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# WORKING WITH THE IRS & DRT

TAX PANEL – 2016 DISTRICT COURT OF GUAM ANNUAL CONFERENCE

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## TAX TRIVIA

- Taxes and taxation are often received with mixed emotions. Historically, taxes have been met with rebellion and unrest; patriotism; war; and voluntary compliance. French tax collectors were sent to the guillotine in 1789.
- **Which ancient civilization revered the tax professional as the most noble man in society?**
  - A. Greece
  - B. Rome
  - C. Egypt
  - D. Incas

# INTERNAL REVENUE CODE: TITLE 26 UNITED STATES CODE

- Subtitle A: Income Taxes
- Subtitle B: Estate & Gift Taxes
- Subtitle C: Employment Taxes
- Subtitle D: Miscellaneous Excise Taxes
- Subtitle E: Alcohol, Tobacco, and Certain Other Excise Taxes
- Subtitle F: Procedure and Administration
- Subtitle G: The Joint Committee on Taxation
- Subtitle H: Financing of Presidential Election Campaigns
- Subtitle I: Trust Fund Code
- Subtitle J: Coal Industry Health Benefits
- Subtitle K: Group Health Plan Requirements

# ORGANIC ACT OF GUAM: TITLE 48 UNITED STATES CODE

- Chapter 8A
  - (a) The income tax laws in force in the United States and those which may hereafter be enacted shall be held likewise in force in Guam.
  - (b) Income tax laws in force in Guam shall be deemed to impose a separate Territorial income tax, payable to the government of Guam, which tax is designated as the “Guam Territorial Income Tax.”
  - (c) The administration and enforcement of the GTITC shall be performed under the supervision of the Governor.
  - (d) Income tax laws in force in Guam include but are not limited to the following provisions of the 1986 IRC, where not manifestly inapplicable or incompatible with the intent of this section:
    - Subtitle A (not including Chapter 2 and Section 931).
    - Subtitle C (Chapters 24 & 25) with reference to collection of income tax at source on wages
    - Subtitle F which apply to the income tax, including provisions for crime, other offenses, and forfeitures.

# MIRROR SYSTEM OF TAXATION

## ■ **Current Status in U.S. Territories**

- IRC is employed by Guam, CNMI, and US Virgin Islands (“USVI”)
- Proceeds of the mirror code possessions are generally paid to the treasuries of the possessions.
- Not all the code provisions are mirrored and generally only the Income Tax Provisions of the Code (Subtitle A) are mirrored by the Territories.
- In the code, the mirrored possession substitutes its name for the United States within the tax statutes that are in effect in the territories.

## ■ **Guam Tax Administration**

- Established under 48 USC §1421i under the purview of the Governor of Guam.
- Guam tax is referred to as Guam Territorial Income Tax Code (“GTITC”)
- Examples:
  - IRC §935 is the equivalent to GTITC §935 providing for the “Coordination of United States and Guam Individual Income Taxes”
  - IRC §7654 is the equivalent to GTITC §7654 providing for the “Coordination of United States and Certain Possessions Individual Income Taxes.”

## CURRENT MIRROR SYSTEM OF TAXATION AND GUAM

- The Tax Reform Act of 1986 granted Guam the ability to cease using the mirror system.
- The 1986 Act repealed rules that provide coordination between the federal statutes and the mirrors statutes (IRC §935 & GTITC §935 noted previously)
- Effective date of the 1986 Act changes are contingent on the existence of an implementation agreement between Guam and the United States. To date, this contingency has not been met.
- In 1989, a Tax Implementation Agreement (TIA) was executed and was expected to be in force by January 1, 1991. However in December 1990, the agreement was amended changing the effective date to “indefinite”.

## COVER-OVER OF SECTION 30 MONIES

- **48 USC § 1421h. Duties, Taxes, and Fees**
  - Established that all customs duties, federal income taxes, and all quarantine, passport, immigration and naturalization fees, collected in Guam shall be covered over into the Treasury of Guam.
  - These funds are referred to as “Section 30 Funds”
  - Requirements:
    - GovGuam must estimate the amount of Section 30 Funds it anticipates to collect in the next fiscal year.
    - US Treasury must:
      - Prior to the commencement of each fiscal year, shall remit to GovGuam the amount of these funds.
      - Deduct from or add to the amounts remitted, the difference between the taxes actually collected during the prior taxable year and the amount of such taxes as estimated and paid at the beginning of the prior fiscal year.

