



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C.

October 23, 2007

SECRETARY OF THE TREASURY

The Honorable Charles E. Grassley  
Ranking Member  
Committee on Finance  
United States Senate  
Washington, DC 20510-6200

Dear Senator Grassley:

Thank you for your letter to me asking for information about the impact on the 2008 income tax return filing season if a one-year alternative minimum tax (AMT) "patch" is not enacted until later this year.

To avoid confusion and delays for taxpayers, it is critical that an AMT patch be enacted by early November. If Congress fails to act, we estimate that 25 million taxpayers will be subject to AMT in 2007 – 21 million more than were subject to the tax in 2006. We estimate that these 25 million taxpayers will pay on average an additional \$2,000 in Federal income tax. For these taxpayers, failure to enact a patch for 2007 would result in a substantial unexpected tax increase. Enactment of a patch beyond early November could also significantly delay processing of these taxpayers' returns and payment of any refunds.

Moreover, the AMT patch has historically been accompanied by a special ordering rule that applies to a number of popular tax credits – including the child tax credit and the retirement savings contribution credit – and affects the computation of those credits for millions of additional taxpayers who are not subject to the AMT. If enactment of the special ordering rule for credits is delayed beyond early November, as many as 25 million additional taxpayers could face delays in processing of their returns and payment of their refunds.

Based on historical filing patterns, we estimate that enactment of a patch in mid-to-late December could delay issuance of approximately \$75 billion in refunds to taxpayers who are likely to file their returns before March 31, 2008. Millions of taxpayers filing returns after that date may also have their refunds delayed.

From a tax administration perspective, the Internal Revenue Service (IRS) has advised me that late enactment of the AMT patch (mid-November or later) will create significant challenges and poses an extremely high risk to the 2008 filing season. It will also create significant compliance challenges and will result in confusion for taxpayers, tax return preparers, and tax software developers.

By this time each year, income tax forms and instructions have been revised to reflect current law. Consistent with historical practice, they do not reflect pending legislation. There are 12

forms (the AMT form and 11 credit forms) that will be affected if and when Congress enacts the AMT patch. These forms are attachments to either the Form 1040 or Form 1040A. The IRS will release the Form 1040 and 1040A tax packages to the printing vendors by November 7, 2007. All additional forms and instructions must be finalized by November 16, 2007, to ensure that the 2008 filing season proceeds with minimal disruption. From the date an AMT patch is enacted, the IRS would have updated tax forms available on [irs.gov](http://irs.gov) in approximately three weeks. Printed forms would be sent to libraries, post offices and other distribution sites two to three weeks later.

Furthermore, the IRS' return processing systems have been programmed to reflect current law. The IRS' information technology systems readied under current law (not including the AMT patch) will begin processing returns the first day of the tax filing season – January 14, 2008. From the date an AMT patch is enacted, the IRS estimates it will take 12-13 weeks to re-program, test, and integrate the changes into the complex computer programs and systems that process tax returns. All software developers and the Free File Alliance participants will have to do the same. Updated tax preparation software would be generally available four weeks after the legislation is signed, although the exact time frame would be somewhat dependent on the extent of the legislation.

Should the AMT patch be enacted in mid-to-late December:

- Updated printed forms would not be available to taxpayers until after the filing season has started.
- The IRS' returns processing systems would not be ready to process tax returns with the AMT or 11 credit forms until mid-to-late March. The IRS would have to delay receipt of electronically filed returns, and hold in abeyance paper returns of not only AMT filers, but also, as described above, many other taxpayers (e.g., those claiming the child tax credit) who typically file early in anticipation of a refund. Thus, this could substantially delay issuance of refunds.
- Because of the built-up backlog in processing returns, refunds on returns filed in March and April could be delayed as well.
- Due to substantial delays in issuance of refunds over the normal schedule, the Government could be required to pay interest if the delay exceeded the time required under the law for issuing refunds.
- Delays in acceptance of electronic returns could adversely affect the IRS' successful efforts to expand e-filing.
- There would be a substantial increase in telephone calls for assistance and written correspondence from people who do not understand the rules, who cannot file their returns electronically, who experience delays in receiving their refunds, or who get an IRS error notice because they incorrectly computed their taxes.
- Potential for errors would increase dramatically, as some taxpayers would be confused and would file incorrect returns or out-of-date forms, resulting in notices to taxpayers and further delays in processing their returns.
- There could be a substantial increase in the number of amended returns because taxpayers would file early using forms that were later updated, and then they would have to file amended returns.

