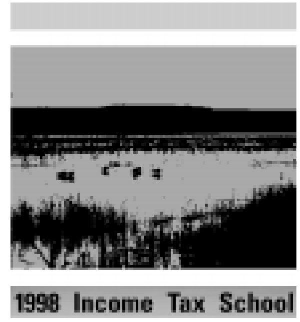
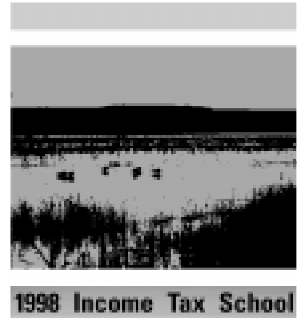


1998 TAX LEGISLATION



1998 TAX LEGISLATION

IRS RESTRUCTURING AND REFORM

Practitioner Note: All substantive changes to the 1997 Act and all technical corrections to that Act are included in that chapter.

1. DIRECTION TO COMMISSIONER TO RESTRUCTURE THE IRS

[Act §1001]

The IRS Commissioner is directed to restructure the IRS by eliminating or substantially modifying the present-law three-tier geographic structure (Figure 1) and replacing it with an organizational structure that features operating units serving particular groups of taxpayers with similar needs [generally, individuals, small businesses, large-sector corporations, and tax-exempt organizations] (see Figures 2 and 3). The plan is also required to ensure an independent appeals function within the IRS. **As part of ensuring an independent appeals function, the reorganization plan is to prohibit ex parte communications between appeals officers and other IRS employees to the extent such communications appear to compromise the independence of the appeals officers**.

Practitioner Note: The legality of IRS actions will not be affected pending further appropriate statutory changes relating to such a reorganization (e.g., eliminating statutory references to obsolete positions).

Effective Date. The provision is effective on the date of enactment (7-22-98).

2. DUTIES, RESPONSIBILITIES, AND POWERS OF A NEW IRS OVERSIGHT BOARD

General Responsibilities of the Board [Act §1101]

The Act provides for the establishment within the Treasury Department of the Internal Revenue Service Oversight Board (the "Board"). The general responsibilities of the Board are to oversee the Inter-

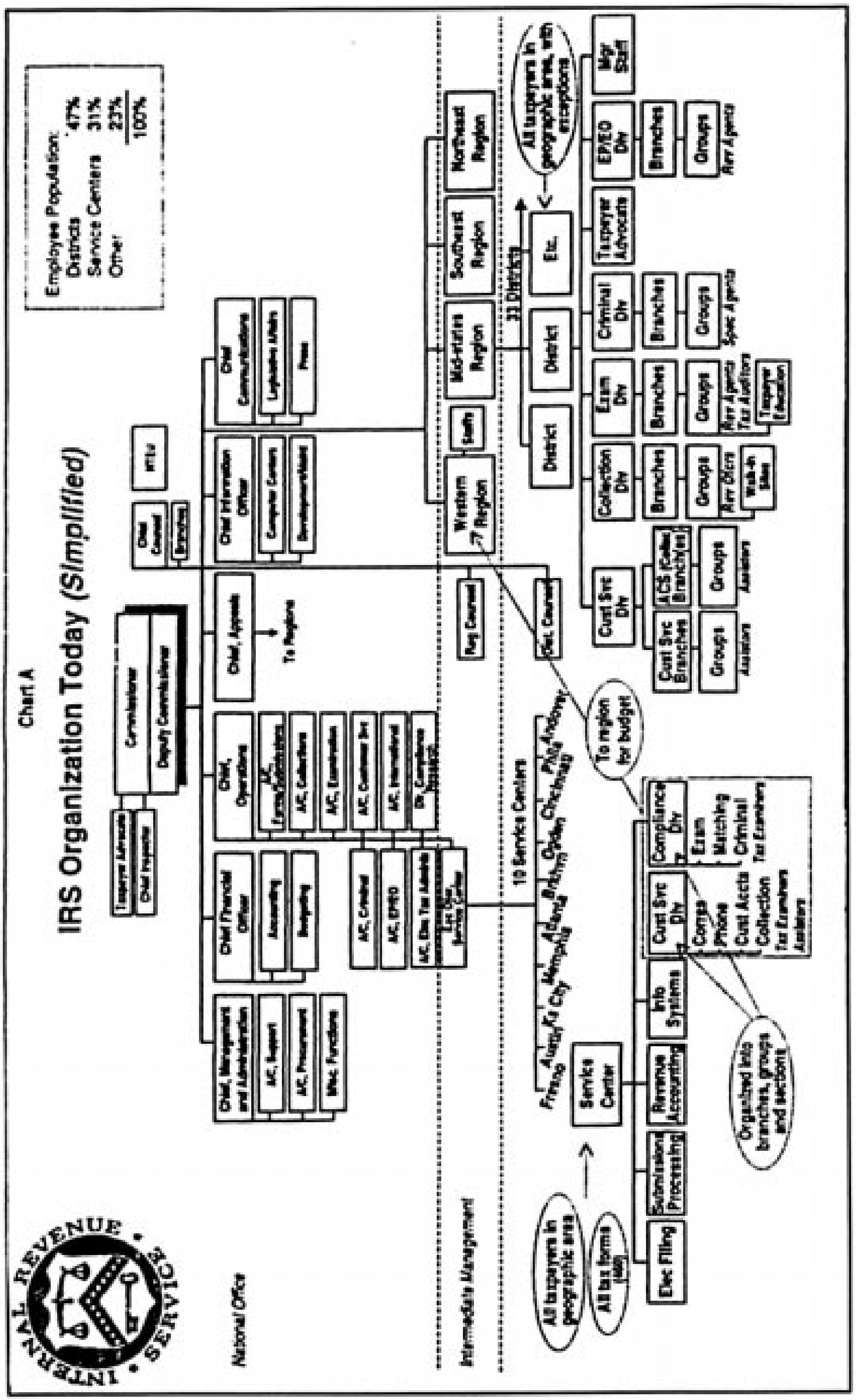


Chart A
IRS Organization Today (Simplified)
National Office
Intermediate Management
10 Service Centers
33 Districts

