TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Tax Products and Computer Programs for Individual Income Tax Returns Were Accurately Updated for the 2006 Filing Season

May 2006

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 19, 2006

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Tax Products and Computer Programs for Individual Income Tax Returns Were Accurately Updated for the 2006 Filing Season (Audit # 200640015)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) accurately updated tax products (such as forms, instructions, and publications) and computer programming for tax law changes that will affect the processing of individual income tax returns during the 2006 Filing Season.[1] This audit focused on updates to tax products and requests for computer programming changes needed to implement new tax provisions, cost-of-living (inflation) adjustments, and changes to the optional standard mileage rates that affect Wage and Investment Division taxpayers'[2] Tax Year (TY) 2005 individual income tax returns.

President Bush signed into law the Gulf Opportunity Zone Act of 2005[3] just as we were completing our review. Because the IRS was still in the process of revising its tax products and computer systems affected by the legislation, we did not assess the IRS' actions relative to this new legislation. However, we are evaluating the IRS' implementation of this legislation during our review of the 2006 Filing Season.

Synopsis

Overall, the IRS accurately updated its tax products and computer programming to incorporate the tax law changes effective for TY 2005, with one exception. We identified 24 new provisions

[1] The period from January through mid-April when most individual income tax returns are filed.
[2] Taxpayers that report primarily wage and investment type income on U.S. Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).
[3] Pub. L. No. 109-135, 119 Stat. 2577 (to be codified in scattered sections of 26 U.S.C. and at 19 U.S.C. § 4033).

included in 6 pieces of tax legislation, 13 cost-of-living adjustments, and changes to the optional standard mileage rates that affected TY 2005 individual income tax returns. As a result of these changes, we identified 44 tax products that required updating. We reviewed 42 of the tax products and determined they were accurately updated. Two of the tax products were not available at the time of our review because they were affected by the late legislation.[4]

We identified and reviewed 6 requests for computer programming changes and 14 amendments for subsequent computer programming changes. The IRS accurately initiated the computer programming requests and updated its return processing programs for the new tax law provisions and other adjustments or changes, with one exception.

The student loan interest deduction allows individual taxpayers to take a deduction for interest on loans taken out to pay for qualified higher education expenses, such as college tuition. The maximum deduction is $2,500, but it is phased out based on the taxpayer's modified adjusted gross income.[5] For TY 2005, the modified adjusted gross income phaseout range is $105,000 to $135,000 for taxpayers filing as married filing jointly. This phaseout was not reflected in any of the requests or amendments for computer programming changes or in the computer programming documentation for return processing programs. We informed IRS officials about this condition in January 2006, and within 2 weeks the IRS corrected its computer programs to accurately compute the deduction. The effect on taxpayers should be minimal because the condition was corrected early and taxpayers claiming the student loan interest deduction generally file their tax returns later in the filing season.

Recommendations

We made no recommendations in this report because the IRS corrected its computer programs to accurately compute the student loan interest deduction claimed by taxpayers filing joint returns.

Response

IRS management reviewed the draft report and provided their concurrence with its contents via email. Since there were no recommendations requiring a formal response, the IRS agreed to the issuance of the report with no formal written response.

Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.

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[4] We subsequently verified the two tax products were issued.
[5] Adjusted gross income is calculated after certain adjustments are made but before standard or itemized deductions and personal exemptions are subtracted. Modified adjusted gross income is calculated without regard to certain deductions or exclusions.

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Background

Each year, the Internal Revenue Service (IRS) faces the significant challenge of incorporating new tax legislation into its tax products (such as forms, instructions, and publications) and computer systems to ensure tax returns are accurately processed during the filing season.[1] Meeting this challenge becomes more difficult when tax legislation is passed late in the year. Preparing for the 2006 Filing Season was particularly difficult due to the new tax law legislation enacted because of the devastation caused by Hurricanes Katrina, Rita, and Wilma that struck the Gulf Coast States between August and October 2005. For example, the Katrina Emergency Tax Relief Act of 2005,[2] which was signed into law on September 23, 2005, contained $3.3 billion in estimated tax relief for Fiscal Year 2006. President Bush signed into law the Gulf Opportunity Zone Act of 2005[3] just as we were completing our review. Because the IRS was still in the process of revising its tax products and computer systems affected by the legislation, we did not assess the IRS' actions relative to this new legislation. However, we are evaluating the IRS' implementation of this legislation during our review of the 2006 Filing Season.

Tax relief for Hurricane Katrina alone is estimated at over $3 billion for Fiscal Year 2006.