## COVER-OVER OF SECTION 30 MONIES

- Overview of Section 30 Funds:
  - Covers the following employee categories:
    - Active duty military
    - Federal employees
    - Retired Federal and Military personnel
  - GTITC §7654 Coordination of United States and Certain Possession Individual Income Tax, provides the cover-over mechanism of taxes deducted and withheld by the U.S. Treasury under Chapter 24 for federal withholding taxes.
- Taxes imposed by Chapter 2 and or Chapter 21 of IRC are not applicable to Guam.

## OVERVIEW: IRS CRIMINAL INVESTIGATION

- Criminal arm of the IRS
- 90,000 Employees,
  - 3,000 work in Criminal Investigation
  - 2,500 Special Agents
- Special Agents are sworn LEO's with power of arrest and are armed.
- Highly specialized financial investigators
- Jurisdiction: Tax, Money Laundering, and BSA
- Partner with other LEA's to pursue financial crime statutes and to investigate the financial side of crime
- Often provides evidence for charges that are complimentary to our other LEA – i.e. money laundering.
- Tax crimes sometimes attractive to pursue as it offers options for charging and admission of evidence.
- Overview of business results FY 2015.
- High profile cases: FIFA, Silk Road, Al Capone, Lindbergh Kidnapping.

## TAX TRIVIA

- **Technically, income tax is voluntary (but not optional) !**
- **The first U.S. Income tax started during the Civil War to help raise money for the war. (1862).**

## DUAL FILING: IRS & DRT

- The *majority* of Guam residents must file their annual individual tax returns with the DRT and not with the IRS.
- IRS determined that some Guam residents filed a return and/or a second return with the IRS with the sole purpose of receiving a tax refund for which they are not entitled.
- How does this happen:
  - Unscrupulous tax preparers encourage Guam residents to file a return with the IRS specifically to receive a tax refund.
  - IRS system is set up to accept returns for those who file with a valid SSN. Guam citizens are required to file with DRT and the filings are not recorded on the IRS system. Therefore when a return is sent to IRS and not recognized as having been filed with DRT by the IRS system, the system permits a return to be filed with both the IRS and DRT. When the IRS receives the filing, the return is processed and a refund is issued.
  - This weakness in the system is well known and many pursue this vulnerability within the IRS system to obtain the refund.

# DUAL FILING: SANCTIONS

- Civil Remedies
  - Dual filers are generally required to pay back the refund to the IRS.
  - Dual filers may be subject to collection action such a lien or wage garnishment.
- Criminal Exposure: Guam & CNMI Residents could face possible criminal charges:
  - Aiding and assisting the Preparation of a false document. (26 USC §7206(2)).
  - Conspiracy to Defraud the Government with Respect to Claims (18 USC §286).
  - False, Fictitious, or Fraudulent Claims (18 USC §287)
- What is CI's focus on these criminal cases:
  - Pursue those who promote the dual filing scheme (tax preparers & accountants).
  - Pursue individuals who have a pattern of dual filing.

## TAX TRIVIA

- The most misused Social Security Number of all time was 078-05-1120, as part of a promotion to sell wallets through Woolworth and other department stores, wallet manufacturer E.H. Ferree Company wanted to demonstrate how a social security card would fit into its wallets. A sample card was placed inside each wallet and displayed the SSN of the company's secretary, Ms. Hilda Schrader Witcher. Even though the sample card was half the size of an actual SSN card, was written in red, and had "specimen" written in bold, many people confusedly used this as their social security number. In 1943, 5,755 people were using her SSN.
- In all, about how many people do you think reported 078-05-1120 as their SSN?
  - 40,000

## IDENTITY THEFT:

- Alice is a resident of Guam and has been filing her income tax returns with the Guam Department of Revenue and Taxation since she first started working at 18 years of age. Alice is now 64 and retired. She regularly visits her daughter who lives in San Ramon, California. On her 65 birthday Alice receives a letter from the IRS informing her that she failed to file her tax returns for the past 5 years. She receives a Notice LT16 from the IRS. Alice calls the IRS and informs them that she is a resident of Guam and has in fact filed her tax returns since she was 18 years of age with the DRT. The IRS informs Alice that if she does not file and pay her tax liability, the IRS will levy her bank accounts and garnish her retirement income on Form 668-A.
- What are the issues here?
- What should Alice do?

