division, Tax-Exempt/Government Entities Division and Small Business/Self-Employed Division, will include a debriefing of the whistleblower, Dalrymple explained. If a debriefing is not conducted, there must be a specific justification for the decision to forgo a debriefing.

*Reference: TRC IRS: 63,060.05.*

### IRS Budget

*Continued from page 405*

### Late legislation

Legislation to renew many of the tax extenders, including the state and local sales tax deduction, higher education tuition deduction and research tax credit, has stalled in the Senate and has moved piecemeal in the House. An extenders package is not likely to come up for a vote in Congress until after the November elections, Koskinen predicted. "Congress

needs to understand that the later these are passed and the more complicated they are, the more challenging it is for taxpayers to file accurate returns on time."

The IRS is challenged to quickly reprogram its processing systems for late legislation. In past years with late legislation, the IRS delayed the start of the filing season. The IRS could do the same with the start of the 2015 filing season, Koskinen said.

### Return preparers

The IRS has launched a new education program for return preparers, the Annual Filing

Season Program (AFSP). Return preparers who elect to participate in the AFSP and receive a Record of Completion from the IRS will be included in a database on the agency's website. "It is important to keep the momentum going for the education of tax preparers but (this) is only an interim step," Koskinen said.

### Identity theft

The IRS put new filters in place and took other measures to curb tax-related identity theft during the 2014 filing season. The agency is also working with software developers, financial institutions and the prepaid debit card industry to combat identity theft. "We rejected 5.7 million suspicious returns last year that may have been tied to identity theft," Koskinen said.

#### Reference Key

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

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## IRS Revised Instructions For Form 5471 Clarify Reporting Of Interests In Foreign Corporations

◆ *Instructions for Form 5471, www.irs.gov*

The IRS has issued draft revised instructions for the 2014 Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. The instructions alert taxpayers that an exception to reporting has expired, and that U.S. shareholders filing Form 5471 may be subject to the net investment income tax on their income from a controlled foreign corporation (CFC).

■ **CCH Take Away.** “Taxpayers should carefully review the instructions to Form 5471 to determine whether they have a filing requirement under Form 5471,” Joseph Calianno, Partner and International Technical Tax Practice Leader, Grant Thornton LLP, Washington, D.C., told CCH. “Failure to file Form 5471 can result in potential penalties and the extension of the statute of limitations under section 6501(c)(8).”

### Form 5471

A U.S. shareholder of a CFC for an uninterrupted period of at least 30 days during the year must include its share of the CFC’s Subpart F income and of earnings invested in U.S. property. A corporation is a CFC if more than 50 percent of its voting power or value is owned by U.S. shareholders. These include U.S. citizens, resident aliens, and domestic corporations, partnerships, trusts, or estates.

Form 5471 applies to multiple filing and reporting requirements under Code Sec. 6038, information reporting with respect to certain foreign corporations and partnerships, and 6046, returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock. The form must be filed with the shareholder’s Form 1040. Failure to timely file can result in penalties and a reduced foreign tax credit.

### Reporting persons

There are categories of persons that must file Form 5471. These categories include the following groups:

- A U.S. person whose acquisition of stock of a foreign corporation makes it a 10 percent owner of the corporation (Category 3);
- A person treated as a U.S. shareholder with respect to a foreign corporation subject to the captive insurance company rules (Category 3);
- A person who becomes a U.S. person while owning 10 percent of the stock of a foreign corporation (Category 3);
- A U.S. citizen or resident who becomes an officer or director of a foreign corporation with a 10-percent U.S. stockholder (Category 2);
- A U.S. person who owns 10 percent of a foreign corporation that undergoes a reorganization (Category 3); and
- A U.S. person who disposes of sufficient stock to reduce his or her interest in a foreign corporation below 10 percent (Category 3).

Categories 4 and 5 apply to U.S. persons who meet the following thresholds for stock ownership in a CFC:

- A U.S. person with control (more than 50 percent stock ownership) of a CFC for at least 30 uninterrupted days during the CFC’s annual accounting period; and
- A U.S. shareholder who owns stock in a CFC more 30 uninterrupted days and who owns the stock on the last day of the corporation’s tax year.

### New items

The updated instructions describe several new items. Certain active financing income had been excepted from Subpart F income from 1999 to 2013. For tax years beginning after December 31, 2013, the exception no longer applies.

A look-through rule that applied to foreign corporations from 2006 to 2013 no longer applies for tax years beginning after December 31, 2013. The NII tax applies, beginning in 2013, and can apply to income from CFCs.

*Reference: TRC INTL: 3,752.05*

## Agencies Issue Regs On Contraceptive Coverage Accommodation

◆ *TD 9690, NPRM REG-129507-14, NPRM REG-129786-14*

The IRS and the U.S. Departments of Health and Human Services (HHS) and Labor (DOL) have issued interim final regs allowing an alternative to self-certification that certain religious organizations may use to give notice that they fall within the safe harbor from federal requirements to cover certain contraceptive services without cost sharing. The agencies also issued proposed regs extending similar treatment to closely held for-profit entities.