Figure 1

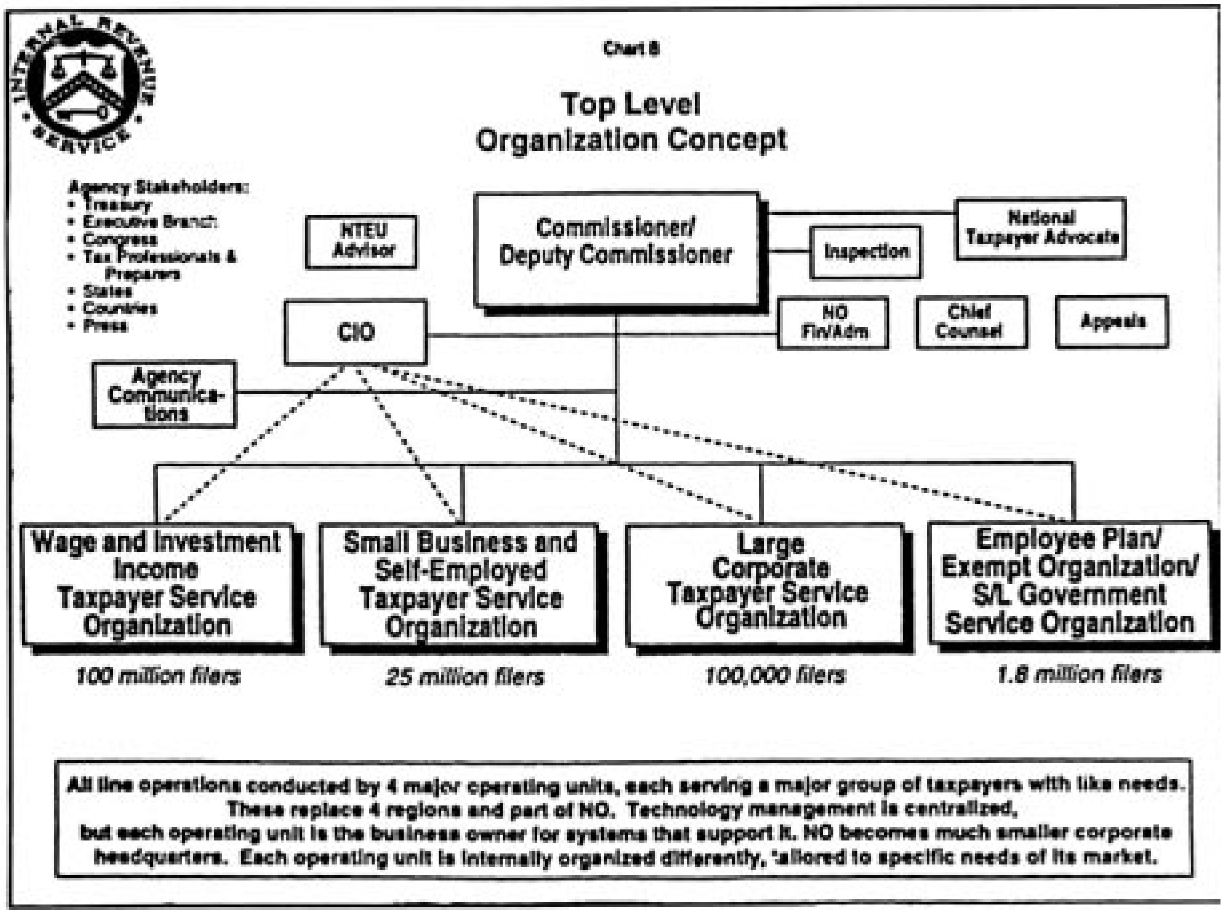


Chart 8
Top Level
Organization Concept
Agency Stakeholders:
• Treasury
• Executive Branch
• Congress
• Tax Professionals & Preparers
• States
• Countries
• Press
NTEU Advisor
Commissioner/ Deputy Commissioner
National Taxpayer Advocate
Inspection
CIO
NO Fin/Adm
Chief Counsel
Appeals
Agency Communications
Wage and Investment Income Taxpayer Service Organization
Small Business and Self-Employed Taxpayer Service Organization
Large Corporate Taxpayer Service Organization
Employee Plan/ Exempt Organization/ S/L Government Service Organization
100 million filers
25 million filers
100,000 filers
1.8 million filers
All line operations conducted by 4 major operating units, each serving a major group of taxpayers with like needs. These replace 4 regions and part of NO. Technology management is centralized, but each operating unit is the business owner for systems that support it. NO becomes much smaller corporate headquarters. Each operating unit is internally organized differently, tailored to specific needs of its market.

Figure 2

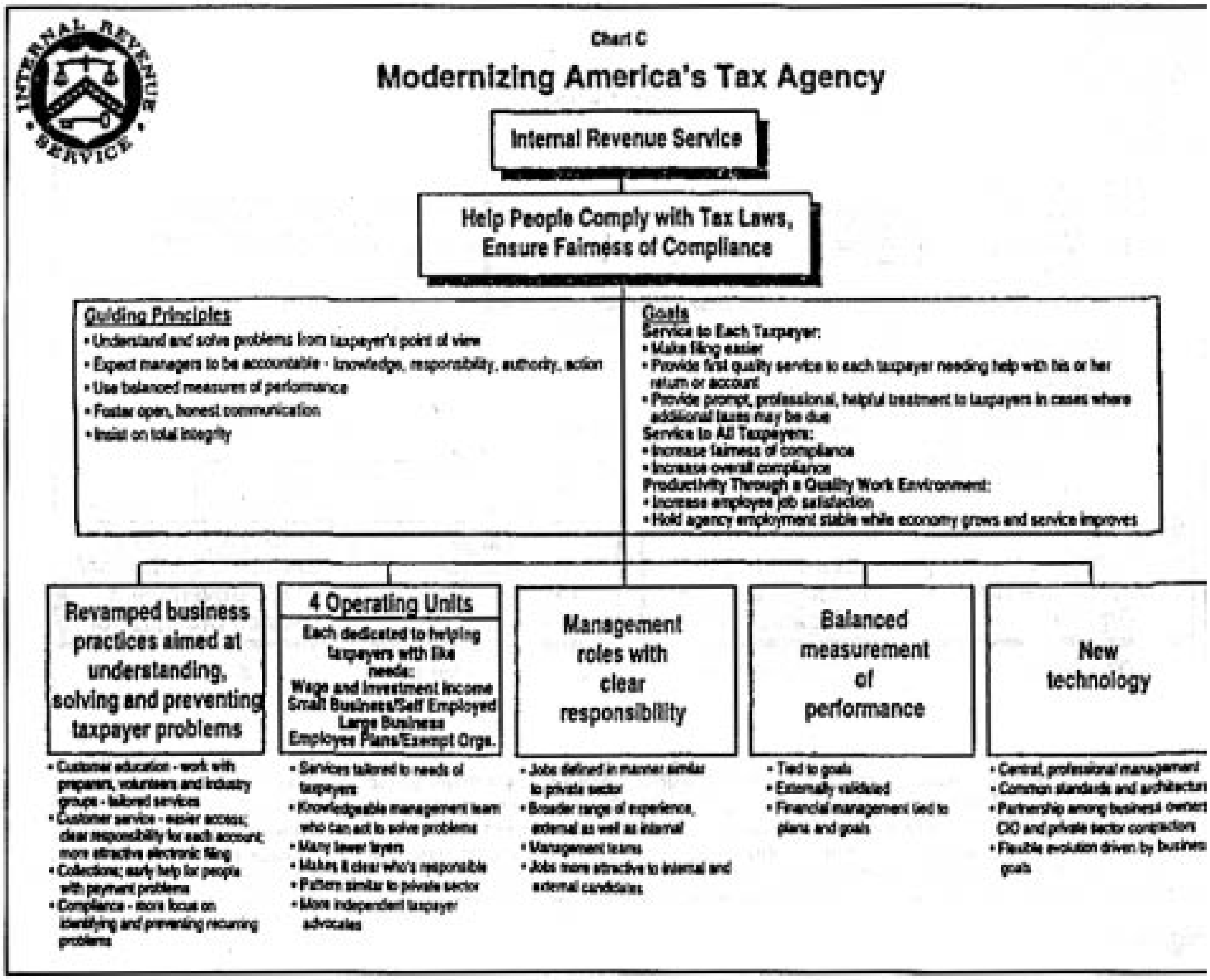

INTERNAL REVENUE SERVICE
Chart C
Modernizing America's Tax Agency
Internal Revenue Service
Help People Comply with Tax Laws, Ensure Fairness of Compliance
Guiding Principles
• Understand and solve problems from taxpayer's point of view
• Expect managers to be accountable - knowledge, responsibility, authority, action
• Use balanced measures of performance
• Foster open, honest communication
• Insist on total integrity
Goals
Service to Each Taxpayer:
• Make filing easier
• Provide first quality service to each taxpayer needing help with his or her return or account
• Provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due
Service to All Taxpayers:
• Increase fairness of compliance
• Increase overall compliance
Productivity Through a Quality Work Environment:
• Increase employee job satisfaction
• Hold agency employment stable while economy grows and service improves
Revamped business practices aimed at understanding, solving and preventing taxpayer problems
• Customer education - work with preparers, volunteers and industry groups - tailored services
• Customer service - easier access; clear responsibility for each account; more attractive electronic filing
• Collections; early help for people with payment problems
• Compliance - more focus on identifying and preventing recurring problems
4 Operating Units
Each dedicated to helping taxpayers with like needs:
Wage and Investment Income
Small Business/Self Employed
Large Business
Employee Plans/Exempt Orgs.
• Services tailored to needs of taxpayers
• Knowledgeable management team who can act to solve problems
• Many fewer layers
• Makes it clear who's responsible
• Pattern similar to private sector
• More independent taxpayer advocates
Management roles with clear responsibility
• Jobs defined in manner similar to private sector
• Broader range of experience, external as well as internal
• Management teams
• Jobs more attractive to internal and external candidates
Balanced measurement of performance
• Tied to goals
• Externally validated
• Financial management tied to plans and goals
New technology
• Central, professional management
• Partnership among business owners
CIO and private sector contractors
• Flexible evolution driven by
goals

Figure 3

nal Revenue Service (the "IRS") in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws.

The Board has **no responsibilities or authority with respect to**:

1. the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws;
2. law enforcement activities of the IRS, including compliance activities such as criminal investigations, examinations, and collection activities;
3. specific procurement activities of the IRS (e.g., selecting vendors or awarding contracts). [The Board **does have** the authority to recommend candidates for IRS Commissioner to the President, and to recommend removal of the Commissioner.]

In addition, the Board has **no authority** to: (1) intervene in specific taxpayer cases, including compliance activities involving specific taxpayers such as criminal investigations, examinations, and collection activities, or (2) intervene in specific individual personnel matters.

The Board **does have authority** with respect to general law enforcement matters, and it has the responsibility to ensure that the organization and operation of the IRS allows it to carry out its mission.

The mission statement is, "The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness."

Composition of the Board

The Board is composed of nine members. Six of the members are so-called "private-life" members who are not Federal officers or employees. These private-life members will be appointed by the President, with the advice and consent of the Senate. The remaining members are (1) the Secretary of the Treasury (or, if the Secretary so designates, the Deputy Secretary of the Treasury), (2) the Commissioner of the IRS, (3) an individual who is a full-time Federal employee or a representative of employees ("employee representative").

3. ELIMINATION OF OFFICE

The Act eliminates the statutory requirement contained in §7802(b) that there be an "Office of Employee Plans and Exempt Organizations" under the supervision and direction of an Assistant Commissioner. The legislative history expresses the Committee's Intent that a comparable structure be created administratively to ensure that adequate resources within the IRS are devoted to oversight of the tax-exempt sector.