The magnitude of these consequences would increase significantly if legislation is enacted that is broader or more complex than the AMT patch enacted for 2006, or is enacted after December 31, 2007, but still applicable to 2007 tax returns.

Enclosed with this letter are responses prepared by the IRS to the specific questions you posed in your letter.

Please be assured that the Treasury Department and the IRS will work as diligently as possible to implement legislation enacted by Congress. If you need additional information, please contact me or Acting IRS Commissioner Linda Stiff at (202) 622-9511.

Sincerely,

A handwritten signature in black ink, appearing to read "Henry M. Paulson, Jr.", written in a cursive style.

Henry M. Paulson, Jr.

Enclosure

**Questions from Congressman McCrery and Senator Grassley  
Concerning the 2007 AMT Patch and  
Its Effect on the Filing Season**

- 1. On what date will the forms, instructions, and publications be sent to the printers?**

To meet the contractual deadline for the Form 1040 and 1040A tax packages, the IRS will release them to the printing vendors by November 7, 2007. All other tax forms and instructions affecting these forms must be finalized by November 16, 2007, to ensure that the 2008 filing season proceeds with minimal disruption.

- 2. If AMT relief is not extended, millions of additional taxpayers may be subject to interest and penalties. Given how late we are in the year, would there be an opportunity for the IRS, through a public service campaign to inform taxpayers that they should send in estimated payments to cover the tax increase and avoid penalties, and would there be value in such a campaign? What would be the estimated cost of such a campaign?**

Given how late it is in the year, we do not believe that it is possible to produce a public service campaign in time to affect taxpayer behavior. In addition, the underlying message to taxpayers may be too complex to address in typical advertising campaigns. Rather than a public service campaign, the IRS would use the news media, the web, tax practitioners and other partners to alert taxpayers to the need to address estimated tax payments.

- 3. How many taxpayers may not be withholding enough to pay their taxes if AMT relief is not extended?**

If AMT relief is not extended, an estimated 2.8 million taxpayers may not have sufficient estimated and withheld taxes to cover their 2007 income tax liability.

- 4. How many of these taxpayers do not have sufficient withholdings to meet safe harbor requirements and, as such, could potentially be subject to penalties?**

Of the 2.8 million taxpayers, an estimated 100,000 may not have sufficient estimated and withheld taxes to meet safe-harbor requirements.

- 5. If taxpayers do not have sufficient withholdings to meet safe harbor requirements, what interest and penalties could possibly be charged to them?**

If AMT relief is not extended, those taxpayers who do not have sufficient estimated and withheld taxes to meet safe-harbor requirements could be subject to an estimated tax penalty.

**6. How much additional tax, on average, will be owed by taxpayers subject to the AMT if AMT relief is not extended?**

If the AMT relief is not extended, it is estimated that the 2007 income tax liability of affected taxpayers would increase by an average of approximately \$2,000.

**7. How would the IRS inform taxpayers of a change in the calculation of AMT liability if an extension of the AMT patch is enacted after the tax forms have been printed?**

If Congress enacts AMT relief legislation after the tax forms have been printed, the IRS will make the revised forms and instructions available on irs.gov. The printed copies of the revised tax products will be available within three weeks after they are available on irs.gov. The IRS would use the news media, the web, tax practitioners, and other partners to alert taxpayers to the change in the AMT due to enactment of the AMT patch.

**8. What additional costs would the IRS incur to notify taxpayers of the change, including the printing of new forms?**

If Congress enacts legislation to extend temporary relief to 2007, there are 12 forms that will be affected, namely:

- Form 6251 – Alternative Minimum Tax - Individuals
- Form 2441 – Child and Dependent Care Expenses
- Form 1116 – Foreign Tax Credit for Individuals
- Form 5695 – Residential Energy Credits
- Form 8396 – Mortgage Interest Credit
- Form 8839 – Qualified Adoption Expenses
- Form 8859 – District of Columbia First Time Homebuyer Credit
- Form 8863 – Education Expenses
- Form 8880 – Credit for Qualified Retirement Savings Contributions
- Schedule R (Form 1040) – Credit for the Elderly or the Disabled
- Schedule 2 (Form 1040A) – Child and Dependent Care Expense for Form 1040A Filers
- Schedule 3 (Form 1040A) – Credit for the Elderly or the Disabled for Form 1040A Filers

The IRS will have to revise and reissue these forms and instructions, along with tax publications that refer to the AMT. The IRS will have to renegotiate the contracts with the printing vendors if the scheduled print dates are missed. The additional costs will, at a minimum, be in the hundreds of thousands of dollars depending on the new time frames established to print and distribute the revised forms.