■ **CCH Take Away.** Section 2713 of the *Public Health Service (PHS) Act*, as added by the *Patient Protection and Affordable Care Act (PPACA)* requires group health plans and insurance issuers to

provide contraceptive coverage without requiring the insured to share costs. The government is now amending its guidance in the wake of the June 30, 2014 U.S. Supreme Court decision in *Burwell v. Hobby Lobby Stores, Inc.*, *SCt*, 2014-2 USTC ¶50,341.

■ **Comment.** A federal district court has enjoined the agencies from enforcing a self-certification regime for contraceptive coverage for nonprofit religious groups (*Brandt v. Burwell, DC-Pa.*, August 20, 2014.) The decision was announced before the agencies issued the interim final regs with an alternative to self-certification.

*Continued on page 408*

## IRS Modifies Safe Harbor To Help REITs Meet 75 Percent Asset Test

◆ *Rev. Proc. 2014-51*

The IRS has modified the asset test safe harbor for real estate investment trusts (REITs) to ensure that an increase in the value of the REIT's real property does not inadvertently reduce compliance with the 75 Percent Asset Test. The revised revenue procedure also provides that a modification of a mortgage loan to reduce the risk of default will not be treated as a new loan or as a prohibited transaction.

■ **CCH Take Away**, Code Sec. 856(c)(4) requires that, at the close of each calendar quarter, at least 75 percent of the value of the

REIT's assets must be represented by qualifying assets -- real estate assets, cash items, and government securities. A real estate asset includes a loan secured by real property. The IRS determined that, under the previous safe harbor test provided in Rev. Proc. 2011-16, an increase in the value of the real property securing a loan reduced the percentage of assets treated as a qualifying asset. The modification of the safe harbor test in Rev. Proc. 2014-51 will avoid this result.

■ **Comment.** If an entity qualifies as a REIT, its undistributed income and capital gains are taxed at corporate rates, while its income that is distributed to shareholders is taxed directly to the shareholders rather than being taxed at both the REIT and the shareholder level.

### Asset test safe harbor

Rev. Proc. 2011-16 provided that the IRS will not challenge a REIT's treatment of a loan as "a real estate asset" for the 75 Percent Asset Test, if the REIT treats the value of the loan as the lesser of:

- The "value of the loan" determined under Reg. §1.856-3(a); or
- The "loan value of the real property" securing the loan.

The value of the loan generally rises as the value of the property securing the loan increases, while the loan value of the property is fixed on the date that the REIT commits to make or purchase the loan and does not vary with increases in the value of the real property collateral. Thus, the numerator of the asset test does not vary with increases, but the denominator of the asset test does increase if the value of the collateral increases, and the portion of a mortgage loan that is a qualifying asset decreases.

To prevent this "anomalous" result, Rev. Proc. 2014-51 modifies the asset test safe harbor. The loan is a real estate asset in an amount equal to the lesser of:

- The value of the loan under Reg. §1.856-3(a), or
- The greater of the current value of the collateral, or the loan value of the collateral determined under Reg. §1.856-5(c).

### Modifications

Under Rev. Proc. 2014-51, a modification because of default or potential default is not a significant modification. Therefore, it is not a new commitment to make or purchase a loan, and the "loan value of the property" does not change. Furthermore, the modification of the loan is not a prohibited transaction, which can be subject to a 100 percent tax.

*References: FED ¶46,408; TRC RIC: 60,070.05.*

### Coverage

*Continued from page 407*

### Interim final regs

The interim final regs provide an alternative process for an organization eligible for the religious employer accommodation. The organization may notify HHS in writing of its religious objection to coverage of all or a subset of contraceptive services, and HHS and the DOL will notify insurers and third-party administrators of that the organization is certified to receive the accommodation.

■ **Comment.** The final interim regs are effective on August 27, 2014.

### Proposed regs

Under proposed regs, an employer eligible for a religious accommodation would include a closely held for-profit entity that has a religious objection to providing coverage for some or all of the contraceptive services otherwise required to be covered. The proposed regs would require that the qualifying closely held for-profit entity's objection, based on its owners' sincerely held religious beliefs, to covering some or all of the contraceptive services otherwise required to be covered, be made in accordance with the entity's applicable rules of governance under state law.

*References: FED ¶¶47,047; 49,629; 49,628; TRC HEALTH: 9,114.25.*

### IRS Reports Increased Individual Income For 2012

The IRS has issued a new report on individual income tax returns from the 2012 tax year. The 2012 Statistics of Income (SOI) for Individual Income Tax Returns shows that U.S. taxpayers reported adjusted gross income, less deficit, totaling \$9.1 trillion, an 8.7-percent increase from the prior year.

Items of investment income experienced notable increases, ostensibly due to economic growth and taxpayers accelerating their investment income into 2012 to avoid the net investment income tax and the expiration of the Bush-era tax cuts on January 1, 2013. For example, the amount reported in ordinary dividends increased by 33.8 percent from 2011; qualified dividends went up 43.9 percent from 2011; net capital gain less loss increased by 65.4 percent (even though the total number of returns reporting net capital gain decreased slightly); and capital distributions increased by 24.7 percent. In contrast, the amount reported in salaries and wages increased by 4.1 percent.