## IDENTITY THEFT: IRS POSITION

- Concern: Identity theft could result in someone filing a return with the IRS under the individual's SSN and illegally reap the benefits of a tax refund. If the IRS has not yet determined that the return was fraudulent and seeks to collect the erroneous refund from the victim taxpayer it could expose the victim to actions by the IRS.
- Process:
  - Complete IRS Form I4039, Identity Theft Affidavit follow instructions for submission.
  - If you are subject to IRS filing requirements, continue to pay taxes and file return, even if you must do so by paper.
  - Contact the Taxpayer Advocate in Honolulu, if necessary.

## IDENTITY THEFT: IRS POSITION

- Filing returns with stolen identities is a crime.
  - **Traditional ID Theft Scheme:** D. Fendant works as a driver who drives elderly folks around to their medical appointments. In order to obtain payment for his services from insurance, the driver has the patients give their name, address, and SSN on a sign-in sheet. D. Fendant steals the patients personal information and files false claims seeking refunds from the IRS. D. Fendant uses the patient's name and address on the return and asks that the refund be electronically deposited into bank accounts in the Driver's name or in the name of a buddy who he gives \$100 for each refund fraudulently received. Driver's buddy is named A. Complice. A. Complice is a driver too and he brings personal information of patients he drives to D. Fendant so he can file false returns in their names too. The patients do not file returns so the tax schemes go undetected until IRS CI catches them.
  - **Emerging Scheme:** Criminal organizations conduct breach of computer systems that house personal information. Organization sells PII (as primary role) or also have tax preparation arm as well. They utilize sophisticated scheme to file returns from foreign jurisdictions, mask IP addresses, use of store valued cards (stripping and wiring), wired funds, nominee (sweetheart) bank accounts for immediate transfer of funds. Difficult to identify the true identity of perpetrator as they utilize social media names, etc. to conduct fraud.

## IDENTITY THEFT: IRS POSITION

- Criminal Charges
  - Filing False Claims (18 USC §287 and §2 aiding and abetting)
  - Conspiracy to File False Claims (18 USC §286)
  - Aggravated Identity Theft (18 USC §1028A – predicate offense of §641 or §1343 wire fraud for electronically received refunds plus D. Fendant and Accomplice know the identities they stole belong to real persons)
  - Theft of Government Funds (18 USC §641)
  - Conspiracy to Defraud the IRS (18 USC §371)
- Special Agents will interview those whose stolen identity was utilized to ensure that the filed returns were false; review bank accounts, stored value cards, and other financial media; trace filing method and determine IP address and device ID's to link perpetrators to the filings; trace disposition of proceeds, and seize assets purchased with SIRF refunds.

## IDENTITY THEFT: DRT PROCESS

- Guam taxpayer receives a Notice from IRS stating that they owe taxes and/or failed to file a return with the IRS.
  - Complete IRS Form 4506 – Request for Copy of Tax Return
  - Complete IRS Form 14039 – Identity Theft Affidavit
  - Copy of IRS Notice Received
  - Identification
  - Certification of Letter Sealed by DRT
  - Formal letter addressed to Taxpayer Advocate
  - Transcripts
- Request will be processed and verified within 24-hours, then sent to Taxpayer Advocate in Honolulu next business day.
- If IRS continues to send Notice after 2 months – taxpayer should contact Taxpayer Advocate and refer to certification provided by DRT.

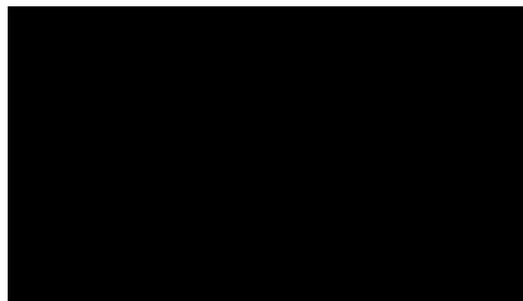
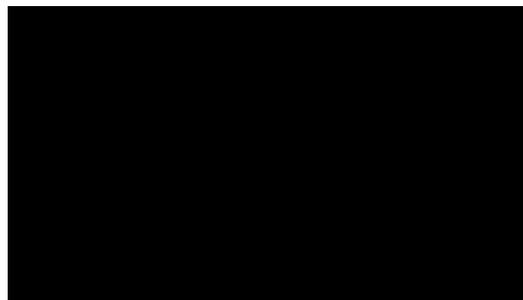
## IDENTITY THEFT: DRT PROCESS

- Taxpayer received a notice requesting to verify address. Please bring all IRS notices to DRT for review.
  - Notice Code: LT16 (call regarding unpaid taxes)
  - Notice Code: 2797 (Assistance to update records)
  - Form 668-A-C (DO) (Notice of Levy)
- Last year alone DRT received 435 reports of alleged ID theft.

