



## SPECIAL ALERTS

### Making Work Pay Credit (MWPC)

Most employees got a bump in their take home pay beginning in April, thanks to reduced federal income tax withholding related to the advanced payment of the Making Work Pay Credit.

#### DANGER ZONE

The MWPC has been advanced to most wage earners via reduced withholding which began last April. The MWPC Danger Zone refers to the fact that some workers may have their federal income tax withholding reduced by more than the Making Work Pay Credit they will claim on their 2009 tax return. This happens because the withholding tables cannot take into account all aspects of a worker's tax situation, such as multiple jobs or dependency status.

[Click here for additional details.](#)

## VOLUNTARY DISCLOSURE DEADLINE

### IRS Extends Deadline for Voluntary Disclosure Program

IRS extends deadline for voluntary disclosure program. Taxpayers with unreported income in foreign accounts now have until October 15, 2009 to apply for the voluntary disclosure program. The deadline for certain FBAR filers and offshore-related information returns that have no unreported income has also been extended to October 15, 2009. The previous deadline was September 23, 2009.

**Planned e-File outage.** The IRS Issue Management Resolution System has advised that once again there will be a planned e-File and e-Services maintenance outage during the Columbus Day holiday just before the 2008 individual return filing deadline. Although the IRS heard many complaints about the timing of the past outages, it was unable to find a reasonable alternative for the current year. However, the IRS has provided advance notice to give tax professionals time to prepare for this inconvenience. This year, the outage will run from Sunday, Oct. 11 at 9:00 P.M. Eastern time through Tuesday, Oct. 13, at 5:00 A.M. Eastern time. The Columbus Day holiday is Monday, Oct. 12.

## For the Tax Pro

### QUESTION OF THE MONTH

*Q. My client released the dependent exemption for her two daughters several years ago. She released the claim for each daughter "for all future years" via a signed Form 8332. She would now like to revoke the release so that she can claim the exemptions herself. Is this possible? If so, how does she revoke the release of the exemptions?*

A. Yes, your client can revoke the dependent exemption release—but the revocation will not be effective for 2009. It will be effective only for future years.



Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent, was recently modified to serve as a revocation of a previous dependent exemption release. To revoke a release, the custodial parent must complete Part III of Form 8332 by noting the specific future year or years the revocation will apply to, or by indicating "all future years" in the space provided. A separate form must be completed for each child, specifying the future year or years that the release is revoked.

**Important:** The effective date of the revocation can be no earlier than the year after it is delivered to the noncustodial parent. Thus, a revocation delivered by Dec. 31, 2009, can only be effective for tax year 2010 and/or later years (in other words, future years).

## IRS WILL REJECT RETURNS WHICH OMIT ECONOMIC RECOVERY PAYMENTS

It is important to ask your clients who work or who receive a government pension whether or not they received the \$250 Economic Recovery Payment (ERP). The question is especially important for those who received benefits from the agencies that issued the ERP (i.e. those clients receiving SSA, SSI, RRB or VA benefits).

The IRS will not be providing a method for taxpayers to confirm payment of the \$250 ERP by these agencies. However, the IRS will match information provided to the IRS by the agency that made the payment and process the return accordingly. Taxpayers who received benefits from agencies who issued the ERP, but who do not remember whether they received an ERP, may contact the appropriate agency for confirmation before filing their tax returns.

The ERP reduces the amount of any Making Work Pay Credit or Government Retirees Credit otherwise available to the taxpayer. Therefore, the IRS will reject e-filed returns that contain incorrect information about the ERP on Schedule M, Making Work Pay and Government Retiree Credit. If a paper return is filed with an incorrect amount on Schedule M, the taxpayer will receive an explanation of the corrected overpayment or additional balance due. Taxpayers who do not agree with the IRS about receiving an ERP should contact the agency which reportedly issued the payment. Taxpayers should also review deposits made automatically to their bank accounts to be sure they did not receive the payment.

## PROPOSED REGULATIONS ON DAMAGES FOR PERSONAL PHYSICAL INJURIES

The IRS has issued proposed regulations (Prop. Reg. §1.104-1) pertaining to the exclusion from gross income for damages received on account of personal physical injuries or sickness. The proposed regulations reflect changes made to §104(a)(2) under the Small Business Job Protection Act of 1996 (SBJPA). Prior to the changes, the statute excluded income from “personal injuries.” The revised statute provided that damages received on account of personal physical injuries or physical sickness were excludable from income.