*IR-2014-83, FED ¶46,407; TRC IRS: 12,350.*

## IRS Eases Rules For Temporary Relief From Certain LIHTC Requirements Following Disasters

### ◆ *Rev. Proc. 2014-49*

The IRS has updated its guidance for governmental agencies and housing owners to obtain temporary relief from certain requirements for claiming the Code Sec. 42 low-income housing tax credit (LIHTC). The relief, which will apply to projects located in areas designated by the President as major disaster areas, expands upon the IRS's guidance in Rev. Proc. 2007-54.

- **CCH Take Away.** Rev. Proc. 2014-49 also gives greater discretion to agencies and building owners to offer emergency housing relief to individuals displaced by presidentially designated major disasters, regardless of whether the individuals qualify as low-income. In conjunction with Rev. Proc. 2014-49, the IRS also issued Rev. Proc. 2014-50, relating to emergency housing relief and certain exempt facility bond requirements.

### Background

Code Sec. 42 provides for a low-income housing credit equal to a certain percentage of the taxpayer's qualified basis of a low-income building. Certain requirements under Code Sec. 42 and its regulations, which set forth how to determine the basis of a qualified building and how to compute the amount of the credit among other things, can impede the provision of emergency low-income housing in areas affected by major disasters. The IRS has issued guidance providing temporary relief for certain requirements. Rev. Proc. 2007-54, for example, provided relief from the carryover allocation provisions under Code Sec. 42(h)(1)(E) and Reg. §1.42-6. The IRS has now expanded upon this relief with new guidance.

### Rev. Proc. 2014-49

In Rev. Proc. 2014-49, the IRS:

- Expanded its procedures for obtaining recapture relief. In particular, the guidance now states that the reasonable restoration period (during which a building whose qualified basis was

reduced by reason of a casualty loss is not subject to recapture) must not extend beyond the 25th month following the close of the month of the major disaster declaration;

- Explained that in determining qualified basis, owners and agencies should use the building's qualified basis at the end of the tax year immediately preceding the first day of the incident period,

rather than the qualified basis at the end of the tax year preceding the major disaster declaration; and

- Eliminated the need for self-certification of income eligibility.
- **Comment.** Rev. Proc. 2014-49 is effective for disasters declared on or after August 21, 2014.

*References: FED ¶46,404;  
TRC BUSEXP: 54,230.*

## Post-Disaster Relief Allows More Emergency Housing From Rental Projects Funded By Exempt Facility Bonds

### ◆ *Rev. Proc. 2014-50*

The IRS has provided temporary relief to qualified residential rental projects funded by exempt facility bonds from certain requirements under Code Sec. 142. Rev. Proc. 2014-50 authorizes, but does not require, bond project operators to provide emergency housing to displaced individuals during a temporary housing period.

- **CCH Take Away.** Release of this guidance was coordinated with the release of a Rev. Proc. 2014-49 (see the article in this week's newsletter), which relieved taxpayers from certain requirements for the low-income housing tax credit (LIHTC). Both pieces of guidance are designed to facilitate availability of emergency housing relief after major disasters.

### Background

An exempt facility bond is a type of private activity bond that is nevertheless considered "qualified," meaning interest earned on an investment in such a bond is exempt for income tax purposes under Code Sec. 103. Code Sec. 142(a) provides that an "exempt facility bond" is any bond issued as part of an issue, from which 95 percent or more of the net proceeds are used to provide qualified residential rental projects.

Qualified residential rental projects must be occupied by individuals whose income falls below certain thresholds. Rev. Proc. 2014-50 authorizes project operators to relax these income requirements for certain displaced individuals during the designated temporary housing period accompanying declaration of a major disaster.

### Rev. Proc. 2014-50

Rev. Proc. 2014-50 modifies the usual exempt facility bond rules for when a project operator provides emergency housing. In particular, the guidance provides (among other things):

- A displaced individual's occupancy of a unit in the project satisfies the non-transient use requirement;
- Rental units occupied by displaced individuals are disregarded for purposes of the next-available-unit rule;
- A displaced individual's actual income: (i) is disregarded in determining the status of the occupied unit and (ii) does not affect whether the project satisfies the set-aside requirement; and
- A rental unit in a bond/low-income housing tax credit project that is occupied by a displaced individual is treated for bond purposes as it is treated for LIHTC purposes.

*References: FED ¶46,405;  
TRC SALES: 51,250.*

## Absence Of Tax Characterization Agreement No Barrier To Deduction, First Circuit Holds

◆ *Fresenius Medical Care Holdings Inc., CA-1, August 13, 2014*

The absence of a tax characterization agreement between the IRS and a taxpayer did not preclude the taxpayer's deduction of amounts paid under a settlement agreement, the Court of Appeals for the First Circuit has found. The taxpayer and the IRS had intentionally left open the tax characterization of the civil settlement payments.

■ **CCH Take Away.** The First Circuit noted that the lower court had been tasked with determining what amount was necessary to put the government in the position it would have been if the taxpayer had not engaged in the underlying misconduct. The lower court had to measure deductibility in terms of the economic realities of make-whole remediation, the court observed.

### Background

Whistleblowers brought claims against the taxpayer under the *False Claims Act* (FCA). The taxpayer eventually entered into criminal and civil settlements. The taxpayer and the IRS agreed that the amounts paid as criminal fines were not deductible. They disagreed over the treatment of part of the civil penalties. A federal district court found that the civil penalties were deductible and the IRS appealed to the First Circuit.