## TAX FACTS

- **To collect taxes, the federal government relied on voluntary compliance. To encourage people to learn about and pay their taxes, the government turned to popular culture and media.**
- Which of the following was NOT one of the ways in which the government used popular culture and the media to inform people about the taxes?
  - A. Cartoon character Donald Duck visited Washington D.C., and learned about taxes in the short film "The New Spirit."
  - B. Popular composer Irving Berlin wrote the song "I Paid My Income Tax Today."
  - C. President Roosevelt appeared in television commercials reminding people to pay taxes.
  - D. Popular singer Danny Kaye included songs about paying taxes in his club appearance.

# TAX FACTS



## CASH IS KING: RECENT DEVELOPMENTS & FORM 8300

- Bank Secrecy Act requires a person to file a Form 8300. Form 8300 is a report of cash payments over \$10,000 received by a person in the course of that person's trade or business.
- Explanation of "What is a trade or business?"
- For Form 8300, "currency" includes U.S. and foreign currency, as well as cashier's checks, traveler's checks, money order, having a face amount of not more than \$10,000.
- This form is required under 31 U.S.C. § 5331 but it is also required under 26 U.S.C. § 6050I. For Guam residents, the Form 8300 is required to be filed with the IRS in addition to any filing obligation the person may also have with territory tax authorities under rules similar to § 6050I, including under territory mirror income tax codes.
- The IRS civil divisions will perform audits on businesses subject to these reporting requirements.

## CASH IS KING: RECENT DEVELOPMENTS & FORM 8300

- Penalties for Failing to File Form 8300
  - Civil penalties.
  - Criminal penalties.
    - Willful failure to File - 26 U.S.C. § 7203 (Felony subject to \$25,000 fine, up to 5 years imprisonment or both)
    - Filing False Return - 26 U.S.C. § 7206(1) (\$100,000 fine, up to 3 years imprisonment or both). 31 U.S.C. § 5322(a). (\$250,000, up to 5 year imprisonment or both).
- Under what situations are criminal penalties typically pursued?
  - Unusual to have a standalone charge with legal income sourced proceeds.
  - Typically tied to narcotics trafficking or other specified unlawful activity.

## CASH IS KING: RECENT DEVELOPMENTS & FORM 8300

- **Cal is a California resident. Cal bought a new car and sold his old one for \$11,000. The buyer paid Cal in cash. Does Cal have to file a Form 8300?**
  - No, because Cal is not in the trade or business of selling cars.
- **What if Cal owns a used car dealership and sells a used Toyota for \$19,000**
  - **Customer pays \$19,000 in cash?**
    - Cal has to file a Form 8300
  - **Customer pays \$19,000 with a personal check?**
    - Cal has no filing requirement
  - **Customer pays with a cashier's check for \$19,000?**
    - Cal does not have to file a Form 8300 (\$19,000 cashier's check is not treated as cash because its face value is more than \$10,000)
  - **Customer pays with two money orders (each for \$9,500)?**
    - Cal has to file a Form 8300 (although two money orders, Cal has received more than \$10,000 cash in one transaction)

## CASH IS KING: RECENT DEVELOPMENTS & FORM 8300

- **What if Cal owns a used car dealership. He sells a used Toyota for \$19,000**
  - **Customer wires \$15,000 from his bank account and gives \$4,000 in cash?**
    - Cal does not have to file a Form 8300 (A wire transfer does not constitute cash for Form 8300 reporting purposes since the remaining cash is below \$10,000)
  - **Customer is Cal's friend so Cal is flexible. Customer pays \$9,000 cash now and one month later pays \$10,000 cash**
    - Cal has to file a Form 8300 (even though more than 24 hours, the original sales contract was for \$19,000 and so this is a related transaction)
  - **Cal is not a California resident but is a resident of GUAM. Customer pays him \$9,500 cashier's check and \$9,500 cash?**
    - Cal has to file a Form 8300. The \$9,500 is cashier's check is treated as cash because its face value is not more than \$10,000.
    - ADDITIONALLY, even though Cal may have filed a Form 8300 with the territory's taxing agency, Cal must also file a Form 8300 with the IRS.

## REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS: FBAR

- In Guam there are a number of taxpayers who own assets or accounts in foreign jurisdictions. What are the reporting requirements:
  - A FBAR is a report of financial interest in, or authority over, a financial account (e.g., bank account, securities account) in a foreign country, which exceeds \$10,000 in the aggregate during one calendar year.
- **Example 1:** U.S citizen and Guam resident (Taxpayer) operates a business and files a return reporting income which includes interest income and business income. Taxpayer has a foreign account located in the Philippines. Taxpayer opened the account in the name of his children but he controls the account and has signatory authority over the account. The account is funded with \$500,000 of profits from Taxpayer's business. This year, the account earned 1% interest.
  - Does Taxpayer have to report foreign account?
    - YES
    - Taxpayer reports on Schedule B of his return indicating a foreign account. The account may be in the name of the children but the question for reporting purposes is whether the taxpayer has an account, is a beneficiary, or has signatory authority over the account.
    - Because the account has more than \$10,000, the taxpayer also has to file FBAR. The FBAR is electronically filed with FINCEN and is due April 15, 2016.

# FBAR

- **Example 2:** What if the account is funded with \$500,000 from a life insurance policy that taxpayer received following the death of his mother?
  - Life insurance proceeds are not taxable income.
  - Taxpayer is still required to declare the account and file a FBAR – it does not matter how the account was funded, only that there was more than \$10,000 in the account.
  - Any interest earned from non-taxable income is still reportable and taxable.
- **Example 3:** What if the account had \$10,000 of business receipts?
  - Taxpayer has to report the foreign account on Schedule B but does not have to file FBAR because the FBAR is triggered if the account has MORE than \$10,000.
- **Example 4:** What if Taxpayer had one account totaling \$5,000 in the name of his children and one account in the name of his business totaling \$6,000?
  - Taxpayer still has to declare he has a foreign account on Schedule B and is still required to file a FBAR because the FBAR is triggered if the foreign accounts in their aggregated total is more than \$10,000.

# CLAIMING DEPENDENTS

- There are 5 tests that must be met to be a qualifying child:
  - Relationship
  - Age
  - Residency
  - Support
  - Joint Return
- In most cases, because of the residency test a child of a divorces or separated parents is the qualifying child of the custodial parent. Custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other is the noncustodial parent.

## CLAIMING DEPENDENTS

Child will be treated as the qualifying child of the noncustodial parent if all four (4) of the following statements are true.

1. Parents are divorced or legally separated under a decree of divorce or separated under a written separation agreement, or lived apart at all times during the last 6 months of the year, whether or not they are or were married.
2. The child received over half of his or her support for the year from the parents.
3. The child is in the custody of one or both parents for more than half of the year.
4. Either one of the following statements are true.
  - Custodial parent signs a written declaration that the parent will not claim the child as a dependent for the year. If the decree or agreement went into effect after 1984 and before 2009, see Post 1984 and Pre-2009 divorce decree or separation agreement. If the decree or agreement went into effect after 2008, see Post 2008 divorce decree or separation agreement.
  - A Pre 1985 decree or separation agreement applies to 2015 if it states that the noncustodial parent can claim the child as a dependent, the decree or agreement wasn't changed after 1984 to say the noncustodial parent cannot claim the child as a dependent, and the noncustodial parent provides at least \$600 for the child's support during the year.

# CLAIMING DEPENDENTS

## ■ **Written Declaration**

- The custodial parent must use either Form 8332 or a similar statement (containing the same information required by the form) to make the written declaration to release the exemption to the noncustodial parent. The noncustodial parent must attach a copy of the form or statement to his or her tax return.
  - The exemption can be released for 1 year, for a number of specified years (for example, alternate years) or for all future years as specified in the declaration.

## ■ **Divorce Decree or Separate Agreement**

- If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332. The decree or agreement must provide the following:
  - The noncustodial parent can claim the child as a dependent without regard to any condition, such as a payment of support.
  - The custodial parent will not claim the child as a dependent for the year.
  - The years for which the noncustodial parent, rather than the custodial parent, can claim the child as a dependent.