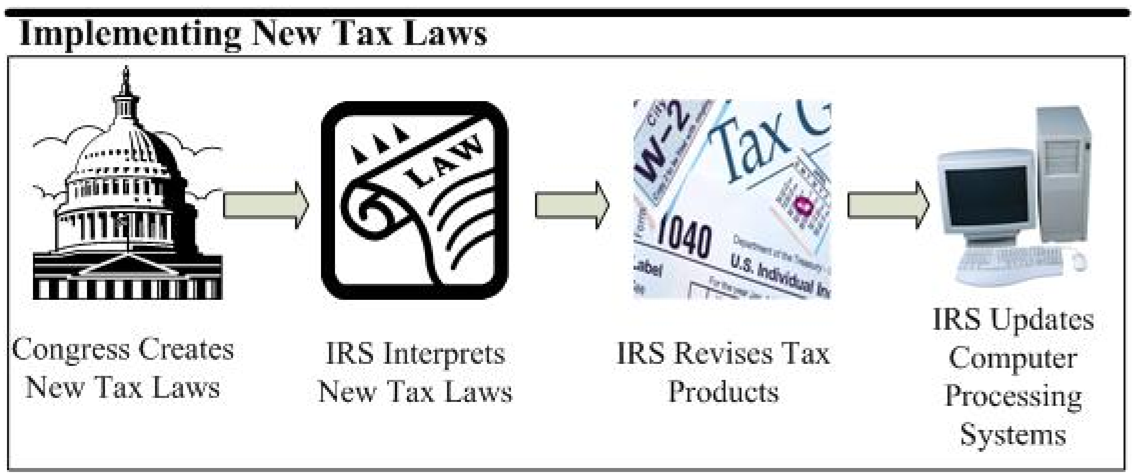
The IRS Legislative Analysis, Tracking, and Implementation Services function is responsible for managing the IRS-wide implementation planning and monitoring of newly enacted tax legislation. The Legislative Implementation Tracking System, an Intranet-based planning and monitoring system, provides real-time status updates and has management information capabilities. Two areas monitored on this System are:

- The revision of various tax forms, instructions, and publications. Annually, the IRS must revise or create new tax products to implement new legislation. The IRS function responsible for tax products is the Tax Forms and Publications Division. This Division originates and improves tax forms and publications, ensuring they are understandable and as easy to use as possible to enable taxpayers to meet their tax filing and payment obligations.
- The reprogramming of computer systems that are used to process tax returns. The process used for requesting computer programming changes is known as a Request for Information Services. The Requests are submitted to the IRS Modernization and

[1] The period from January through mid-April when most individual income tax returns are filed.
[2] Pub. L. No. 109-73, 119 Stat. 2016 (to be codified in scattered sections of 26 U.S.C.).
[3] Pub. L. No. 109-135, 119 Stat. 2577 (to be codified in scattered sections of 26 U.S.C. and at 19 U.S.C. § 4033).

Information Technology Services (MITS) organization by the function responsible for the computer process being changed. The computer programming requests needed for implementing new tax law provisions during the annual processing of individual income tax returns normally should be identified and submitted to the MITS organization before the filing season.

Figure 1: Overview of Tax Law Implementation



Source: Treasury Inspector General for Tax Administration analysis of IRS activities for implementing new tax laws.

This review was performed at the Wage and Investment (W&I) Division Headquarters in Atlanta, Georgia; the Tax Forms and Publications Division Headquarters in Washington, D.C.; the Submission Processing offices in Lanham, Maryland, and Cincinnati, Ohio; and the Austin Submission Processing Site[4] in Austin, Texas, during the period October 2005 through February 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[4] Submission Processing sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Results of Review

Tax Forms, Instructions, and Publications for Tax Year 2005 Were Accurately Updated

Overall, the IRS accurately updated its tax products for tax law changes that affect W&I Division taxpayers'[5] Tax Year (TY) 2005 individual income tax returns. During our review, we identified 24 new provisions included in 6 pieces of tax legislation that became effective in TY 2005. We also identified 13 cost-of-living (inflation) adjustments and changes to the optional standard mileage rates that were effective in TY 2005. Descriptions of these new provisions and other changes for TY 2005 can be found in Appendix IV.

We identified a total of 44 tax products that required updates as a result of the new tax law provisions and other adjustments or changes that became effective in TY 2005. Specifically, we examined the new tax law provisions and queried the Legislative Implementation Tracking System and identified 33 tax products requiring updates as a result of the new tax law provisions. We also examined the inflation adjustments and changes to the standard mileage rates and identified an additional 11 tax products requiring updates.

We reviewed 42 of the tax products and found that they were consistent with the provisions enacted by Congress or with the information contained in the Internal Revenue Bulletins. The IRS publications entitled *Highlights of 2005 Tax Changes* (Publication 553) and *Individual Retirement Arrangements (IRAs)* (Publication 590) were issued subsequent to the completion of our review. Passage of the Gulf Opportunity Zone Act of 2005 late in the year delayed their issuance. Issuance of the Publications was delayed as long as possible to ensure they contained the most up-to-date information. To help keep taxpayers informed of tax changes for 2005, the IRS is providing updated articles and guidance under the "What's Hot In Tax Forms, Publications, and Other Tax Products" section of its web site, IRS.gov. Under the circumstances, delaying issuance of these two Publications should not cause significant problems for taxpayers.[6] A list of the 42 tax products we examined can be found in Appendix V.

