



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

October 23, 2007

The Honorable Thomas M. Reynolds
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Reynolds:

Thank you for your letters to me and Linda Stiff, Acting Commissioner of Internal Revenue, 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 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 Tom Reynolds
Concerning the 2007 AMT Patch and
Its Effect on the Filing Season**

- 1. Do the IRS's draft forms and instructions assume that Congress will extend the temporary AMT relief to 2007, or do they reflect the current law (i.e., AMT exemption levels have now reverted to their pre-2001 levels)?**

Consistent with the IRS' historical practice, the draft 2007 Forms 1040 and 1040A tax packages and other tax forms attached to the Forms 1040 and 1040A for the upcoming filing season reflect current law, not pending legislation.

- 2. If the draft forms reflect current law, what plans does the IRS have in place to revise those forms, were Congress to enact legislation to extend temporary relief to 2007?**

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.

- 3. By what date does the IRS anticipate distributing its individual tax form packages to taxpayers and preparers so that taxpayers can begin filing their 2007 taxes in January 2008?**

Individual taxpayers who file paper returns will begin receiving tax packages that reflect the current law within a few days after December 25, 2007. Other tax products will be available to the public beginning the first week in January.

- 4. In order to meet their contractual deadline with its printing vendors, by what date does the IRS need to provide the contents of the final tax forms package to its printing vendors?**

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.

- 5. In order to meet that contractual deadline with its printing vendors, how much lead time does the IRS need to compose, arrange, and make final revisions to its form?**

If Congress enacts legislation in November or later, the IRS will make revised forms and instructions available on its website – irs.gov – within three weeks after the date of enactment. The printed copies of the revised tax products will be available within three weeks after they are available on irs.gov. Form 1040 and 1040A tax packages will not be revised.

- 6. As a practical matter, by what date must the IRS have finalized all of its forms and instructions to ensure that the 2007 tax filing season proceeds with minimal disruption?**

The individual tax packages will be released to the printing vendors by November 7, 2007. All other forms and instructions affecting these tax forms must be finalized by November 16, 2007, to ensure that the 2008 filing season proceeds with minimal disruption.

- 7. If Congress has not extended the temporary AMT relief to 2007 by that date, but then does so after the forms have gone to print, what plans does the IRS have in place to issue supplemental instructions or materials explaining the impact of those subsequent changes? What cost would be associated with producing and distributing these supplemental instructions or materials?**

If Congress does not extend the temporary AMT relief to 2007 by the time the IRS has gone to print with the 2007 tax forms and instructions, the IRS will not revise or reissue the Forms 1040 and 1040A instructions. The IRS will revise and reissue Form 6251, the 11 credit forms (listed in the response to Question 2 above), and any other publications that are affected by AMT legislation. The IRS will make the revised forms and instructions available on irs.gov and distribute printed copies through the normal distribution channels. Software developers and Free File Alliance participants will also have to reprogram and re-test their software.

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.

8. Under the scenario described above, is there any risk of an increased rate of taxpayer errors in determining whether particular taxpayers are liable for AMT or in calculating their AMT liability?

A substantial risk of increased taxpayer error exists because many taxpayers will be confused and file their tax returns and incorrectly compute AMT, because they are not aware of the tax law changes. Accordingly, the IRS will have to refigure their taxes and issue them an error notice. This also could delay issuing any applicable refunds.

9. If so, could that risk include increased numbers of taxpayers paying AMT than were, in fact, actually liable for it in 2007?

There is a significant risk that increased numbers of taxpayers will file their returns paying AMT for which they are not liable in tax year 2007. The IRS will have to correct returns of taxpayers that erroneously calculated AMT.

10. What impact would Congress's enactment of an extension of AMT relief very late in the year have on the IRS's manual and electronic processing capabilities? Would additional training be required of IRS employees to educate them about that late change in law? If so, what costs would be associated with this additional training?

The IRS' information technology (IT) systems for processing the tax year 2007 returns have already been programmed to reflect the current law. Those systems, readied under current law (not including an extension of temporary AMT relief), will begin processing returns on January 14, 2008. 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.

Additional training will be required of IRS employees and volunteer income tax assistants (who prepare returns for taxpayers free of charge through, for example, the VITA program) to educate them on the tax law changes to the AMT. Revised operating procedures for processing returns and assisting taxpayers will be necessary. Additional resources will be needed to provide for the updated training and operating procedures.

11. Would the late enactment of such legislation cause you to anticipate an increase in (a) taxpayers' demand for telephone assistance, (b) delayed refunds, or (c) amended return filings?

The likely late enactment of temporary AMT relief (late December) will result in a holding of millions of paper tax returns of not only AMT filers, but also low-income taxpayers (e.g., those with Child Tax Credit) who are not subject to the AMT but who typically file early. The IRS will also have to reject e-filed returns that contain the AMT or any of the 11 credit forms until the IRS implements the systems changes for the AMT. Refunds will be delayed for taxpayers whose returns cannot be processed timely. This will result in a substantial increase in telephone calls for assistance and written correspondence due to lack of timely tax return processing. The number of amended returns will increase because many taxpayers will file early without the AMT or credit forms in order to get a refund and will then need to file amended returns).

12. Are you aware of any impact that late enactment of such legislation could have on developers of tax preparation software? If so, could any of those potential impacts cause additional disruptions to the tax filing season?

All software developers and the Free File Alliance participants will have to re-program and re-test their software. In general, these companies begin programming as soon as the IRS can provide new programming specifications. Taxpayers who use tax software or rely on tax professionals who use tax software to prepare their returns will either not be able to file their returns until the software changes are available or risk filing an incorrect return because the software did not reflect the legislation.