### Court's analysis

The court first found that generally a taxpayer may not deduct a fine or similar penalty paid for the violation of any law. However, compensatory damages do not constitute a fine or penalty. The taxpayer argued that the disputed amounts were compensatory in nature. The IRS countered that the absence of an agreement between the parties as to whether the payments will be deductible precluded any deduction.

The court found the IRS's reliance on a similar case, *Talley Industries, 116 F.3d 382 (9th Cir. 1997)*, misplaced. The Ninth Circuit had found that FCA multiple damages can serve either compensatory or

punitive purposes. There, the settlement agreement was unclear and the court remanded the case to the Tax Court with instructions to examine if the parties intended the payment to compensate the government or to punish the taxpayer.

In the process, the court stressed that the taxpayer bore the burden of proving eligibility for deductions and, therefore, would suffer the consequences of any lack of evidence as to the parties' intent.

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### AFRs Issued For September 2014

◆ *Rev. Rul. 2014-22*

The IRS has released the short-term, mid-term, and long-term applicable interest rates for September 2014.

#### Applicable Federal Rates (AFR) for September 2014

Short-Term	Annual	Semiannual	Quarterly	Monthly
AFR	.36%	.36%	.36%	.36%
110% AFR	.40%	.40%	.40%	.40%
120% AFR	.43%	.43%	.43%	.43%
130% AFR	.47%	.47%	.47%	.47%
<b>Mid-Term</b>				
AFR	1.86%	1.85%	1.85%	1.84%
110% AFR	2.05%	2.04%	2.03%	2.03%
120% AFR	2.23%	2.22%	2.21%	2.21%
130% AFR	2.42%	2.41%	2.40%	2.40%
150% AFR	2.80%	2.78%	2.77%	2.76%
175% AFR	3.27%	3.24%	3.23%	3.22%
<b>Long-Term</b>				
AFR	2.97%	2.95%	2.94%	2.93%
110% AFR	3.28%	3.25%	3.24%	3.23%
120% AFR	3.57%	3.54%	3.52%	3.51%
130% AFR	3.88%	3.84%	3.82%	3.81%

#### Adjusted AFRs for September 2014

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.36%	.36%	.36%	.36%
Mid-term adjusted AFR	1.35%	1.35%	1.35%	1.35%
Long-term adjusted AFR	2.94%	2.92%	2.91%	2.90%

The Code Sec. 382 adjusted federal long-term rate is 2.94%; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 3.06%; the Code Sec. 42(b) (2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.56% and 3.24%, respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before January 1, 2014, shall not be less than 9%; and the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 2.2%.

*References: FED ¶46,403; TRC ACCTNG: 36,162.05.*

## IRS Again Rejects Use Of Consolidated Return By Parent Owning Less Than 80 Percent Of Stock Of Subsidiary

### ◆ CCA 201433013

IRS Chief Counsel has again rejected a corporation's (parent's) request to file a consolidated income tax return with a target (subsidiary) corporation that was owned less than 80 percent by the parent. Chief Counsel reaffirmed its position that although the parent owned a majority of the target's stock, it did not initially own at least 80 percent of the target's stock. As a result, the target corporation had to file a separate income tax return for a short period.

■ **CCH Take Away.** For a corporation to be included in an affiliated group under Code Sec. 1504(a), the parent or another subsidiary must own at least 80 percent of the voting power of the corporation's stock. In prior advice, CCA 201414015 (November 12, 2013), Chief Counsel concluded that the parent was not the owner of Target shares held in escrow until purchased by parent and released by the escrow agent. The parent then unsuccessfully

submitted additional arguments for being treated as the owner of the escrowed stock.

### Background

Parent agreed to acquire all of the outstanding stock of the target, under a stock purchase agreement with target's shareholders. The shareholders agreed to surrender all their shares to a third-party escrow agent, except for those shares initially purchased by parent. The initial purchase was for more than 50 percent, but less than 80 percent of target's shares.

The agent agreed to release additional shares when purchased by the parent. The shareholders remained the owners of the stock for tax purposes until they were released, with the rights to vote and receive dividends and distributions. In a subsequent year, the parent acquired additional shares that gave it more than 80 percent of target's stock. The price was fixed and determined on the day before the beginning of the year of purchase.

### Chief Counsel's analysis

The taxpayer claimed that the shareholders did not effectively retain voting and distribution rights for the escrowed stock because the purchaser, as the holder of a majority of the stock, completely controlled target, including the choice of directors and the decisions whether to declare dividends or liquidate. Chief Counsel responded that the shareholders retained their ownership rights to vote the escrowed stock and to receive dividends and distributions, regardless of the practical significance of those rights. Practical control of a corporation does not provide affiliation, Chief Counsel noted.

Chief Counsel also rejected taxpayer's claim that it owned the benefits and burdens of the escrowed stock. Even if the fixed-price term shifted the risk of appreciation/depreciation to the parent, the parent lacked legal title, the right to sell the stock, the right to vote the stock, and the right to possess the stock and receive dividends.

*Reference: TRC CONSOL: 7,154.*

## Tax Briefs

### Jurisdiction

A couple's refund claim was dismissed for lack of subject matter jurisdiction because it was filed more than three years after their original return and more than two years after paying their taxes. Therefore, they failed to satisfy the jurisdictional prerequisite in Code Sec. 6511.