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[5] W&I Division taxpayers are individuals that report primarily wage and investment type income on U.S. Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).
[6] We subsequently verified these two Publications were issued.

Computer Programs for Processing Individual Income Tax Returns Were Accurately Updated

With one exception, the IRS accurately initiated computer programming requests to update return processing programs for new tax law provisions and other adjustments or changes that affect TY 2005 individual income tax returns.

Many of the new tax law provisions for TY 2005 include changes that require the IRS to update its return processing computer programs to ensure taxpayers receive the correct deduction or credit and comply with eligibility requirements. For example, Section 302 of the Katrina Emergency Tax Relief Act of 2005 created an additional exemption for housing individuals displaced by Hurricane Katrina. The provision applies to TYs 2005 and 2006. Several factors are used in the computation of the allowable exemption amount claimed by the taxpayer. These include:

- The additional exemption is $500 for providing housing to each individual displaced by Hurricane Katrina.
- The total for additional exemptions that can be claimed over the 2-year period is $2,000 ($1,000 if married filing separately).
- The exemption may be claimed only once for each displaced individual for all taxable years.
- The taxpayer must provide the Taxpayer Identification Number of the displaced individual.
- The additional exemption is not subject to the income-based phaseouts applicable to personal exemptions.
- The additional exemption is allowed as a deduction in computing the alternative minimum taxable income.

It is essential that IRS computer programs are updated accurately for new tax provisions and other adjustments or changes to the tax laws. According to the Joint Committee on Taxation, the tax effect for Section 302 alone will be $96 million in Fiscal Year 2006.

We identified and reviewed six requests that were initiated for computer programming changes needed to implement the new tax provisions and other adjustments or changes that affect TY 2005 individual income tax returns. In addition, we identified and reviewed 14 amendments for subsequent changes made to the computer programming requests. Analyses of the requests and amendments determined the requested changes submitted by the W&I Division Submission Processing function to the MITS organization were complete and accurate, with one exception. In addition, our analyses of computer programming documentation for return processing programs determined the programs were accurately updated for the new tax provisions and other adjustments or changes, with one exception.

The requests for computer changes and computer programming documentation did not contain a required change for the student loan interest deduction, which allows individual taxpayers to take a deduction for interest on loans taken out to pay for qualified higher education expenses such as college tuition. Revenue Procedure 2004-71[7] included an inflation adjustment to the interest on education loans (student loan interest deduction) allowed under Internal Revenue Code Section 221.[8] For TY 2005, the maximum student loan interest deduction is $2,500. This deduction is phased out when modified adjusted gross income[9] falls between $105,000 and $135,000 for taxpayers filing as married filing jointly. This phaseout was not reflected in any of the requests or amendments for computer programming changes or in the computer programming documentation for return processing programs.

We informed IRS officials about this condition on January 11, 2006, and they submitted a request for computer programming changes to the MITS organization. The computer programming documentation for the student loan interest deduction was accurately updated and implemented on January 23, 2006. The effect on taxpayers should be minimal because the condition was corrected early in the filing season and taxpayers claiming the deduction generally file their tax returns later in the filing season.

[7] Rev. Proc. 2004-71, 2004-50 I.R.B. 970.
[8] 26 U.S.C. § 221 (2004).
[9] Adjusted gross income is calculated after certain adjustments are made but before standard or itemized deductions and personal exemptions are subtracted. Modified adjusted gross income is calculated without regard to certain deductions or exclusions.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) accurately updated tax products (such as forms, instructions, and publications) and computer programming for tax law changes that affect the processing of individual income tax returns during the 2006 Filing Season.[1] The audit focused on updates to tax products and computer programming required by provisions of the six pieces of tax legislation, inflation adjustments for 2005, and changes to the optional standard mileage rates described in Appendix IV. To accomplish our objective, we:

I. Determined whether the IRS initiated changes to the tax products and the Requests for Information Services (RIS)[2] needed to implement new tax law provisions that affect the processing of Wage and Investment (W&I) Division taxpayers'[3] Tax Year (TY) 2005 individual income tax returns.

   A. Reviewed the IRS Legislative Implementation Tracking System and identified the actions items requiring updates to IRS tax products and computer programs associated with tax law changes for TY 2005.

      1. Examined the action items in Steps I.B., I.C., and I.D. and verified the updates were properly implemented.

   B. Identified and reviewed 24 new tax law provisions, 13 inflation adjustments, and changes to the optional standard mileage rates that affect TY 2005 individual income tax returns.

   C. Identified 44 tax products that will require updating as a result of new tax law provisions and other adjustments or changes affecting TY 2005 returns. We examined 42 of the tax products (25 tax forms and instructions and 17 publications) and determined whether they were accurately updated.[4]

   D. Identified and reviewed 6 RISs and 14 RIS amendments initiated by the W&I Division and determined whether they addressed the new tax law provisions and other adjustments or changes identified in Step I.B.