Effective Date. 7-22-98.

4. NATIONAL TAXPAYER ADVOCATE

[IRS §7803]

It is intended that the renamed National Taxpayer Advocate has the responsibility to appoint local taxpayer advocates and make available at least one local taxpayer advocate for each State. That is, a local taxpayer advocate will be available to taxpayers in each State. The renamed "Advocate" has other taxpayer-friendly obligations.

5. NEW OFFICE

[I.R.C. §7803]

The Act establishes a new, independent, Treasury Inspector General for Tax Administration ("Treasury IG for Tax Administration") within the Department of the Treasury. The IRS Office of the Chief Inspector is eliminated, and all of its powers and responsibilities are transferred to the Treasury IG for Tax Administration. The role of the existing Treasury IG is redefined to exclude responsibility for the IRS.

Effective Date. 7-22-98.

6. EXECUTIVE OFFICE INFLUENCE ON AUDITS

Present Law. Under present law, there is no explicit prohibition in the Code on high-level Executive Branch influence over taxpayer audits and collection activity.

New Law. The Act makes it **unlawful** for a specified person to request that any officer or employee of the IRS conduct or terminate an audit or otherwise investigate or terminate the investigation of any particular taxpayer with respect to the tax liability of that taxpayer. The prohibition applies to the President, the Vice President, and employees of the executive offices of either the President or Vice President, as well as any individual (except the Attorney General) serving in a position specified in §5312 of Title 5 of the United States Code (these are generally Cabinet-level positions). **The prohibition applies to both direct requests and requests made through an intermediary.**

Effective Date. The provision applies to violations occurring after the date of enactment.

7. IRS PERSONNEL FLEXIBILITIES

[Act §1201(a)]

The Act requires the IRS to establish a new performance management system within **one year** from the **date of enactment.**

It is intended to give the IRS flexibility to establish a new performance management system. It is expected that this will refocus the IRS' personnel system on the overall mission of the IRS and how each employee's performance relates to that mission. Although the new performance standards are premised on the notion of retention, such standards go beyond simply establishing a retention/nonretention or pass-fail performance system. At a minimum, it is believed that there should be at least one standard above the retention standard. **This will enable managers to make meaningful distinctions among employees based on performance, to encourage employees to perform at a higher level, and to reward superior performance.**

TAXPAYER INFORMATION ENHANCEMENT

8. TAXPAYER ASSISTANCE ORDERS

[I.R.C. §7803]

The provision expands the circumstances under which a Taxpayer Assistance Order (TAO) may be issued. The Act provides that a "significant hardship" is deemed to occur if **one** of the following four factors exists: (1) there is an immediate threat of adverse action; (2) there has been a delay of more than 30 days in resolving the taxpayer's account problems; (3) the taxpayer will have to pay significant costs (including fees for professional services) if relief is not granted; or (4) the taxpayer will suffer **irreparable** injury, or long-term adverse impact, if relief is not granted. These factors are not an exclusive list of what constitutes a significant hardship; a TAO may also be issued in other circumstances in which it is determined that the taxpayer is or will suffer a significant hardship.

Effective Date. 7-22-98.

9. SUSPENSION OF INTEREST AND CERTAIN PENALTIES IF SECRETARY FAILS TO CONTACT INDIVIDUAL TAXPAYER

[I.R.C. §6404(h) and §6404(g)]

Present Law. In general, interest and penalties accrue during periods for which taxes are unpaid without regard to whether the taxpayer is aware that there is tax due.

The Act. The Act suspends the accrual of penalties and interest after 18[1] months if the IRS has not sent the taxpayer a notice of deficiency within 18 months following the date on which the return was timely filed. The suspension applies only to taxpayers who file a timely tax return. The Act applies only to individuals and **does not** apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. **Interest and penalties resume 21 days after the IRS sends a notice and demand for payment to the taxpayer.**
For example, if the IRS sends a math error notice to a taxpayer two months after the return is filed and also sends a notice of deficiency related to a different item two years later, the provision applies to

the item reflected on the second notice (notwithstanding that the first notice was sent within the applicable time period).

Effective Date. Notices issued, and penalties assessed for tax years ending after 7-22-1998.

1. [This applies to taxable years beginning before 1-1-2004; it is 12 months thereafter]

10. NOTICE OF INTEREST CHARGES

[I.R.C. §6631]

The Act requires every IRS notice that is sent to an individual taxpayer and includes an amount of interest required to be paid by the taxpayer to include a detailed computation of the interest charged and a citation to the Code section under which such interest is imposed

.

Effective Date. Notices issued after 12-31-2000.

11. UNIFORM APPLICATION OF CONFIDENTIALITY TO TAXPAYER COMMUNICATIONS WITH FEDERALLY AUTHORIZED PRACTITIONERS

[I.R.C. §7525]

The Act extends the present law attorney-client privilege of confidentiality to **tax advice that is furnished to a client-taxpayer (or potential client-taxpayer) by any individual who is authorized under Federal law to practice before the IRS if such practice is subject to regulation under §330 of Title 31, United States Code**.

Individuals subject to regulation under §330 of Title 31, United States Code include **attorneys**, **certified public accountants**, **enrolled agents** and **enrolled actuaries**. Tax advice means advice that is within the scope of authority for such individual's practice with respect to matters under Title 26 (the Internal Revenue Code). The privilege of confidentiality may be asserted in any noncriminal tax proceeding before the IRS, as well as in noncriminal tax proceedings in the Federal Courts where the IRS is a party to the proceeding.

The provision allows taxpayers to consult with other qualified tax advisors in the same manner they currently may consult with tax advisors that are licensed to practice law. **The provision does not modify the attorney-client privilege of confidentiality, other than to extend it to other authorized practitioners**. The privilege established by the provision applies only to the extent that communications would be privileged if they were between a taxpayer and an attorney. Accordingly, the privilege does not apply to any communication between a certified public accountant, enrolled agent, or enrolled actuary and such individual's client (or prospective client) if the communication would not have been privileged between an attorney and the attorney's client or prospective client.

For example, information disclosed to an attorney for the purpose of preparing a tax return is not privileged under present law. Such information would not be privileged under the provision, whether it was disclosed to an attorney, a certified public accountant, an enrolled agent, or an enrolled actuary.

The privilege granted by the provision may be asserted only in noncriminal tax proceedings before the IRS and in the Federal Courts with regard to such noncriminal tax matters in proceedings where

the IRS is a party. The privilege **may not** be asserted to prevent the disclosure of information to any regulatory body other than the IRS.

Effective Date. The provision is effective with regard to communications made on or after 7-22-98.

12. NOTICE OF IRS CONTACT OF THIRD PARTIES

[I.R.C. §7609(a)(1) and 7602(c)]

The Act provides that the IRS may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice in advance to the taxpayer that the IRS may contact persons other than the taxpayer. It is intended that in general this notice will be provided as part of an existing IRS notice provided to taxpayers.

The Act also requires the IRS to provide periodically to the taxpayer a record of persons previously contacted during that period by the IRS with respect to the determination or collection of that taxpayer's tax liability. This record shall also be provided upon request of the taxpayer.

The provision does not apply to criminal tax matters, instances when the collection of the tax liability is in jeopardy; instances when the Secretary determines for good cause shown that disclosure may involve reprisal against any person; or instances when the taxpayer authorized the contact.

Effective Date. Contacts made after 180 days after 7-22-98.

13. DISCLOSURE OF CRITERIA FOR EXAMINATION SELECTION

[Act §3502]

The provision requires that IRS add to Publication 1 ("Your Rights as a Taxpayer") a statement that sets forth, in simple and nontechnical terms, the criteria and procedures for selecting taxpayers for examination. The statement must not include any information the disclosure of which would be detrimental to law enforcement. The statement must specify the general procedures used by the IRS, including whether taxpayers are selected for examination on the basis of information in the media or from informants.

Effective Date. The addition to Publication 1 must be made not later than 180 days after 7-22-98.

14. EXPLANATION OF REASON FOR REFUND DISALLOWANCE

[I.R.C. §6402(j)]

Present Law. The Examination Division of the IRS examines claims for refund submitted by taxpayers. The Internal Revenue Manual requires examination or other audit action on refund claims within 30 days after receipt of the claims. The refund claim is preliminarily examined to determine whether it should be disallowed. The taxpayer will receive a form from the IRS stating that the claim for refund cannot be considered. Other cases will be examined as quickly as possible and the disposition of the case, including the reasons for the disallowance or partial disallowance of the claim for refund.

New Law. The Act requires the IRS to notify the taxpayer of the specific reasons for the disallowance (or partial disallowance) of the refund claim.

Effective Date. 180 days after 7-22-98.