*D. Kearns, DC N.Y., 2014-2 USTC ¶50,412; TRC IRS: 27,152.*

### Deductions

A professional couple overstated business expenses claimed as deductions on their joint income tax return, claimed professional and legal expenses as business deductions rather than as miscellaneous itemized deductions, and overstated S cor-

poration losses. Moreover, the couple was liable for accuracy-related penalties and additions to tax, and the husband was not entitled to innocent spouse relief.

*Hall, TC, CCH Dec. 59,999(M), FED ¶48,115(M); TRC BUSEXP: 24,800.*

A couple was allowed to claim a deduction for nonpassive losses from their two S corporations; the husband materially participated in the companies' activities on a regular, continuous and substantial basis during the tax year at issue. He spent over 100 hours participating in the two businesses, and his participation consisted primarily of non-management and noninvestment activities.

*Wade, TC, CCH Dec. 59,997(M), FED ¶48,113(M); TRC BUSEXP: 33,150.*

### Liens and Levies

The government was entitled to interpleaded funds explicitly reserved to satisfy an administratively dissolved LLC's outstanding unemployment (FUTA) taxes. The business sale agreement between the LLC and its purchaser clearly established that the funds were to be held in trust pending resolution of the federal tax lien attaching to the entity's property.

*In re Struemke Enterprises, LLC, DC Minn., 2014-2 USTC ¶50,413; TRC IRS: 45,160.*

A bank failed to honor an IRS jeopardy levy on two bank accounts belonging to a tax debtor; therefore, the bank was liable for the money removed from the accounts.

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## Tax Briefs

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Although the bank was not required to immediately surrender the property, it was required to preserve the government's interest by placing a temporary hold on the individual's accounts or to bear the risk of loss from the delay.

*JPMorgan Chase Bank NA, DC Calif., 2014-2*  
*USC ¶50,411; TRC IRS: 51,064.05.*

### Refund Claims

An individual was entitled to payment for his misappropriated tax refund. The individual's complaint was timely because he filed it more than six-months after he filed his administrative refund claim and he commenced his suit within two years from the date of the IRS's disallowance notice because the IRS never sent him one.

*Hill, FedCl, 2014-2 USC ¶50,415;*  
*TRC LITIG: 9,052.*

### Collection Due Process

The Tax Court properly held that an IRS Appeals officer's determination to proceed with a proposed levy against an individual was not an abuse of discretion. The individual received deficiency notices for the tax years at issue but did not challenge the underlying liabilities; therefore, he was precluded from raising that issue at his Collection Due Process (CDP) hearing. Further, the Tax Court properly admitted into evidence Forms 4340, Certificates of Assessments and Payments, which were presumptive proof that notices and assessments were properly made.

*Buckardt, CA-9, 2014-2 USC ¶50,414;*  
*TRC IRS: 27,202.*

The IRS appeals settlement officer did not abuse his discretion when he concluded that an individual had not demonstrated her entitlement to have her account placed in currently not collectible (CNC) status. He determined that her income significantly exceeded her allowable expenses according to national and local standards, and that she could make monthly payments toward her delinquent tax obligations.

*Doonis, TC, CCH Dec. 59,996(M),*  
*FED ¶48,112(M); TRC IRS: 51,056.15.*

### Deficiencies and Penalties

The IRS could refuse to accept the amended joint returns of a doctor and his wife, and instead impose deficiencies and accuracy-related penalties for the two years in issue.

*Brown, TC, CCH Dec. 59,995(M),*  
*FED ¶48,111(M); TRC LITIG: 6,610.*

### Bankruptcy

An IRS claim to recover a tax imposed under Code Sec. 857(b)(7)(A) on a involuntarily bankrupt REIT for violating the transfer pricing rules was properly denied priority. The "tax" imposed under Code Sec. 857(b)(7)(A) is a nonpecuniary loss penalty, not a tax for purposes of 11 USC §507(a)(8).

*In re Desert Capital REIT, Inc, BAP-9,*  
*2014-2 USC ¶50,410; TRC IRS: 57,100.*

### Innocent Spouse Relief

An individual did not qualify for equitable innocent spouse relief. He stated that he had set aside money in a joint checking account to pay the taxes due on distributions taken from his retirement account; however, his spouse withdrew most of the designated money when their divorce became a concern. He failed to provide any bank records or other documentation showing that the money was actually set aside for the payment of the tax liability.

*Hammernik, TC, CCH Dec. 59,998(M),*  
*FED ¶48,114(M); TRC INDIV: 18,054.20.*

### Res Judicata

The government was not entitled to dismiss state (Indiana) school districts' challenges to Reg. §1.36B-1(k), which implemented the premium tax credit provision of the Patient Protection and Affordable Care Act (PPACA) (P.L. 111-148) by allowing policies purchased on federal exchanges to qualify for the credit. The doctrine of *res judicata* did not apply to the school districts since they were not parties to the prior litigation and the government failed to demonstrate that they were in privity with the state.

*State of Indiana, DC Ind., 2014-2 USC*  
*¶50,409; TRC HEALTH: 3,300.*

## Deduction

*Continued from page 410*

*Talley* did not, the court found, hold that intent can be proven only by showing a tax characterization agreement.