[1] The period from January through mid-April when most individual income tax returns are filed.
[2] A RIS is used to request computer programming changes.
[3] Taxpayers that report primarily wage and investment type income on U.S. Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).
[4] Two of the tax products were not available at the time of our review because they were affected by the late legislation. We subsequently verified the two tax products were issued.

II. Determined whether the RISs initiated by the W&I Division completely and accurately reflect the new provisions of the tax laws and other adjustments or changes that affect TY 2005 individual income tax returns.

A. Reviewed the new tax law provisions and other adjustments or changes identified in Step I.B. and determined the specific elements and criteria that required updating.

B. Reviewed the RIS documentation and determined whether the necessary elements and criteria were included.

C. Reviewed the Function Specification Packages[5] that required updating as a result of the RISs identified and determined whether the necessary elements and criteria were accurately included in return processing program documentation.

[5] Functional Specification Packages provide text descriptions of the computer programs used by the IRS to process tax returns.

Appendix II

Major Contributors to This Report

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Appendix III

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Appendix IV

Overview of Tax Law Provisions and Other Tax Law Changes Examined During the Review

The following information describes new tax law provisions and other changes that affect Tax Year (TY) 2005 tax products[1] or the processing of TY 2005 individual income tax returns filed by Wage and Investment Division taxpayers[2] during the 2006 Filing Season.[3]

Taxpayer Relief Act of 1997[4]

This Act contained the following provision:

1) Section 301 – Restoration of IRA [Individual Retirement Arrangement] Deduction for Certain Taxpayers. Provides for taxpayers covered by a retirement plan at work. For TY 2005, the deduction for contributions to a traditional IRA will be phased out over a $10,000 range in the taxpayer's modified adjusted gross income (MAGI).[5] For a married couple filing a joint return or a qualified widow(er), the deduction will begin to be phased out at a MAGI of $70,000. For single individuals or taxpayers filing as head of household, the deduction will begin to be phased out at a MAGI of $50,000.

Internal Revenue Service (IRS) Restructuring and Reform Act of 1998[6]

This Act contained the following provision:

1) Section 7004 – Modification of AGI [Adjusted Gross Income] Limit for Conversions to Roth IRAs. Provides that, beginning in TY 2005, required minimum distributions are excluded from a taxpayer's MAGI for purposes of determining eligibility to convert from a traditional IRA to a Roth IRA.

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[1] Defined as tax forms, instructions, and publications.
[2] Taxpayers that report primarily wage and investment type income on U.S. Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).
[3] The period from January through mid-April when most individual income tax returns are filed.
[4] Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).
[5] Adjusted gross income is calculated after certain adjustments are made but before standard or itemized deductions and personal exemptions are subtracted. Modified adjusted gross income is calculated without regard to certain deductions or exclusions.
[6] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[7]

The EGTRRA contained the following provision:

1) Section 601 – Modification of IRA Contribution Limits. Provides that, for TY 2005, the maximum contribution limit to a traditional IRA is increased to $4,000. The maximum catchup contribution for individuals age 50 and over remains at $500 for TY 2005.

Working Families Tax Relief Act of 2004[8]

This Act contained the following nine provisions:[9]

1) Section 101 – Repeal of Scheduled Reductions in Child Tax Credit, Marriage Penalty Relief, and 10-Percent Rate Bracket. Provides for a repeal of the scheduled reductions in the Child Tax Credit, the standard deduction and 15-percent tax rate bracket for joint returns (marriage penalty relief), and 10-percent tax rate bracket. The items will generally remain at their TY 2004 levels through TY 2010, after which the EGTRRA sunset will apply the law in effect for TY 2000. Through TY 2010, the Child Tax Credit will remain at $1,000, both the standard deduction and width of the 15-percent bracket for joint filers will continue to be twice that for single filers, and the 10-percent bracket will continue to be indexed for inflation after TY 2003.

2) Section 103 – 1-Year Extension of Minimum Tax Relief to Individuals. Provides for a 1-year extension to TY 2005 of the Alternative Minimum Tax exemption amounts of $58,000 for a joint return, $40,250 for single returns, and $29,000 for a married person filing a separate return. These amounts were previously scheduled to decrease to $45,000, $33,750, and $22,500, respectively.

3) Section 201 – Uniform Definition of Child, Etc.. Provides a uniform definition of "qualifying child" in Internal Revenue Code (I.R.C.) Section (§) 152(c)[10] to be used in determining the tax benefits of the dependency exemption, Child Tax Credit, Earned Income Tax Credit (EITC), Credit for Child and Dependent Care Expenses, and Head of Household filing status. Each tax benefit has separate criteria for determining whether a taxpayer qualifies with respect to a particular child. Generally, a child is a qualifying child of a taxpayer if the child satisfies each of three tests: 1) the child has the same principal place of abode as the taxpayer for more than one-half of the taxable year (temporary absences due to illness, education, vacation, etc. are disregarded), 2) the child has a specified relationship to the taxpayer, and 3) the child has not yet attained a specified age. Except for the EITC, a child who provides over one-half of his or her own support may not

[7] Pub. L. No. 107-16, 115 Stat. 38 (2001).
[8] Pub. L. No. 108-311, 118 Stat. 1166 (2004).
[9] Source: IRS *Legislative Affairs Update 2004-6, Summary of Provisions in the Working Families Tax Relief Act of 2004, P.L. 108-311* (October 2004).
[10] 26 U.S.C. § 152 (2004).

be a qualifying child. The prior-law support and gross income tests for determining whether an individual is a dependent no longer apply if the child meets the requirements of the uniform definition of qualifying child.