15. DISCLOSURE OF CHIEF COUNSEL ADVICE

[I.R.C. § 6110]

Present Law

There has been controversy as to whether the Office of Chief Counsel must release forms of advice other than written determinations pursuant to the Freedom of Information Act (FOIA)[1]. In *Tax Analysts v. IRS,* the D.C. Circuit held that the legal analysis portions of field service advice created in the context of specific taxpayers' cases are not "return information," as defined by §6103(b)(2), and **must be released under** FOIA. The court also found that portions of field service advice issued in docketed cases may be withheld as privileged attorney work product. However, some issues remain outstanding. Although the extent to which such materials must be released is still in dispute, it is clear that they are not expressly covered by I.R.C. §6110. As a consequence, there exists no mechanism by which taxpayers may participate in the administrative process of redacting their private information from such documents or to resolve disagreements in court.

New Law

In general. Pursuant to the Act, the written documents issued by the National Office of Chief Counsel to its field components and field agents of the IRS should be subject to public release in a manner similar to technical advice memoranda or other written determinations. In this way, all taxpayers can be assured of access to the "considered view of the Chief Counsel's national office on significant issues." Creating a structured mechanism by which these types of legal memoranda are open to public inspection will increase the public's confidence that the tax system operates fairly and in an even-handed manner with respect to all taxpayers.

As part of making these documents public, however, the privacy of the taxpayer who is the subject of the advice must be protected. Any procedure for making such advice public must therefore include adequate safeguards for taxpayers whose privacy interests are implicated. There should be a mechanism for taxpayer participation in the deletion of any private information. There should also be a process whereby appropriate governmental privileges may be asserted by the IRS and contested by the public or the taxpayer.

Effective Date. The provision applies to Chief Counsel Advice issued more than 90 days after 7-22-98.

16. MATHEMATICAL OR CLERICAL ERRORS—NOTICE TO TAXPAYERS

The IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. **Where the IRS uses the summary assessment procedure for mathematical or cleri-**

1. Definition of Chief Counsel Advice.- For purposes of this provision, Chief Counsel Advice is written advice or instruction prepared and issued by any national office component of the Office of Chief Counsel to field employees of the Service or the Office of Chief Counsel that convey certain legal interpretations or positions of the IRS or the Office of Chief Counsel concerning existing or former revenue provisions. For these purposes, the term "revenue provisions" includes, without limitation: the Internal Revenue Code itself; regulations, revenue rulings, revenue procedures, or other administrative interpretations or guidance, whether published or unpublished (including, for example, other Chief Counsel Advice); tax treaties; and court decisions and opinions. Chief Counsel Advice also includes legal interpretation of State law, foreign law, or other federal law relating to the assessment or collection of liabilities under revenue provisions.

cal errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire.

If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures.

The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he or she believes the assessment was made in error.

Effective Date. Effective for tax years ending after 7-22-98.

17. LISTING OF LOCAL IRS TELEPHONE NUMBERS AND ADDRESSES

[Act §3709]

The Act requires the IRS, as soon as is practicable but no later than 180 days after the date of enactment, to publish addresses and local telephone numbers of local IRS offices in appropriate local telephone directories.

Effective Date. The provision is effective on 7-22-98.

18. LIMITATION ON FINANCIAL STATUS AUDIT

[Act §3412]

The Act prohibits IRS from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS has a reasonable indication that there is a likelihood of unreported income.

Effective Date. The provision is effective on 7-22-98.

19. EXPLANATION OF THE APPEALS AND COLLECTION PROCESS

[Act §3504]

New Law. The provision requires that, no later than 180 days after the date of enactment, a description of the entire process from examination through collections, including the assistance available to taxpayers from the Taxpayer Advocate at various points in the process, be provided with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review by the IRS Office of Appeals.

Effective Date. The provision requires that the explanation be included as soon as practicable, but no later than 180 days after 7-22-98.

OFFERS-IN-COMPROMISE AND INSTALLMENT PAYMENT AGREEMENTS

20. OFFERS-IN-COMPROMISE

[I.R.C. §§6331(k) and 7122]

Present Law

The Code permits the IRS to compromise a taxpayer's liability. An offer-in-compromise is an offer by the taxpayer to settle unpaid tax accounts for less than the full amount of the assessed balance due. An offer-in-compromise may be submitted for all types of taxes, as well as interest and penalties, arising under the Internal Revenue Code.

There are two bases on which an offer can be made: doubt as to **liability for** the amount owed and doubt as to **ability to pay** the amount owed.

A compromise agreement based on doubt as to **ability to pay** requires the taxpayer to file returns and pay taxes for five years from the date the IRS accepts the offer. Failure to do so permits the IRS to begin immediate collection actions for the original amount of the liability. The Internal Revenue Manual provides guidelines for revenue officers to determine whether an offer-in-compromise is adequate. An offer is adequate if it **reasonably reflects collection potential**. Although the revenue officer is instructed to consider the taxpayer's assets and future and present income, the IRM advises that rejection of an offer solely based on narrow asset and income evaluation should be avoided.

Pursuant to the IRM, collection normally is withheld during the period an offer-in-compromise is pending, unless it is determined that the offer is a delaying tactic and collection is in jeopardy.

New Law

Rights of taxpayers entering into offers-in-compromise. The Act requires the IRS to develop and publish schedules of national and local allowances that will provide taxpayers entering into an offer-in-compromise with adequate means to provide for basic living expenses.

The IRS also is required to consider the facts and circumstances of a particular taxpayer's case in determining whether the national and local schedules are adequate for that particular taxpayer. If the facts indicate that use of scheduled allowances would be inadequate under the circumstances, the taxpayer is **not** limited by the national or local allowances.

The Act prohibits the IRS from rejecting an offer-in-compromise from a low-income taxpayer **solely on the basis of the amount of the offer**. The Act provides that, in the case of an offer-in-compromise submitted solely on the basis of doubt as to liability, the IRS may not reject the offer merely because the IRS cannot locate the taxpayer's file. **It prohibits the IRS from requesting a financial statement if the taxpayer makes an offer-in-compromise based solely on doubt as to liability**.

Suspend collection by levy while offer-in-compromise is pending. The Act prohibits the IRS from collecting a tax liability levy

1. during any period that a taxpayer's offer-in-compromise for that liability is being processed,
2. during the 30 days following rejection of an offer, and
3. during any period in which an appeal of the rejection of an offer is being considered.

Taxpayers whose offers are rejected and who make good faith revisions of their offers and resubmit them within 30 days of the rejection or return are eligible for a continuous period of relief from collection by levy. This prohibition on collection by levy would not apply if the IRS determines that collection is in **jeopardy** or that the offer was submitted solely to **delay** collection. The Act provides that the statute of limitations on collection will be tolled for the period during which collection by levy is barred.

Procedures for reviews or rejections of offers-in-compromise and installment agreements. The Act requires that the IRS implement procedures to review all proposed IRS rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer. It also requires the IRS to allow the taxpayer **to appeal** any rejection of suchoffer or agreement to the IRS Office of Appeals. The IRS must notify taxpayers of their right tohave an appeals officer review a rejected offer-in-compromise, on the application form for anoffer-in-compromise.

Liberal acceptance policy. The Act provides that the IRS will adopt a liberal acceptance policy for offers-in-compromise to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.

Effective Date. Generally effective for offers-in-compromise submitted after 7-22-98. However, the provision suspending levy is effective with respect to offers-in-compromise pending on or made after December 31, 1999.

The provision suspending collection by levy while an offer-in-compromise is pending is also expanded to apply while an installment agreement is pending.

The provision authorizes the Secretary to prescribe guidelines for the IRS to determine whether an offer-in-compromise is adequate and should be accepted to resolve a dispute. Accordingly, the present regulations **will be expanded** so as to permit the IRS, in certain circumstances, to consider additional factors (i.e., factors other than doubt as to liability or collectibility) **in determining whether to compromise the income tax liabilities of individual taxpayers**.

For example, it is anticipated that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. Among other situations, the IRS may utilize this new authority to resolve long-standing cases by forgoing penalties and interest that accumulated as a result of delay in determining the taxpayer's liability. In addition, the IRS is to be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the IRS is to attempt to make it easier for taxpayers to enter into offer-in-compromise agreements, and do more to educate the taxpaying public about the availability of such agreements.

21. AGREEMENTS FOR PAYMENT OF TAX LIABILITY IN INSTALLMENTS

[I.R.C. §6159]

Present Law. The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed. An installment agreement does not reduce the amount of taxes, interest, or penalties owed, but does provide for a longer period during which payments may be made during which other IRS enforcement actions (such as levies or seizures) are held in abeyance. The IRS in most instances readily approves these requests if the amounts involved are not large (in general, below $10,000) and if the taxpayer has filed tax returns on time in the past. Some taxpayers are required to submit background information to the IRS substantiating their application.