Under the proposed regulations:

- Punitive damages do not qualify for the exclusion.
- The exclusion is generally limited to amounts received on account of personal physical injuries or physical sickness. However, amounts paid for medical care for emotional distress may qualify for the exclusion if the emotional distress is attributable to physical injuries or physical sickness.

In addition, the proposed regulations eliminate a requirement in the prior regulations that damages for physical injuries must be based on tort or tort-type rights. Prior regulations reflected Supreme Court decision *U.S. v. Burke*, 504 U.S. 229 (1992), which held that the exclusion was limited to damages for personal injuries for which the full range of tort-type remedies is available. In *Burke*, a back pay award was considered only a narrow remedy for damages under the Civil Rights Act of 1964 and not a tort-type remedy. Many critics thought the remedies test applied by the Court in *Burke* was too restrictive.

Other judicial decisions since *Burke*, and the subsequent legislative change under the SBJPA restricting the exclusion to physical injuries or sickness, have made the remedies test unnecessary. Accordingly, under the proposed regulations, damages may qualify for exclusion even if the injury giving rise to the damages is not defined as a tort under state or common law. Nor does the exclusion depend on the scope of remedies available under state or common law.

**Caution:** The “reversal” of *Burke* does not mean that back pay awards qualify for the exclusion. At the time the *Burke* decision was made, awards for personal nonphysical injuries could qualify for the exclusion, which is no longer the case under current law.

Generally, the new regulations will apply to amounts received after the date final regulations are published in the Federal Register. However, taxpayers may apply these proposed regulations to amounts paid pursuant to a written binding agreement, court decree, or mediation award entered into or issued after September 13, 1995, and received after August 20, 1996. If such application results in an overpayment of tax, the taxpayer may file a claim for refund. The claim must be filed within the statute of limitations under §6511.

Prop. Reg. §1.104-1

## IRS UPDATES INTERNAL REVENUE MANUAL AFTER LANTZ DECISION

In *Lantz v. Comm'r*, 132 T.C. No. 8 (April 7, 2009), the Tax Court struck down Treas. Reg. § 1.6015-5(b)(1), which stated that a spouse requesting innocent spouse relief under §6015(f) is required to file Form 8857, Request for Innocent Spouse Relief, or a similar statement with the IRS within two years from the date of the first collection activity against the spouse requesting relief.

The IRS amended Internal Revenue Manual 25.15.1.6.2, effective retroactively to June 3, 2009, to state that until further notice, claims for equitable relief under §6015(f) would not be disallowed as untimely if they were filed after two years. However, claims filed under other innocent spouse provisions (§6015(b) and §6015(c)) must continue to be filed no later than two years after the first collection activity.

I.R.M. 25.16.1.6.2

## IRS ADDRESSES PIGFORD CLAIMS INCOME TAX ISSUES

The IRS recently released guidance on discharge of indebtedness issues resulting from the Pigford class action lawsuit. For more information on the Pigford lawsuit, see the TAX in the news 7/14/08 article titled “African-American Farmers’ Discrimination Claims Against USDA.”

One portion of the Pigford settlement provides for forgiveness of loans made by the USDA to the claimants. The IRS guidance emphasizes the general rule that income from a discharge occurs for tax purposes when an event occurs that results in the forgiveness of debt. In the Pigford case:

- Claimants realize discharge of indebtedness income when the arbitrator’s decision to award debt relief becomes final. The final decision results in forgiveness of the debt from a legal perspective. The first decisions became final in July of 2000. Decisions became final for different claimants at different times, depending on when the claims were considered and whether the decisions were appealed. Although the USDA may have administratively delayed “implementing” the discharge of debt for some claimants, the delay doesn’t impact the tax year the discharge is considered to occur for tax purposes. In other words, the discharge results in income in the year the USDA was required to forgive the debt by the arbitrator’s decision, not the year the USDA actually ended up “implementing” the forgiveness of debt.
- Some claimants realized additional debt relief income in 2001 under an order providing for the forgiveness of subsequent loans. All additional debt relief under this order is considered to have occurred in 2001, and does not relate back to the original decision (which may have occurred in the prior year).
- Some claimants realized additional debt relief income in 2008, under an agreement to make the forgiveness of additional debt (approved in 2001) retroactive to the date the arbitrator’s decision became final.
- If an individual claimant’s decision was later modified, the modification may have resulted in additional income in the year of the modification.

The USDA is required to issue Forms 1099-C to claimants for each year that a discharge occurred. The PMTA linked below provides detailed guidance on handling debt relief issues resulting from the Pigford settlement.

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