4) Section 202 – Modifications of Definition of Head of Household. Modifies the qualifications for Head of Household filing status to incorporate the new uniform definition of a qualifying child contained in amended I.R.C. § 152(c). The prior-law requirement that the taxpayer provide over one-half of the cost of maintaining the household is retained. In addition, an individual who is not a qualifying child will continue to qualify the taxpayer for Head of Household filing status if the taxpayer is entitled to a dependency exemption for the individual or if the individual is the taxpayer's father or mother and certain other requirements are satisfied.

5) Section 203 – Modifications of Dependent Care Credit. Eliminates the prior-law requirement that a taxpayer maintain a household in order to claim the Credit for Child and Dependent Care Expenses. Generally, if other applicable requirements are satisfied, a taxpayer may claim the credit with respect to a qualifying individual who lives with the taxpayer for more than one-half of the year, even if the taxpayer does not provide more than one-half of the cost of maintaining the household. A qualifying individual includes (1) a qualifying child who is a dependent and under age 13 when the care was provided or (2) a taxpayer's spouse or dependent who is physically or mentally unable to care for himself or herself and who has the same principle place of abode as the taxpayer for more than one-half of the year.

6) Section 204 – Modifications of Child Tax Credit. Modifies I.R.C. § 24(c)(1)[11] to incorporate the new uniform definition of qualifying child provided in amended I.R.C. § 152(c). In addition, the provision eliminates the prior-law requirement that a foster child and certain other children be cared for as the taxpayer's own child.

7) Section 205 – Modifications of [the] EITC. Modifies I.R.C. § 32(c)(3)[12] to define a qualifying child for purposes of the EITC by reference to the new uniform definition of qualifying child provided in section I.R.C. § 152(c). The prior-law requirement that a foster child and certain other children be cared for as the taxpayer's own child is eliminated. The tie-breaker rules applicable to the EITC remain unchanged and have been incorporated in the new uniform definition of a qualifying child in I.R.C. § 152. The provision retains the requirement that the taxpayer's principal place of abode be in the United States.

[11] 26 U.S.C. § 24 (2004).
[12] 26 U.S.C. § 32 (2004).

8) Section 206 – Modifications of Deduction for Personal Exemption for Dependents. Removes from I.R.C. § 151(c)[13] the rules and definitions that are no longer applicable or that are now provided in amended I.R.C. § 152(c).

9) Section 207 – Technical and Conforming Amendments. Provides numerous and technical conforming changes to the I.R.C. to incorporate the new uniform definition of child.

American Jobs Creation Act of 2004[14]

This Act contained the following provision:

1) Section 884 – Donations of Motor Vehicles, Boats, and Airplanes. Amends I.R.C. §170(f)[15] relating to the disallowance of a charitable contributions deduction by requiring taxpayers to substantiate contributions of used motor vehicles, boats, and airplanes with a claimed value of more than $500. Taxpayers must attach to their returns a written acknowledgement of the contribution from the donee organization.

Katrina Emergency Tax Relief Act of 2005[16]

This Act contained the following 11 provisions:[17]

1) Section 101 – Tax-Favored Withdrawals From Retirement Plans for Relief Relating to Hurricane Katrina. Provides an exception to the 10-percent early withdrawal tax in the case of a qualified Hurricane Katrina distribution up to $100,000 from a qualified retirement plan, a section 403(b) plan, a section 457(b) Governmental deferred compensation plan, or an IRA. In addition, income attributable to a qualified Hurricane Katrina distribution may be included in income ratably over 3 years, and, to the extent the distribution is eligible for tax-free rollover and is recontributed within a 3-year period, the amount recontributed will not be included in gross income.

2) Section 102 – Recontributions of Withdrawals for Home Purchases Cancelled Due to Hurricane Katrina. Provides that qualified distributions from a section 401(k) plan, a section 403(b) plan, or an IRA to purchase a home in the Hurricane Katrina disaster area may be recontributed to an eligible retirement plan. Any amounts recontributed are treated as direct rollovers. The qualified distribution must have been received after February 28, 2005, and before August 29, 2005, in order to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence was not

[13] 26 U.S.C. § 151 (2004).
[14] Pub. L. No. 108-357, 118 Stat. 1418 (2004).
[15] 26 U.S.C. § 170 (2004).
[16] Pub. L. No. 109-73, 119 Stat. 2016 (to be codified in scattered sections of 26 U.S.C.).
[17] Source: *TECHNICAL EXPLANATION OF H.R. 3768, THE "KATRINA EMERGENCY TAX RELIEF ACT OF 2005" AS PASSED BY THE HOUSE AND THE SENATE ON SEPTEMBER 21, 2005*, Joint Committee on Taxation, JCX-69-05 (September 2005).

purchased or constructed due to Hurricane Katrina. To be treated as rollovers, the recontributions must be made between August 25, 2005, and February 28, 2006.