New Law. The Act requires the Secretary to enter an installment agreement, at the taxpayer's option, if:

1. the liability is $10,000, or less (excluding penalties and interest);
2. within the previous 5 years, the taxpayer has not failed to file or to pay, nor entered an installment agreement under this provision;
3. if requested by the Secretary, the taxpayer submits financial statements, and the Secretary determines that the taxpayer is unable to pay the tax due in full;
4. the installment agreement provides for full payment of the liability within 3 years; and
5. the taxpayer agrees to continue to comply with the tax laws and the terms of the agreement for the period (up to 3 years) that the agreement is in place.

Effective Date. 7-22-98.

21A. MITIGATION OF PENALTY ON INDIVIDUAL'S FAILURE TO PAY FOR MONTHS DURING PERIOD OF INSTALLMENT AGREEMENT

[I.R.C. §§6651, 6159]

Present Law. Taxpayers who fail to pay their taxes are subject to a penalty of one-half percent per month on the unpaid account, up to a maximum of 25 percent (§6651(a)). If the liability should have been shown on the return but was not, the penalty generally begins to accrue after the date that is 21 days from the date of the IRS notice and demand for payment with respect to such liability (§6651 (a)(3)). Taxpayers who make installment payments pursuant to an agreement with the IRS (under §6159) are also subject to this penalty (Treas. reg. §301.6159-1(f) and §6601(b)).

Explanation of Act. The Act provides that the penalty for failure to pay taxes is not imposed with respect to the tax liability of an individual for any month in which an installment payment agreement with the IRS (under §6159) is in effect, provided that the individual filed the tax return in a timely manner (including extensions)

Effective Date. Installment payments made after 12-31-1999.

ELECTRONIC FILING ITEMS

22. ELECTRONIC FILING OF TAX AND INFORMATION RETURNS

[ACT §2001(a)]

The Act states that the policy of Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least 80 percent of all tax returns in electronic form by the year 2007. The provision requires the Secretary of the Treasury to establish a strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase taxpayer use of electronic filing. The provision requires all returns prepared in electronic form but filed in paper form to be filed electronically, to the extent feasible, by the year 2002.

Effective Date. 7-22-98.

23. DUE DATE FOR CERTAIN INFORMATION RETURNS

[I.R.C. §6071 (b)]

Present Law. Information such as the amount of dividends, partnership distributions, and interest paid during the calendar year must be supplied to taxpayers by the payors by January 31 of the following calendar year. The payors must file an information return with the IRS with the information by February 28 of the year following the calendar year for which the return must be filed. Under present law, the due date for filing information returns with the IRS is the same whether such returns are filed on paper, on magnetic media, or electronically. Most information returns are filed on magnetic media (such as computer tapes), which are physically shipped to the IRS.

New Law. The Act provides an incentive to filers of information returns to use electronic filing by extending the due date for filing such returns with the IRS from February 28 (under present law) to March 31 of the year following the calendar year to which the return relates.

Effective Date. Information returns required to be filed after December 31, 1999.

24. PAPERLESS ELECTRONIC FILING

[I.R.C. §6011]

Present Law. Code §6061 requires that tax forms be signed as required by the Secretary. The IRS will not accept an electronically filed return unless it has also received a Form 8453, which is a paper form that contains signature information of the filer.

A return generally is considered timely filed when it is received by the IRS on or before the due date of the return. If the requirements of Code §7502 are met, timely mailing is treated as timely filing. If the return is mailed by registered mail, the dated registration statement is prima facie evidence of delivery.

The IRS periodically publishes a list of the forms and schedules that may be electronically transmitted, as well as a list of forms, schedules, and the information that cannot be electronically filed.

New Law. The Act requires the Secretary to develop procedures that **would eliminate** the need to file a paper form relating to signature information. Until the procedures are in place, the provision authorizes the Secretary to provide for alternative methods of signing all returns, declarations, statements, or other documents or to waive the signature requirement. An alternative method of signature would be treated identically, for both civil and criminal purposes, as a signature on a paper form.

The provision also provides rules for determining when electronic returns are deemed filed and for authorization for return preparers to communicate with the IRS on matters included on electronically filed returns.

The provision requires the Secretary to establish procedures, to the extent practicable, to receive all forms electronically for taxable periods beginning after December 31, 1999.

Effective Date. 7-22-98.

25. ELECTRONIC ACCESS TO ACCOUNT INFORMATION

[Act §2005]

Present Law. Taxpayers who file their returns electronically cannot review their accounts electronically.

New Law. The Act requires the Secretary to develop procedures not later than December 31, 2006, under which a taxpayer filing returns electronically (or the taxpayer's designee under §6103(c)) could review the taxpayer's own account electronically, but not if all necessary privacy safeguards are not in place by that date.

LIENS, LEVIES, AND COLLECTIONS

26. CIVIL DAMAGES FOR COLLECTION CASES

[I.R.C. §7433]

Present Law. A taxpayer may sue the United States for up to $1 million of civil damages caused by an officer or employee of the IRS who recklessly or intentionally disregards provisions of the Internal Revenue Code or Treasury regulations in connection with the collection of Federal tax with respect to the taxpayer.

New Law. The Act permits up to $100,000 in civil damages caused by an officer or employee of the IRS who **negligently disregards** provisions of the Internal Revenue Code or Treasury regulations in connection with the collection of Federal tax with respect to the taxpayer. The provision also permits up to $1 million in civil damages caused by an officer or employee of the IRS who **willfully** violates provisions of the Bankruptcy Code relating to automatic stays or discharges. The provision also provides that persons other than the taxpayer may sue for civil damages for unauthorized collection actions.

Effective Date. Actions of officers or employees of the IRS occurring after 7-22-98.

27. DUE PROCESS IN IRS COLLECTION ACTIONS

[I.R.C. §§6320, 6330, 7443(a)(5), 7443A(b)(4)]

New Law. The Act establishes formal procedures designed to ensure due process where the IRS seeks to collect taxes by levy (including by seizure). The due process procedures also apply after the Federal tax lien attaches, but before the notice of the Federal tax lien has been given to the taxpayer.

As under present law, notice of the intent to levy must be given at least 30 days (90 days in the case of a life insurance contract) before property can be seized or salary and wages garnished. During the 30-day (90-day) notice period, the taxpayer may demand a hearing to take place before an **appeals officer** who has had no prior involvement in the taxpayer's case. If, within that period, the taxpayer demands a hearing, the proposed collection action may not proceed until the hearing has concluded and the appeals officer has issued his or her determination.

Service by registered or certified mail, return receipt requested would be required. The Notice of Intent to Levy would be required to itemize the property the Secretary seeks to levy on.

Prior judicial approval required for seizures of principal residences
[I.R.C. §7443 A(b)]

No seizures of a dwelling that is the principal residence of the taxpayer or the taxpayer's spouse, former spouse, or minor child would be allowed without prior judicial approval. Notice of the judicial hearing must be provided to the taxpayer and family members residing in the property. At the judicial hearing, the Secretary would be required to demonstrate (1) that the requirements of any applicable law or administrative procedure relevant to the levy have been met, (2) that the liability is owed, and (3) that no reasonable alternative for the collection of the taxpayer's debt exists.

During the hearing, the IRS is required to verify that all statutory, regulatory, and administrative requirements for the proposed collection action have been met.

The taxpayer (or affected third party) is allowed to raise any relevant issue at the hearing.

Once the taxpayer has had a hearing with respect to an issue, the taxpayer would not be permitted to raise the same issue in another hearing.

The determination of the appeals officer is to address whether the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the taxpayer that the collection action be no more intrusive than necessary.

The taxpayer may contest the determination of the appellate officer in Tax Court by filing a petition within 30 days of the date of the determination. The IRS may not take any collection action pursuant to the determination during such 30-day period or while the taxpayer's contest is pending in Tax Court.

IRS Appeals would retain jurisdiction over its determinations. IRS Appeals could enter an order requiring the IRS collection division to adhere to the original determination. In addition, the taxpayer would be allowed to return to IRS Appeals to seek a modification of the original determination based on any change of circumstances.

In the case of a continuous levy, the due process procedures would apply to the original imposition of the levy.

This provision does not apply in the case of jeopardy and termination assessments. Jeopardy and termination assessments would be subject to post-seizure review as part of the Appeals determination hearing as well as through any existing judicial procedure. A jeopardy or termination assessment must be approved by the IRS District Counsel responsible for the case. Failure to obtain District Counsel approval would render the jeopardy or termination assessment void.

28. LIENS

[I.R.C. §6320]

Taxpayers have a right to a hearing after the Notice of Lien is filed. The IRS would be required to notify the taxpayer that a Notice of Lien had been filed within five days after filing. During the 30-day period beginning with the mailing or delivery of such notification, the taxpayer may demand a hearing before an **appeals officer** who has had no prior involvement with the taxpayer's case. In general, any issue relevant to the appropriateness of the proposed collection against the taxpayer can be raised at this hearing. For example, the taxpayer can request innocent spouse status, make an offer-in-compromise, request an installment agreement, or suggest which assets should be used to satisfy the tax liability. However, the validity of the tax liability can be challenged only if the taxpayer did not actually receive the statutory notice of deficiency or has not otherwise had an opportunity to dispute the liability. This hearing right applies only after the first Notice of Lien with regard to each tax liability is filed.