Here, the taxpayer and the IRS did not agree on the tax characterization of the civil settlement payments. The court found that the intent of the taxpayer and the IRS was expressed as an agreement not to agree. The appeals court ultimately affirmed the district court's decision.

*References: 2014-2 USC ¶50,416;*  
*TRC INDIV: 45,060.*

## Puerto Rico Pension Plans May Participate In 81-100 Group Trusts

The IRS has announced that trusts of pension plans qualified only under Puerto Rico law may participate in group trusts described in Rev. Rul. 81-100. The IRS also clarified that assets held by certain separate accounts maintained by insurance companies may be invested in 81-100 group trusts.

**Background.** Under Rev. Rul. 81-100, qualified retirement plans and individual retirement accounts may pool their assets for investment purposes in an 81-100 group trust. The IRS reported that it has been asked if trusts of certain plans (Code Sec. 1022(i)(1) plan trusts) that satisfy the qualification requirements under Puerto Rico law could participate in an 81-100 group trust.

**Rev. Rul. 2014-24.** Code Sec. 1022(i)(1) plan trusts are eligible to participate in 81-100 group trusts, the IRS determined. This treatment would allow the Code Sec. 1022(i)(1) plan to diversify its investments, the IRS explained. Additionally, a separate account maintained by an insurance company may invest in an 81-100 group trust without affecting the tax status of either the group trust or the group trust retiree benefit plans participating in the group trust. The IRS also provided transition relief.

*Rev. Rul. 2014-24; FED ¶46,406; TRC RETIRE: 9,256.*



# Practitioners' Corner

## Employers, IRS Lay Groundwork For Code Sec. 6056 Reporting

The *Patient Protection and Affordable Care Act* (PPACA) requires applicable large employers (ALEs) – generally employers with at least 50 full-time employees, including full-time equivalent employees – to file information returns reporting the terms and conditions of the health care coverage, if any, provided to full-time employees. This is known as “Code Sec. 6056 reporting.” Under transition relief in Notice 2013-45, Code Sec. 6056 reporting is optional for 2014. The first Code Sec. 6056 information returns required to be filed are for 2015 and subsequent years.

■ **Comment.** “With mandatory 2015 reporting just around the corner, employers and insurers eagerly await the final IRS forms and instructions (as the draft forms were issued last month) to properly design systems to track and report the necessary data,” Elizabeth Thomas Dold, principal, The Groom Law Group Chartered, Washington, D.C. told CCH. “Thankfully, IRS provided penalty relief for 2014 and 2015 to help facilitate compliance with these complex disclosure rules.”

■ **Comment.** The IRS has posted draft forms for Code Sec. 6056 reporting on its website: Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, and Form 1095-C, Employer-Provided Health Insurance Offer and Coverage. Draft Instructions for these forms are expected to be released in the near future, Ligeia Donis, senior technician reviewer, Employment Tax Branch, IRS Office of Associate Chief Counsel, Tax Exempt and Government Entities (TEGE) said during a recent

webinar sponsored by the agency on Code Sec. 6056 reporting.

### Employer mandate

Code Sec. 6056 reporting is linked to the PPACA’s employer shared responsibility provision (known as the “employer mandate”). An ALE may be liable for an employer shared responsibility payment under Code Sec. 4980H(a) or Code Sec. 4980H(b).

more full-time employees is certified to the employer as having received a Code Sec. 36B premium assistance tax credit or cost-sharing reduction.

**Code Sec. 4980H(b) liability.** Code Sec. 4980H(b) liability arises where the employer offers to all or at least 95 percent of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time

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*“The IRS has posted draft forms for Code Sec. 6056 reporting on its website...draft Instructions for these forms are expected to be released in the near future.”*

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■ **Comment.** Mid-size employers (employers that employ on average at least 50 full-time employees, including full-time equivalents, but fewer than 100 full-time employees, including full-time equivalents) are exempt from the employer mandate for 2015 under transition relief. However, mid-size employers must file Code Sec. 6056 information returns for 2015.

■ **Reminder.** Employers with fewer than 50 full-time employees, including full-time equivalent employees, are always exempt from the employer mandate and from Code Sec. 6056 reporting.

**Code Sec. 4980H(a) liability.** Code Sec. 4980H(a) liability arises where the employer does not offer—or offers coverage to less than 95 percent of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time employees) and their dependents—the opportunity to enroll in minimum essential coverage and one or

employees) and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and one or more full-time employees is certified to the employer as having received a Code Sec. 36B premium assistance tax credit or cost-sharing reduction.

■ **Comment.** Employers that are subject to the employer responsibility provisions in 2015 must offer coverage to at least 70 percent of full-time employees as one of the conditions for avoiding an employer shared responsibility payment, rather than 95 percent which will begin in 2016.

To determine ALE status, employers must identify their full-time employees and full-time equivalent employees, who, in turn, are identified as such based on their hours of service. An hour of service is generally defined as each hour for which an employee is paid, or entitled to payment, for the performance of duties, as well as each hour of service during which no duties are performed because of holiday leave, illness/

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# Washington Report

by the CCH Washington News Bureau



## Treasury continues review of corporate inversions

On August 25, a White House spokesperson said that Treasury continues to review the tax treatment of corporate inversions. “Treasury is considering a range of administrative actions on inversions,” the spokesperson said at a White House news briefing. President Obama has directed that Treasury look at existing laws and regs and how they may curb or eliminate corporate inversions. Options for action are expected to be presented to Treasury Secretary Jack Lew in September.