## CLAIMING DEPENDENTS

- The noncustodial parent must attach all of the following pages of the decree or agreement to his or her return.
  - Cover page with the other parent's SSN.
  - Pages that include all of the information identified above.
  - Signature page with the other parent's signature and the date of the agreement
- **Post 2008 divorce decree or separation agreement**
  - A noncustodial parent claiming an exemption for a child cannot attach pages of the decree or agreement.
  - The noncustodial parent must complete and sign Form 8332 or a similar statement. The only purpose of this statement must be to release the custodial parent's claim to the child's exemption. The noncustodial parent must attach the form to his or her return. The form or statement must release the custodial parent's claim to the child without any conditions. For example the release must not depend on the noncustodial parent paying support.

## CLAIMING DEPENDENTS

- **Example 1** – Child lived with one parent greater number of nights. You and your child’s other parent are divorces. In 2015, your child lived with you 210 nights and with the other parent 155 nights.
  - You are custodial parent.
  - Assume child lived the same number of days with each parent.
    - Your son lived with you 180 nights during the year and lived the same number of nights with his other parent, your ex-spouse. Your AGI is \$40,000. Your ex-spouse’s SGI is \$25,000. You are treated as the custodial parent because you have the higher AGI.
- **Example 2** –
  - Child emancipated in May. Your son turned 18 in May 2015, he became emancipated under the laws of the state where he lives. As a result, he is not considered in the custody of his parents for more than half of the year. The special rule of divorced or separated parents does not apply.
  - Assume your child is emancipated in August. Your daughter lives with you from January 1, 2015 until May 31, 2015, and lives with her other parent, your ex-spouse from June 1, 2015 through the end of the year. She turns 18 and is emancipated under state law on August 1, 2015. Because she is treated as not living with either parent beginning August 1, 2015, she is treated as living with you the greater number of nights of 2015. You are the custodial parent.

## TAX TRIVIA

- Which of the issues below had the most lobbyist working on it in 1999?
  - Education
  - Taxation
  - Agriculture
  - Tobacco
- In 1999, taxation and the IRS Code had almost 3,000 lobbyists working on it, serving 1,411 interest groups.

## BUSINESS PRIVILEGE TAX: PROFESSIONALS

- With the on going military build-up, Guam has experiences an influx of various professionals. As an attorney who recently arrived, what are the local tax requirements and its authority?
  - Are there any exemptions?

## BPT: PROFESSIONALS

- **II GCA §26201. Levy.** There is hereby levied and shall be assessed and collected monthly privilege taxes against the persons on account of their businesses operating within and without Guam measured by the application of rates against values, gross proceeds, of sales or gross income, as the case may be.
- **II GCA §26202. Rates.**
  - (d) Professions. Upon every person engaging or continuing within Guam in the practice of a profession, excluding those expounding the religious doctrines of any church, a tax equivalent to four percent (4%) of the gross income of such practice.

## BPT: PRACTICE OF LAW

- What are local requirements for a practicing attorney in Guam?
  - Professionals are governed by the boards that are organized through local statute. Guam's local statute commonly known as GRT, is simply a 4% tax on the gross income received. This tax is assessed on a monthly basis and as such is due and payable on the 20<sup>th</sup> day of the following month.
- Is all income received taxable or are there any exemptions allowed for attorneys?
  - A taxpayer is allowed to exempt the first \$40,000 earned or received per taxable year by any person as income service, which includes but is not limited to legal, medical, dental, accounting, consulting, and engineering fees; commissions on real estate sales or property management; fees charged by barbershops, beauty parlors, shoe shining parlors, dry cleaning and laundry establishments; and automobile, appliance, electronic and computer repair shops, whose gross annual service income is less than \$50,000 during the most recent tax year. This exemption shall apply annually commencing on the first day of the month of the new tax year, subject to the gross annual service income of the person during the most recent tax year and shall end on the last day of the month on the same tax year.
  - What is the exemption amount allowed for the first year that an attorney started his or her practice?
    - Exemption is \$40,000. If the attorney's gross annual service income in the prior year is less than \$50,000, then the exemption is allowed.
  - What if the attorney's first year income is \$65,000?
    - The attorney is not allowed the exemption amount for the following year, whether or not he or she earned less than \$50,000

QUESTIONS ?

**Thank You!**