29. MODIFICATIONS TO CERTAIN LEVY EXEMPTION AMOUNTS

[I.R.C. §6334(a)(2) and (3)]

The Act increases the value of personal effects exempt from levy to $6,250 and the value of books and tools exempt from levy to $3,125. These amounts are indexed for inflation.

Effective Date. Levies issued after 7-22-98.

30. RELEASE OF LEVY UPON AGREEMENT THAT AMOUNT IS UNCOLLECTIBLE

[I.R.C. §6343(e)]

The Act requires the IRS to release a wage levy as soon as is practical upon agreement with the taxpayer that the tax is **not collectible**.

Effective Date. Levies imposed after December 31, 1999.

31. WAIVER OF EARLY WITHDRAWAL TAX FOR IRS LEVIES ON EMPLOYER-SPONSORED RETIREMENT PLANS OR IRAS

[I.R.C. §72(d)(2)(A)(iii)]

The Act provides an exception from the 10% early withdrawal tax for amounts withdrawn from an employer-sponsored retirement plan or an IRA that are subject to a levy by the IRS. The exception applies only if the plan or IRA is levied; it does not apply, for example, if the taxpayer withdraws funds to pay taxes in the absence of a levy, or in order to release a levy on other interests.

Effective Date. The provision is effective for distributions after December 31, 1999.

32. CODIFICATION OF IRS ADMINISTRATIVE PROCEDURES FOR SEIZURE OF TAXPAYER'S PROPERTY

[I.R.C. §6331(j)]

Present Law. The Internal Revenue Manual (IRM) provides general guidelines for seizure actions. Prior to the levy action, the revenue officer must determine that there is sufficient equity in the property to be seized to yield net proceeds from the sale to apply to unpaid tax liabilities. If it is determined after seizure that the taxpayer's equity is insufficient to yield net proceeds from the sale to apply to the unpaid tax, the revenue officer will immediately release the seized property.

New Law. The Act codifies the IRS Administrative procedures that require the IRS to investigate the status of property prior to levy.

Effective Date. 7-22-98.

33. PROCEDURES FOR SEIZURE OF RESIDENCES AND BUSINESSES

[I.R.C. §6334(a)(13)(A)]

Present Law. Subject to certain procedural rules and limitations, the Secretary may seize the property of the taxpayer who neglects or refuses to pay any tax within 10 days after notice and demand. The IRS may not levy on the personal residence of the taxpayer unless the District Director (or the assistant District Director) personally approves in writing or in cases of jeopardy. **There are no special rules for property that is used as a residence by parties other than the taxpayer**. IRS Policy Statement P-5-34 states that the facts of a case and alternative collection methods must be thoroughly considered before deciding to seize the assets of a going business.

New Law. The prohibition on seizing a residence to satisfy an unpaid liability of $5,000 or less is clarified to apply to **any real property** used as a residence by the taxpayer or any nonrental real property of the taxpayer used by any other individual as a residence.

The definition of business assets **is clarified** to apply to tangible personal property or real property used in the trade or business of an individual taxpayer (other than real property that is rented).

The Act provides that a levy is permitted on a principal residence only if a judge or magistrate of a United States district court approves of the levy (in writing).

Effective Date. 7-22-98.

RELIEF FOR INNOCENT SPOUSES AND FOR TAXPAYERS UNABLE TO MANAGE THEIR FINANCIAL AFFAIRS DUE TO DISABILITIES

34. RELIEF FOR INNOCENT SPOUSES

[I.R.C. §6015 (b)(2)]

Present Law. Under present law, relief from liability for tax, interest and penalties is available for "innocent spouses" in certain circumstances. To qualify for such relief, the innocent spouse must establish: (1) that a joint return was made; (2) that **an understatement of tax**, which exceeds the greater of $500 or a **specified percentage** of the innocent spouse's adjusted gross income for the preadjustment (most recent) year, is attributable to a **grossly erroneous item** of the other spouse; (3) that in signing the return, the innocent spouse **did not know**, and **had no reason to know**, that there was an understatement of tax; and (4) that taking into account all the facts and circumstances, it is **inequitable** to hold the innocent spouse liable for the deficiency in tax.

The specified percentage of adjusted gross income is 10 percent if adjusted gross income is $20,000 or less. Otherwise, the specified percentage is 25 percent.

The proper forum for contesting the Secretary's denial of innocent spouse relief was determined by whether an underpayment was asserted or the taxpayer was seeking a refund of overpaid taxes. Accordingly, the Tax Court **probably did not have jurisdiction** to review all denials of innocent spouse relief.

Notice 1213. Changes to Innocent Spouse Rules (August 1998). The March 1998 version of Form 8857, Request for Innocent Spouse Relief, no longer reflects current tax law as a result of the Internal Revenue Service Restructuring and Reform Act of 1998. The new law applies to **any tax liability arising after July 22, 1998. It also applies to a prior tax liability which was unpaid as of that date.**

Form 8857 and its instructions are currently being revised. The new version will be available in the near future. If you want to file for innocent spouse relief before the revised instructions are available, please disregard the following items on the March 1998 form.

1. The **Caution** above line 3. You now can file Form 8857 if the additional tax due is $500 or less.
2. The word "grossly" wherever used. You are no longer restricted to having "grossly" erroneous items to qualify for innocent spouse relief.

Please use the instructions only as a guide in completing the form and for address and assistance information. The instructions do not reflect the new tax law.

Pub. 971, Innocent Spouse Relief (4-98), is also being revised.

If you have any questions or need help in completing the form, call 1-800-829-1040.

Note the following important changes in the law:

1. Relief now applies to **all** understatements due to erroneous items of the other spouse.
2. The **substantial requirement** no longer applies.
3. The items no longer have to be **grossly** erroneous, just erroneous.
4. The spouse seeking relief **still must establish** that he or she did not know or had no reason to know there was an understatement of tax.
5. The election for relief will be on an IRS form. [Form 8857]
6. Under the right circumstances there is either "innocent spouse" relief [I.R.C. §6015(a)] or separate liability relief [I.R.C. §6015(b)].
7. Under the separate liability provision the spouse only has to prove that he or she did not have "actual knowledge" of the understatement of tax. "Innocent spouse" relief requires that the spouse must prove that he or she "did not know or should not have known" of the understatement.

Note: The innocent "spouse provision" and "separate liability" provision of the new law are different.

Code Section6015. Relief from joint and several liability on joint return

(a) In General. Notwithstanding §6013(d)(3)–
(1) an individual who has made a joint return may elect to seek relief under the procedures prescribed under subsection (b), and
(2) if such individual is eligible to elect the application of subsection (c), such individual may, in addition to any election under paragraph (1), elect to limit such individual's liability for any deficiency with respect to such joint return in the manner prescribed under subsection (c).
Any determination under this section shall be made without regard to community property laws.
(b) Procedures For Relief From Liability Applicable To All Joint Filers.
(1) In General. Under procedures prescribed by the Secretary, if–
(A) a joint return has been made for a taxable year,
(B) on such return there is an understatement of tax attributable to erroneous items of 1 individual filing the joint return,
(C) the other individual filing the joint return establishes that in signing the return he or she did not know, and had no reason to know, that there was such understatement,
(D)taking into account all the facts and circumstances, it is inequitable to hold the other individual liable for the deficiency in tax for such taxable year attributable to such understatement, and
(E) the other individual elects (in such form as the Secretary may prescribe) the benefits of this subsection not later than the date which is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election, then the other individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement.
(2) Apportionment of Relief. If an individual who, but for paragraph (1)(C), would be relieved of liability under paragraph (1), establishes that in signing the return such individual did not know, and had no reason to know, the extent of such understatement, then such individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent that such liability is attributable to the portion of such understatement of which such individual did not know and had no reason to know.
(3) Understatement. For purposes of this subsection, the term understatement has the meaning given to such term by section 6662(d)(2)(A).
(c) Procedures To Limit Liability For Taxpayers No Longer Married Or Taxpayers Legally Separated Or Not Living Together.
(1) In General. Except as provided in this subsection, if an individual who has made a joint return for any taxable year elects the application of this subsection, the individual's liability for any deficiency which is assessed with respect to the return shall not exceed the portion of such deficiency properly allocable to the individual under subsection (d).

(2) Burden of Proof. Except as provided in subparagraph (A) (ii) or (C)of paragraph (3), each individual who elects the application of this subsection shall have the burden of proof with respect to establishing the portion of any deficiency allocable to such individual.

(3)Election.