Meanwhile, some lawmakers are preparing inversion legislation. Senate Finance Committee (SFC) Chair Ron Wyden, D-Ore., said recently that he is working with SFC ranking member Orrin Hatch, R-Utah, on inversion legislation. On August 25, Sen. Bernie Sanders, I-Vt., predicted that the Senate will take up legislation to curb or eliminate inversions after the August recess.

## House Budget Chair Ryan signals support for preserving charitable deduction

House Budget Committee Chairman Paul Ryan, R-Wisc., recently said that he does not support changing the tax deductibility of charitable donations. “I think there are a lot of things you can do to pull more money into the charitable sector,” Ryan said. “I think that it is a very important thing to preserve.” Earlier this year, the House voted to extend permanently the incentive for gifts to charities from IRAs by qualified individuals.

## Lawmakers urge clarification of education tax incentives

Twelve U.S. senators have sent a letter to the Obama administration asking for clarification of federal tax incentives for education. In the effort led by Sen. Debbie Stabenow, D-Mich., the senators requested Treasury and the Department of Educa-

tion create a simple-to-understand guide to education tax benefits and that students be informed of their estimated tax benefits when filing out federal student aid forms.

According to Stabenow and her colleagues, one in six tax filers fail to take the maximum higher education tax benefit available to them. “By creating informative tools and raising awareness of tax credits, tax-free savings plans and tax deductions, higher education will be made more accessible and affordable for students and their families,” the senators wrote.

“It is our hope that your departments can develop a simple guide to higher education tax benefits that can be circulated to parents and prospective students, school counselors, financial aid administrators, tax preparers, college admission counselors, and any other interested party,” the senators wrote. The guide should provide an easy-to-understand overview of the current benefits and provide guidance to students and their families on where they can access more detailed information.

## Bill would exempt farm workers from employer mandate

Legislation introduced by Rep. Renee Ellmers, R-N.C., would exclude temporary farm workers from the employer mandate under the *Patient Protection and Affordable Care Act* (PPACA). Ellmers has introduced the Fairness for Farmers Bill of 2014 (HR 5392) The bill would generally exempt seasonal agricultural workers who are employed under H-2A visas from the employer mandate. Requiring coverage would make some farm operations unprofitable, especially labor intensive crops such as sweet potatoes and tobacco, Ellmers said. “It would be hard to claim that the Affordable Care Act was meant to cover foreign nationals, who, by their very nature, are here as temporary visa workers,” Ellmers said.

## IRS lags in collection of medical device tax, TIGTA reports

The IRS needs to improve the reporting and payment of the medical device excise tax, the Treasury Inspector General for Tax Administration (TIGTA), recently reported. The *Patient Protection and Affordable Care Act* (PPACA) imposes an excise tax equal to 2.3 percent of the sales price for medical devices sold beginning January 1, 2013. Manufacturers, producers and importers are responsible for the collection of the tax and they must file Form 720, Quarterly Federal Excise Tax Return.

TIGTA found that the number of Forms 720 filed reporting the medical device excise tax and the revenue reported were lower than the Joint Committee on Taxation had originally estimated. The IRS is developing a strategy to ensure compliance with the filing and paying requirements; however, it cannot identify the population of the medical device manufacturers registered with the Food and Drug Administration that are required to file Form 720 and pay the excise tax.

TIGTA recommended that the IRS refine its compliance strategy to include actions to identify noncompliant manufacturers. TIGTA also recommended that the IRS review the returns TIGTA identified to determine the proper amount of tax owed, establish a process to verify the accuracy of the medical device excise tax for paper-filed Forms 720, and initiate a process to correspond with taxpayers to obtain missing taxable sales or tax amounts. The IRS agreed with all the recommendations and indicated that it plans to consider alternative strategies.

“While the IRS has taken steps to educate medical device manufacturers of the medical device excise tax during implementation, it faces challenges to definitively identify manufacturers subject to the medical device excise tax reporting and payment requirements,” TIGTA Inspector General J. Russell George said.

## Practitioners' Corner

*Continued from page 413*

medical leave and other authorized leave. An employee is a full-time employee if he or she works on average at least 30 hours a week. Final regs provide that 130 hours of service in a calendar month are treated as the monthly equivalent of at least 30 hours of service per week. A part-time employee for purposes of Code Sec. 4980H is an employee whom the employer reasonably expects to be employed on average less than 30 hours of service per week.

■ **Comment.** The determination of whether an employer is an ALE is determined separately for each calendar year, by reference to the prior calendar year, Stephen Tackney, deputy division counsel/associate chief counsel, IRS Office of Associate Chief Counsel (TEGE), explained during the webinar. "Taxpayers will use 2014 information to determine if they are an ALE for 2015."

### Code Sec. 6056 reporting

Code Sec. 6056 reporting is needed for the administration of Code Sec. 4980H and the Code Sec. 36B premium assistance tax credit. For purposes of Code Sec. 6056, an ALE generally is required to report:

- The employer's name, address, and employer identification number;
- The calendar year for which information is being reported;
- A certification as to whether the employer offered to its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan;
- The number, address and Social Security/taxpayer identification number of all full-time employees;
- The number of full-time employees eligible for coverage under the employer's plan; and
- The employee's share of the lowest cost monthly premium for self-only coverage providing minimum value offered to that full-time employee.