**9. What additional costs would the IRS incur to reprogram their computer systems? How long would that process take?**

The IRS' information technology (IT) systems for processing the tax year 2007 returns have already been programmed to reflect the current law (i.e., not including the AMT patch). Significant modifications to the manual and electronic processing systems will be necessary if the AMT legislation is enacted. The IRS requires at least 12-13 weeks to re-program, re-test, and implement the changes upon enactment. At this time, the IRS is still assessing the additional costs that will be incurred for re-programming its IT systems.

**10. What would continued delay (November 15, December 1, December 15, December 22?) in passing AMT relief impact the ability of the IRS to process returns filed during the season, especially during the early part of the filing season? If so, how many taxpayers could potentially be affected? How large of an interest free loan to the government, in terms of total dollars associated with the delayed refunds of these filers, would this create?**

The IRS' IT systems readied under current law (not including the AMT patch) will begin processing the first day of the tax filing season – January 14, 2008. The IRS' return processing systems would not be ready to process tax returns with the AMT or 11 credit forms until: (a) mid-February if AMT relief is enacted November 15, (b) late February if enacted December 1, (c) mid-March if enacted December 15, and (d) mid-to-late March if enacted December 22.

Without enactment of AMT relief, an estimated 25 million taxpayers will be subject to AMT in 2007 – 21 million more than were subject to the tax in 2006. Although enactment of a patch later in the year may prevent 21 million additional taxpayers from paying more tax, it could significantly delay processing of their returns and payment of their refunds.

Moreover, the AMT patch has historically been accompanied by a special ordering rule that applies to a number of popular tax credits – including the child tax credit and the retirement savings contribution credit – and affects the computation of those credits for millions of additional taxpayers who are not subject to the AMT. If enactment of the special ordering rule for credits is delayed beyond early November, as many as 25 million additional taxpayers could face delays in processing of their returns and payment of their refunds.

Based on historical filing patterns, we estimate that enactment of a patch in mid-to-late December could delay issuance of approximately \$75 billion in refunds to taxpayers who are likely to file their returns before March 31, 2008. Millions of taxpayers filing returns after that date may also have their refunds delayed.

**11. How would continued delay in passing AMT relief impact the ability of the IRS to program its Electronic Fraud Detection System for the 2008 filing**

**season? Could the delay lead to more fraud going undetected? How would continued delay (November 15, December 1, December 15, December 22) impact IRS efforts to address the tax gap and implement the Secretary's proposals in this regard?**

The Electronic Fraud Detection System (EFDS) is one of the return processing systems that must be reprogrammed to reflect an AMT patch. The IRS would have to reject electronically filed returns and hold in abeyance paper returns that contain the AMT or any of 11 tax credits the computation of which is connected to the AMT. Because these returns would not be processed until the systems have been re-programmed, re-tested and implemented, the delay would not result in more fraud being undetected. Late passage of AMT relief, however, would require diversion of management and technical resources to ensure the complex and highly integrated work is completed timely and accurately. At this time, we are unable to determine whether the diversion of these resources would affect our efforts to address the tax gap and implement the Administration's proposals.

**12. If AMT relief is enacted late this year, and if taxpayers mistakenly pay too much tax because they did not incorporate information advising them of AMT relief, what mechanisms exist for the IRS to catch these mistakes and refund the overpayment?**

Once the IRS' IT systems have been reprogrammed, re-tested, and implemented to reflect an AMT patch, these systems would automatically flag as an error any taxpayer who pays too much tax because their return did not reflect the correct patch. The IRS would notify these taxpayers about the error.

**13. In what other ways could a delay in AMT relief affect taxpayers' abilities to file their tax returns, receive their refunds, and comply with their obligations?**

The following are other consequences that will likely occur due to late passage of the AMT patch.

- Updated tax preparation software would not be generally available for four weeks after signed legislation, although the exact timeframe would be somewhat dependent on the extent of the legislation.
- There would be an increase in telephone calls for assistance and written correspondence from people who do not understand the rules, who cannot file their returns electronically, who experience delays in receiving their refunds or who get an IRS error notice because they incorrectly computed their taxes.
- Potential for errors would increase dramatically, as some taxpayers would be confused and would file incorrect returns, resulting in notices to taxpayers and further delays in processing their returns.

- There could be a substantial increase in the number of amended returns because taxpayers would file early without the AMT and credit forms in order to get a refund and then would have to file amended returns.