(A) Individuals Eligible To Make Election–

(i) In General. An individual shall only be eligible to elect the application of this subsection if –

(I) at the time such election is filed, such individual is no longer married to, or is legally separated from, the individual with whom such individual filed the joint return to which the election relates, or

(II) such individual was not a member of the same household as the individual with whom such joint return was filed at any time during the 12-month period ending on the date such election is filed.

(ii) Certain Taxpayers Ineligible To Elect–If the Secretary demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme by such individuals, an election under this subsection by either individual shall be invalid (and section 6013(d)(3) shall apply to the joint return).

(B) Time For Election. An election under this subsection for any taxable year shall be made not later than 2 years after the date on which the Secretary has begun collection activities with respect to the individual making the election.

(C) Election Not Valid With Respect To Certain Deficiencies–If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). This subparagraph shall not apply where the individual with actual knowledge establishes that such individual signed the return under duress.

(4) Liability Increased By Reason Of Transfers Of Property To Avoid Tax.

(A) In General. Notwithstanding any other provision of this subsection, the portion of the deficiency for which the individual electing the application of this subsection is liable (without regard to this paragraph) shall be increased by the value of any disqualified asset transferred to the individual.

(B) Disqualified Asset. For purposed of this paragraph–

(i) In General. The term "disqualified asset" means any property or right to property transferred to an individual making the election under this subsection with respect to a joint return by the other individual filing such joint return if the principal purpose of the transfer was the avoidance of tax or payment of tax.

(ii) Presumptions.

(I) In General. For purposed of clause (i), except as provided in subclause (II), any transfer which is made after the date which is 1 year before the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent shall be presumed to have as its principal purpose the avoidance of tax or payment of tax.

(II) Exceptions. Subclause (I) shall not apply to any transfer pursuant to a decree of divorce or separate maintenance or a written instrument incident to such a decree or to transfer which an individual established did not have as its principal purpose the avoidance of tax or payment of tax.

(d) Allocation of Deficiency. For purposes of subsection (c)–

(1) In General. The portion of any deficiency on a joint return allocated to an individual shall be the amount which bears the same ratio to such deficiency as the net amount of items taken into account in computing the deficiency and allocable to the individual under paragraph (3) bears to the net amount of all items taken into account in computing the deficiency.

(2) Separate treatment of certain items. If a deficiency (or portion thereof) is attributable to–

(A) the disallwoance of a credit, or

(B) any tax (other than tax imposed by section 1 or 55) required to be included in the joint return,

and such an item is allocated to 1 individual under paragraph (3), such deficiency (or portion) shall be allocated to such individual. Any such item shall not be taken into account under paragraph (1).

(3) Allocation of items giving rise to the deficiency. For purposes of this subsection–

(A) In general. Except as provided in paragraphs (4) and (5), any item giving rise to a deficiency on a joint return shall be allocated to individuals filing the return in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year.

(B) Exception where other spouse benefits. Under rules prescribed by the Secretary, an item otherwise allocable to an individual under subparagraph (A) shall be allocated to the other individual filing the joint return to the extent the item gave rise to a tax benefit on the joint return to the other individual.

(C) Exception for fraud. The Secretary may provide for an allocation of any item in a manner not prescribed by subparagraph (A) if the Secretary establishes that such allocation is appropriate due to fraud of 1 or both individuals.

(4) Limitations on separate returns disregarded. If an item of deduction or credit is disalllowed in its entirety solely because a separate return is filed, such disallowance shall be disregarded and the item shall be computed as if

a joint return had been filed and then allocated between the spouses appropriately. A similar rule shall apply for purposes of section 86.

(5) Child's liability. If the liability of a child of a taxpayer is included on a joint return, such liability shall be disregarded in computing the separate liability of either spouse and such liability shall be allocated appropriately between the spouses.

In general

- The Act modifies the innocent spouse provisions to permit a spouse to elect to limit his or her liability for unpaid taxes on a joint return to the spouse's separate liability amount.
- In the case of a deficiency arising from a joint return, a spouse could elect to be liable only to the extent that items giving rise to the deficiency are allocable to the spouse.
- The **separate liability election** also applies in situations where the tax shown on a joint return is not paid with the return. In this case, the amount determined under the separate liability election equals the amount that **would have been reported** by the electing spouse on a separate return.
- However, if any item of credit or deduction would be disallowed solely because a separate return is filed, the item of credit or deduction will be computed without regard to such prohibition.
- Special rules apply to prevent the inappropriate use of the election.
- **The separate liability election may not be used to create a refund, or to direct a refund to a particular spouse.**
- Items are generally allocated between spouses in the same manner as they would have been allocated had the spouses filed separate returns.
- The Secretary may prescribe other methods of allocation by regulation.
- The allocation of items is to be accomplished without regard to community property laws.
- The election applies **to all unpaid taxes** under subtitle A of the Internal Revenue Code, including the income tax and the self-employment tax.
- The election may be made at any time **not later than** two years after the collection activities begin with respect to **the electing spouse**.
- It is intended that the two-year period not begin until collection activities have been undertaken against the electing spouse that have the effect of giving the spouse **notice** of the IRS' intention to collect the joint liability from such spouse.

For example, garnishment of wages or a notice of intent to levy against the property of the electing spouse would constitute collection activity against the electing spouse. The mailing of a notice of deficiency and demand for payment to the last known address of the electing spouse, addressed to both spouses, **would not**.

The Tax Court has jurisdiction of disputes arising from the "separate liability election." For example, a spouse who makes the separate liability election may petition the Tax Court to determine the limits on liability applicable under this provision. The Tax Court is authorized to establish rules that would allow the Secretary of the Treasury and the electing spouse to require, with adequate notice, the other spouse to become a party to any proceeding before the Tax Court.

1. The Secretary of the Treasury is required to develop **a separate form with instructions for taxpayers to use in electing to limit liability**.
2. The Internal Revenue Service is required to **notify all taxpayers** who have filed joint returns of their rights to elect to limit their joint and several liability under this provision.
3. It is expected that notice will appear in appropriate IRS publications, and in collection-related notices sent to taxpayers.
4. In addition, the Internal Revenue Service should, whenever practicable, send appropriate notifications **separately to each spouse**.

Effective Date.

Note: The Act applies to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date, but remaining unpaid as of such date.

An election may be made under the provision through the later of two years after the date of enactment or two years after the date of the first collection action that has the effect of giving the spouse **notice** of the IRS' intention to collect the joint liability from the spouse. This rule does not extend the statute of limitations.

An individual may elect under the provision without regard to whether such individual has previously been denied spouse relief under present law.

The Act applies with respect to deficiencies of a taxpayer who is no longer married to, is legally separated from, or has been living apart **for at least 12 months** from the person with whom the taxpayer originally filed the joint return. **The taxpayers, whether or not eligible to make the separate liability election, may be granted innocent spouse relief where appropriate.** In addition, the Act authorizes the Secretary to provide equitable relief in appropriate situations. The Act establishes jurisdiction in the Tax Court over disputes arising in this area.

35. DEFICIENCIES OF CERTAIN TAXPAYERS

Electing Separate Liability [I.R.C. §6015(c)]

The part of the Act applies with respect to deficiencies of a taxpayer who, at the time of election, is no longer married (including a widow or widower) to, is legally separated from, or has been living for at least 12 months apart from the person with whom the taxpayer originally filed the joint return.

Such taxpayers may elect to limit their liability for any deficiency to the portion of the deficiency that is attributable to items allocable to themselves.

For example, a deficiency is assessed after the IRS audit of a joint return. The deficiency relates to income earned by the husband that was not reported on the return. If the spouses who joined in the return are no longer married, are legally separated, or have lived apart for at least 12 months, **either** may elect limited liability under this provision. If the wife elects, she would owe none of the deficiency. The deficiency would be the sole responsibility of the husband **whose income** gave rise to the deficiency.

If the deficiency relates to the items of **both spouses**, the separate liability for the deficiency **is allocated** between the spouses in the same proportion as the net items taken into account in determining the deficiency.

For example, a deficiency is assessed that is attributable to $70,000 of unreported income allocable to the husband and the disallowance of a $30,000 miscellaneous itemized deduction to the wife. If the spouses who joined in the return are no longer married, are legally separated, or have lived apart for at least 12 months, **either may elect limited liability under this provision**. If the husband and wife elect, the husband's liability would be limited to 70 percent of the deficiency (if he elects) and the wife's liability limited to 30 percent (if she elects). This would be the case even if a portion of the miscellaneous itemized deductions had been disallowed under §67(a). The election is required in order to limit liability. If either spouse fails to elect, that spouse would be liable for the full amount of the deficiency, unless reduced by innocent spouse relief or pursuant to the grant of authority to the Secretary to provide equitable relief.

If the deficiency arises as a result of the denial of an item of deduction or credit, the amount of the deficiency allocated to the spouse to whom the item of deduction or credit is allocated is **limited to the amount of income tax allocated to such spouse that was offset by the deduction or credit**. The remainder of the liability is allocated to the other spouse to reflect the fact that income or tax allocated to that spouse was originally offset by a portion of the disallowed deduction or credit.