3) Section 301 – Temporary Suspension of Limitations on Charitable Contributions. Provides that, in the case of an individual, the deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. A taxpayer must elect this treatment for qualified contributions. Deductions elected to be treated under this section are not subject to the overall limit on itemized deductions under section 68. Contributions in excess of this amount are carried over to succeeding taxable years as contributions described in I.R.C. § 170(b)(1)(A), subject to the limitations of I.R.C. § 170(d)(1)(A)(i) and (ii). Qualified contributions are cash contributions made between August 28, 2005, and December 31, 2005, to a charitable organization described in I.R.C. § 170(b)(1)(A) (other than a supporting organization described in I.R.C. § 509(a)(3) or donor-advised funds).[18]

4) Section 302 – Additional Exemption for Housing Hurricane Katrina Displaced Individuals. Provides an additional exemption of $500 for each Hurricane Katrina displaced individual. The maximum additional exemption amount is $2,000 for married taxpayers filing jointly, $1,000 for married taxpayers filing separately and $2,000 for all other taxpayers. The taxpayer may claim the exemption only 1 time for each displaced individual for all taxable years. A Hurricane Katrina displaced individual is a person (1) whose principal place of abode on August 28, 2005, was in the Hurricane Katrina disaster area; (2) who is displaced from such abode; (3) whose abode, if located within the disaster area but outside the core disaster area the abode must be damaged by Hurricane Katrina, or who was evacuated from the abode because of Hurricane Katrina, and (4) who is provided housing free of charge in the taxpayer's principal residence for a period of 60 consecutive days that ends in the taxable year in which the exemption is claimed. The displaced individual cannot be the taxpayer's spouse or dependent. The taxpayer cannot receive any compensation from any source for providing housing to the displaced individual. The taxpayer must provide the Taxpayer Identification Number of the displaced individual.

5) Section 303 – Increase in Standard Mileage Rate for Charitable Use of Vehicles. Allows taxpayers who use vehicles to provide charitable services related to Hurricane Katrina to compute their charitable mileage deduction using 70 percent of the business mileage rate in effect on the date of the contribution. This amount is 29 cents a mile after August 24, 2005, and 34 cents a mile after August 31, 2005.

6) Section 304 – Mileage Reimbursements to Charitable Volunteers Excluded from Gross Income. Provides that reimbursements by an organization described in I.R.C. § 170(c) to taxpayers who use their vehicles to provide charitable services related to Hurricane Katrina

[18] 26 U.S.C. § 509 (2004).

are excludable from gross income, up to an amount that does not exceed the standard mileage rate for business use.

7) Section 401 – Exclusion of Certain Cancellations of Indebtedness by Reason of Hurricane Katrina. Provides that cancellation of indebtedness income from the discharge of certain nonbusiness indebtedness of qualifying individuals by certain creditors ("applicable entities" as defined in section 6050P(c)) after August 24, 2005, and before January 1, 2007, will be excluded from gross income if the individual's principal home was located in the Hurricane Katrina core disaster area or in the Hurricane Katrina disaster area if the individual suffered an economic loss as a result of Hurricane Katrina. An individual who excludes cancellation of indebtedness income from gross income by reason of section 401 is required to reduce his or her tax attributes by the amount of the excluded income.

8) Section 402 – Suspension of Certain Limitations on Personal Casualty Losses. Provides that casualty or theft losses of personal-use property that are attributable to Hurricane Katrina need not exceed the $100-per-casualty or -theft limitation. In addition, casualty or theft losses of personal-use property that are attributable to Hurricane Katrina are disregarded for purposes of applying the 10-percent threshold to other personal casualty or theft losses.

9) Section 405 – Extension of Replacement Period for Nonrecognition of Gain. Extends from 2 years to 5 years the replacement period for postponing gain realized on property located in the Hurricane Katrina disaster area and converted after August 24, 2005, as a result of Hurricane Katrina if substantially all of the use of the replacement property is in the Hurricane Katrina disaster area.

10) Section 406 – Special Look-Back Rule for Determining the EITC and the Refundable Child Credit. Permits a qualified individual to elect to calculate both the EITC and the refundable Additional Child Tax Credit for the taxable year that includes August 25, 2005, using the earned income from the prior taxable year. This election can be made only if the qualified individual's earned income for the taxable year that includes August 25, 2005, is less than earned income for the preceding taxable year.