■ **Comment.** Some employers with many highly-paid employees

had asked the IRS to exempt them from reporting under Code Sec. 6056 because, they argued, it would be unlikely that their employees would obtain health coverage in the PPACA Marketplace and, in the event they did, they would be ineligible for the Code Sec. 36B premium assistance tax credit. The IRS countered that employers would not be in a position to know the correlation between an employee's Form W-2 wages and household income.

Although Code Sec. 6056 reporting is optional for 2014, the IRS has encouraged voluntary reporting. Code Sec. 6056 reporting for 2015 is not optional. The IRS is requiring all Code Sec. 6056 information returns to be filed no later than February 28 (March 31 if filed electronically) of the year immediately following the calendar year to which the return relates.

■ **Comment.** The due dates for Code Sec. 6056 information returns mirror filing dates for other information returns, Tackney said.

### Streamlined reporting for employers that self-insure

Additionally, the PPACA requires every health insurance issuer, sponsor of a self-insured health plan, government agency that administers government-sponsored health insurance programs, and other entities that provide minimum essential coverage to file annual returns reporting information for each individual for whom such coverage is provided. This is known as "Code Sec. 6055 reporting." The IRS has posted draft versions of Form 1094-B, Transmittal of Health Coverage Information Returns, and Form 1095-B, Health Coverage, on its website.

Employers that self-insure have a streamlined way to report for purposes of Code Sec. 6055 reporting and Code Sec. 6056 reporting. The top half of Form 1095-C includes information needed for Code Sec. 6056 reporting; the bottom half includes information needed for Code Sec. 6055 reporting.

■ **Comment.** In a Fact Sheet, Treasury explained that employers that are large enough to be subject to the PPACA employer shared responsibility provisions

and that self-insure will complete both parts of the combined form for information reporting.

### Simplified reporting

The IRS has developed a simplified reporting method for employers that provide a "qualifying offer" to any of their full time employees, as an alternative to reporting monthly, employee-specific information on those employees. A qualifying offer is an offer of minimum value coverage that provides employee-only coverage at a cost to the employee of no more than about \$1,100 in 2015 (9.5 percent of the federal poverty level), combined with an offer of coverage for the employee's family, Treasury explained in a Fact Sheet

In the case of employees who receive qualifying offers for all 12 months of the year, employers will need to report only the names, addresses, and taxpayer identification numbers (TINs) of those employees and the fact that they received a full-year qualifying offer. For employees who receive a qualifying offer for fewer than all 12 months of the year, employers will be able to simplify reporting to the IRS and to employees for each of those months by simply entering a code indicating that the qualifying offer was made.

To provide for a phase-in of the simplified option, employers certifying that they have made a qualifying offer to at least 95 percent of their full-time employees (plus an offer to their families) will be able to use an even simpler alternative reporting method for 2015. They may use the simplified reporting method for their entire workforce, including for any employees who do not receive a qualifying offer for the full year.

Additionally, employers have the option to avoid identifying in the report which of its employees are full-time, and instead to just include in the report those employees who may be full-time. To take advantage of this option, the employer must certify that it offered affordable, minimum value coverage to at least 98 percent of the employees on whom it is reporting.

■ **Comment.** "Setting the level at 98 percent ensures that the employer has offered coverage to at least 95 percent of its full-time employees," Donis said.

# Compliance Calendar

## ■ August 29

Employers deposit Social Security, Medicare, and withheld income tax for August 23, 24, 25, and 26.

## ■ September 2

For vehicles first used on a public highway in July 2014, truckers and owners of heavy highway use vehicles file Form 2290, Heavy Highway Vehicle Use Tax Return.

## ■ September 4

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

## ■ September 5

Employers deposit Social Security, Medicare, and withheld income tax for August 30, 31, September 1, and 2.

## ■ September 10

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

Employees who received more than \$20 in tips during August report them to their employers using Form 4070.

## ■ September 12

Employers deposit Social Security, Medicare, and withheld income tax for September 6, 7, 8, and 9.

# Monthly Quizzer

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

**Q** 1. The IRS's new voluntary continuing education program for return preparers is called the:

- (a) Annual Filing Season Program
- (b) CE Initiative
- (c) Voluntary Certification Project
- (d) None of the above

**Q** 2. President Obama directed Treasury to explore options to curb or eliminate corporate inversions. *True or False?*

**Q** 3. The IRS will no longer accept a Form 2848, Power of Attorney, filed using which of the following ways?

- (a) Regular mail
- (b) Fax
- (c) Electronic filing
- (d) The IRS still accepts all of the above

**Q** 4. The IRS issued final regs on penalties where material advisors fail to file or file a false or incomplete return for reportable and/or listed transactions. *True or False?*

## Answers:

- Q1.** (a), See Issue #35, page 405.  
**Q2.** True, See Issue #34, page 393.  
**Q3.** (c), See Issue #33, page 382.  
**Q4.** True, See Issue #32, page 369.

# TRC Text Reference Table

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

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