11) Section 407 – Secretarial Authority to Make Adjustments Regarding Taxpayer and Dependency Status for Taxpayers Affected by Hurricane Katrina. Authorizes the Secretary of the Treasury or the Secretary's delegate to make adjustments in the application of the internal revenue laws to ensure taxpayers do not lose any deduction or credit or experience a change of filing status by reason of temporary relocations caused by Hurricane Katrina. For example, such adjustments may include addressing the residency requirements relating to the exemption for dependents.

Cost-of-Living (Inflation) Adjustments for TY 2005

Revenue Procedure 2004-71[19] contained the following 13 inflation-adjusted items:

1) Tax Rate Tables. For TY 2005, the Tax Rate Tables under I.R.C. § 1[20] were revised by adjusting the taxable income brackets for each filing status. The adjusted Tax Rate Tables for individuals are included in the TY 2005 Form 1040 Instructions.

2) Adoption Credit. For TY 2005, the maximum Adoption Credit under I.R.C. § 23[21] is $10,630 per child. The maximum credit begins to phase out when the taxpayer's MAGI reaches $159,450 and is completely phased out when the MAGI exceeds $199,450.

3) Child Tax Credit. For TY 2005, the value used in I.R.C. § 24(d)(1)(B)(i) in determining the amount of the Additional Child Tax Credit that may be refundable is $11,000.

4) Hope and Lifetime Learning Credits. For TY 2005, the $1,500 maximum Hope Credit for each eligible student and the $2,000 maximum Lifetime Learning Credit for each return begin to phase out when the taxpayer's MAGI reaches $43,000 ($87,000 for joint returns) and are completely phased out when the MAGI reaches $53,000 ($107,000 for joint returns). If a student is eligible for both credits in TY 2005, the taxpayer can claim either credit but not both.

5) EITC. For TY 2005, the earned income amounts,[22] maximum amounts of EITC, and threshold amounts for phase out of the credit under I.R.C. § 32(b) were increased. The adjusted amounts are reflected in the 2005 Earned Income Credit (EIC) Table included the TY 2005 Form 1040 Instructions. The investment income amount under I.R.C. § 32(i)(1) was increased to $2,700.

6) Standard Deduction. For TY 2005, the standard deduction amounts under I.R.C. § 63(c)(2)[23] were increased to $5,000 for Single or Married Filing Separately filing statuses, $7,300 for Head of Household filing status, and $10,000 for Married Filing Jointly or Surviving Spouse filing statuses. The standard deduction amount under I.R.C. § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $800 or the sum of $250 and the individual's earned income. The additional standard deduction amounts under I.R.C. § 63(f) for the aged and for the blind are $1,000 each or $1,250 each if the individual is also unmarried and not a surviving spouse.

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[19] Rev. Proc. 2004-71, 2004-50 I.R.B. 970.
[20] 26 U.S.C. § 1 (2004).
[21] 26 U.S.C. § 23 (2004).
[22] The earned income amount is the amount of earned income at or above which the maximum amount of the EITC is allowed.
[23] 26 U.S.C. § 63 (2004).

7) Overall Limitation on Itemized Deductions. For TY 2005, the total amount of otherwise allowable itemized deductions is reduced under I.R.C. § 68[24] when a taxpayer's adjusted gross income exceeds $145,950 ($72,975 if married filing separately).

8) Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses. For TY 2005, the exclusion under I.R.C. § 135[25] (regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses) begins to phase out when the taxpayer's MAGI reaches $61,200 ($91,850 for joint returns) and is completely phased out when the MAGI exceeds $76,200 ($121,850 for joint returns).

9) Personal Exemption. For TY 2005, the personal exemption under I.R.C. § 151(d)[26] is $3,200.

10) Eligible Long-Term Care Premiums. For TY 2005, the limitations under I.R.C. § 213(d)(10)[27] (regarding eligible long-term care premiums includible in the term "medical care") are as follows: $270 if age is 40 or less before the close of the taxable year, $510 if age is 41 to 50 before the close of the taxable year, $1,020 if age is 51 to 60 before the close of the taxable year, $2,720 if age is 61 to 70 before the close of the taxable year, and $3,400 if age is more than 70.

11) Medical Savings Accounts. For TY 2005, the term "high-deductible health plan" as defined in I.R.C. § 220(c)(2)(A)[28] for self-only coverage means a health plan that has an annual deductible that is not less than $1,750 and not more than $2,650 and under which the annual out-of-pocket expenses required to by paid (other than premiums) for covered benefits do not exceed $3,500. The amounts for family coverage are $3,500, $5,250, and $6,450, respectively.

12) Interest on Education Loans. For TY 2005, the $2,500 maximum deduction for interest paid on qualified education loans under I.R.C. § 221[29] begins to phase out when the taxpayer's MAGI reaches $50,000 ($105,000 for joint returns) and is completely phased out when the MAGI exceeds $65,000 ($135,000 for joint returns).

13) Health Savings Accounts. For TY 2005, the monthly contribution limit on deductions under I.R.C. § 223(b)(2)(A)[30] for an individual with self-only coverage under a high-deductible plan as of the first day of such month is 1/12 of the lesser of (1) the annual deductible or (2) $2,650 ($5,250 for an individual with family coverage). A

[24] 26 U.S.C. § 68 (2004).
[25] 26 U.S.C. § 135 (2004).
[26] 26 U.S.C. § 151 (2004).
[27] 26 U.S.C. § 213 (2004).
[28] 26 U.S.C. § 220 (2004).
[29] 26 U.S.C. § 221 (2004).
[30] 26 U.S.C. § 223 (2004).

high-deductible health plan is defined under I.R.C. § 223(c)(2)(A) as a health plan with an annual deductible that is not less than $1,000 for self-only coverage or $2,000 for family coverage and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $5,100 for self-only coverage or $10,200 for family coverage.

Changes to the Optional Standard Mileage Rates for TY 2005

1) Revenue Procedure 2004-64[31] provides the optional standard mileage rates to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes for TY 2005. The rates are:

- 40.5 cents for business use.
- 14 cents for charitable use.
- 15 cents for medical or moving use.

2) IRS Announcement 2005-71[32] provides revised optional standard mileage rates for business, medical, and moving expenses purposes that are effective on September 1, 2005. The revised rates are:

- 48.5 cents for business use.
- 22 cents for medical or moving use.

[31] Rev. Proc. 2004-64, 2004-49 I.R.B. 898.
[32] 2005-41 I.R.B. 714-15.

Appendix V

List of Tax Products Examined

Tax Forms

Tax Product	Title
1. Form 1040	U.S. Individual Income Tax Return
2. Form 1040, Schedules A & B	Schedule A–Itemized Deductions Schedule B–Interest and Ordinary Dividends
3. Form 1040, Schedule EIC	Earned Income Credit
4. Form 1040A	U.S. Individual Income Tax Return
5. Form 1040-ES	Estimated Tax for Individuals
6. Form 1040EZ	Income Tax Return for Single and Joint Filers With No Dependents
7. Form 1098-C	Contributions of Motor Vehicles, Boats, and Airplanes
8. Form 6251	Alternative Minimum Tax–Individuals
9. Form 8283	Noncash Charitable Contributions
10. Form W-5	Earned Income Credit Advance Payment Certificate
11. Form 8812	Additional Child Tax Credit
12. Form 8815	Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989 (For Filers With Qualified Higher Education Expenses)
13. Form 8839	Qualified Adoption Expenses
14. Form 8863	Education Credits (Hope and Lifetime Learning Credits)

Tax Form Instructions

Tax Product	Title
1. Form 1040	2005 1040 Instructions
2. Form 1040, Schedules A & B	2005 Instructions for Schedule A, Itemized Deductions and for Schedule B, Interest and Ordinary Dividends
3. Form 1040A	2005 1040A Instructions
4. Form 1040A, Schedule 2	2005 Instructions for Schedule 2 (Form 1040A), Child and Dependent Care Expenses for Form 1040A Filers
5. Form 1040EZ	2005 1040EZ Instructions
6. Form 2441	2005 Instructions for Form 2441, Child and Dependent Care Expenses
7. Form 4684	2005 Instructions for Form 4684, Casualties and Thefts
8. Form 5329	2005 Instructions for Form 5329, Additional Taxes on Qualified Plans (Including IRAs[1]) and Other Tax-Favored Accounts
9. Form 8283	2005 Instructions for Form 8283, Noncash Charitable Contributions
10. Form 8606	2005 Instructions for Form 8606, Nondeductible IRAs
11. Form 8839	2005 Instructions for Form 8839, Qualified Adoption Expenses

Tax Products

Tax Product	Title
1. Publication 17	*Your Federal Income Tax For Individuals*
2. Publication 54	*Tax Guide for U.S. Citizens and Resident Aliens Abroad*
3. Publication 501	*Exemptions, Standard Deduction, and Filing Information*
4. Publication 502	*Medical and Dental Expenses (Including the Health Coverage Tax Credit)*
5. Publication 503	*Child and Dependent Care Expenses*

[1] Individual Retirement Arrangement.

6. Publication 504	*Divorced or Separated Individuals*
7. Publication 526	*Charitable Contributions*
8. Publication 550	*Investment Income and Expenses (Including Capital Gains and Losses)*
9. Publication 554	*Older Americans' Tax Guide*
10. Publication 596	*Earned Income Credit (EIC)*
11. Publication 596SP	*Credito por Ingreso del Trabajo (Spanish-speaking version of Publication 596)*
12. Publication 907	*Tax Highlights for Persons with Disabilities*
13. Publication 929	*Tax Rules for Children and Dependents*
14. Publication 969	*Health Savings Accounts and Other Tax-Favored Health Plans*
15. Publication 970	*Tax Benefits for Education*
16. Publication 972	*Child Tax Credit*
17. Publication 4492	*Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*