For example, a married couple files a joint return with wage income of $100,000 allocable to the wife and $30,000 of self-employment income allocable to the husband. On examination, a $20,000 deduction allocated to the husband is disallowed, resulting in a **deficiency of $5,600**.

Under the provision, the liability is allocated in proportion to the items giving rise to the deficiency. Since the only item giving rise to the deficiency is allocable to the husband, and because he reported sufficient income to offset the item of deduction, **the entire deficiency is allocated to the husband and the wife has no liability with regard to the deficiency**, regardless of the ability of the IRS to collect the deficiency from the husband.

If the joint return has shown only $15,000 (instead of $30,000) of self employment income for the husband, the income offset limitation rule discussed above would apply. In this case, the disallowed $20,000 deduction entirely offsets the $15,000 of income of the husband, and $5,000 remains. This remaining $5,000 of the disallowed deduction **offsets income of the wife.** The liability for the deficiency is therefore divided in proportion to the amount of income offset for each spouse. **In this example, the husband is liable for ¾ of the deficiency ($4,200), and the wife is liable for the remaining ¼ ($1,400)**.

Where a deficiency is attributable to the disallowance of a credit, or to any tax other than regular or alternative minimum income tax, the portion of the deficiency attributable to such credit or other tax is considered first.

For example, on examination a deficiency of $10,000 ($2,800 of self-employment tax and $7,200 of income tax) is determined to be attributable to $20,000 of unreported self-employment income of the **husband** and a disallowed itemized deduction of $5,000 allocable to the wife. **The $2,800 of deficient self-employment taxes is first allocated to the husband, and the remaining $7,200 of income tax deficiency is allocated 80 percent to the husband and 20 percent to the wife**.

Other Rules: **First**, if the IRS demonstrates that assets were transferred between the spouses in a fraudulent scheme joined in by both spouses, **neither spouse** is eligible to make the election under the provision (and consequently joint and several liability applies to both spouses).

Second, if the IRS proves that the electing spouse **had actual knowledge** that an item on a return is incorrect, the election will **not apply** to the extent any deficiency is attributable to such item. Such actual knowledge must be established by the evidence and shall not be inferred based on indications that the electing spouse **had a reason to know**.

The rule that the election will not apply to the extent any deficiency is attributable to an item the electing spouse had **actual knowledge of is expected to be applied by treating the item as fully allocable to both spouses**.

For example, a married couple files a joint return with wage income of $150,000 allocable to the **wife** and $30,000 of self employment income allocable to the **husband**. On examination, an additional $20,000 of the husband's self-employment income is discovered, resulting in a deficiency of $9,000. The IRS proves that the wife had **actual knowledge** of $5,000 of this additional self-employment income, but had **no**

knowledge of the remaining $15,000. In this case, the **husband** would be liable for the full amount of the deficiency, since the item giving rise to the deficiency is **fully allocable to him**. In addition, the **wife** would be liable for the amount that would have been calculated as the deficiency based on the $5,000 of unreported income of which she had actual knowledge. The IRS would be allowed to collect that amount from **either spouse**, while the remainder of the deficiency could be collected from **only the husband**.

Third, the portion of the deficiency for which the electing spouse is liable is increased by the value of any disqualified assets received from the other spouse.

Disqualified assets include any property or right to property that was transferred to an electing spouse if the **principle purpose** of the transfer is the avoidance of tax (including the avoidance of payment of tax).

A rebuttable presumption exists that a transfer is made for tax avoidance purposes if the transfer was made **less than one year** before the earlier of the payment due date or the date of the notice of proposed deficiency.

The rebuttable presumption **does not apply** to transfers pursuant to a decree of **divorce or separate maintenance**. The presumption may be rebutted by a showing that the **principal purpose** of the transfer was not the avoidance of tax or the payment of tax.

Other Deficiencies

The Act also includes the provision modifying innocent spouse relief. Taxpayers who do not make the separate liability election may be eligible for innocent spouse relief.

For example, a taxpayer may be ineligible to make the separate liability election for a deficiency because he or she is **not** widowed, divorced, legally separated, or living apart (for at least 12 months) from the person with whom the taxpayer originally joined in filing the joint return.

Such a taxpayer may apply for relief of any deficiency that is attributable to an erroneous item of the other spouse, provided he or she did not know or have reason to know of the understatement of tax and it would be inequitable to hold the taxpayer responsible for the deficiency.

The election is required to be made **no later** than the date that is **two years after the Secretary has begun collection actions** with respect to the individual. The rule allowing innocent spouse relief to be provided on an apportioned basis is included in the conference agreement.

Other Circumstances, Including Tax Shown on a Return but Not Paid

The Act **does not** include a provision that could provide relief in situations where tax was shown on a joint return, **but not paid** with the return. The Secretary will consider using the grant of authority to provide **equitable relief** in appropriate situations to avoid the inequitable treatment of spouses in such situations.

For example, it is intended that equitable relief be available to a spouse t**hat does not know, and had no reason to know**, that funds intended for the payment of tax were instead taken by the other spouse for such other spouse's benefit.

It is not intended to limit the use of the Secretary's authority to provide equitable relief to situations where tax is shown on a return but not paid. Such authority should be used where, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return. The relief where there is both an understatement and an underpayment of tax.

Effective Date

The separate liability election, expanded innocent spouse relief and authority to provide equitable relief **all apply** to liabilities for tax arising after the date of enactment, [7-22-98] as well as any liability for tax arising **on or before** the date of enactment that remains **unpaid** on the date of enactment. The applicable two-year election periods **do not expire** before the date that is two years after the **first collection activity** taken by the IRS after the date of enactment. The Secretary is required to develop a separate form for electing innocent spouse relief within 180 days after the date of enactment.

STATUTE OF LIMITATIONS

36. SUSPENSION OF STATUTE OF LIMITATIONS ON FILING REFUND CLAIMS DURING PERIODS OF DISABILITY

[Act §3202(a); I.R.C. §§6511(i) and 6511(b)]

Present Law. In general, a taxpayer must file a refund claim within three years of the filing of the return or within two years of the payment of the tax, whichever period expires later (if no return is filed, the two-year limit applies) (§6511(a)). A refund claim that is not filed within these time periods is rejected as untimely.

There is no explicit statutory rule providing for equitable tolling of the statute of limitations. The U.S. Supreme Court has held that Congress did not intend the equitable tolling doctrine to apply to the statutory limitations of §6511 on the filing of tax refund claims.

New Law. The Act permits the **equitable tolling** of the statute of limitations for refund claims of an individual taxpayer during any period of the individual's life in which he or she is **unable to manage his or her financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months**. Tolling does not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters.

Effective Date. The provision applies to periods of disability before, on, or after the date of enactment but does not apply to any claim for refund or credit that (without regard to the provision) is barred by the operation of any law, including the statute of limitations, as of January 1, 1998.

EFFORTS TO SIMPLIFY TAX LAW AND TAX LAW ADMINISTRATION

37. RETURN-FREE TAX SYSTEM

[Act §2004]

Explanation of Act

The Act requires the Secretary or his delegate to study the feasibility of and develop procedures for the implementation of a return-free tax system for taxable years beginning after 2007. The Secretary is required annually to report to the tax-writing committees on the progress of the development of such system, including what additional resources the IRS would need to implement the system, the changes to the Internal Revenue Code that would facilitate the system, the procedures developed to date, **and the number and classes of taxpayers who would be permitted to use such a system**. The Secretary is required to make the first report on the development of the return-free filing system to the tax-writing committees on **June 30, 1999.**

It is contemplated that the return-free filing system **would initially** be targeted at taxpayers who had taxable income from wages, interest, dividends, pensions, and unemployment compensation; did not itemize deductions; and did not take any tax credits **other than** the earned income tax credit.

Effective Date. 7-22-98.

Important Practitioner Note: This provision could be interpreted as changing the tax law in ways that will substantially reduce the number of people actually required to file an income tax return. Potentially, this could mean that practioners should continue to improve their skills in the more **complicated** areas of the income tax code in order to maintain their present level of income and practice.

38. TAX LAW COMPLEXITY ANALYSIS

[Act §4021]

It is the sense of Congress that the Internal Revenue Service should provide Congress with an independent view of tax administration, and that during the legislative process, the tax writing committees of Congress should hear from front-line technical experts at the Internal Revenue Service with respect to the administrability of pending amendments to the Internal Revenue Code of 1986.

39. TAX LAW COMPLEXITY ANALYSIS

[Act §4022]

Below is an excerpt from the Tax provision in regard to this subject.

(a) COMMISSIONER STUDY.–

1 **In General.** The Commissioner of Internal Revenue shall conduct each year after 1998 an analysis of the sources of complexity in administration of the Federal tax laws. Such analysis may include an analysis of–

A questions frequently asked by taxpayers with respect to return filing,

B common errors made by taxpayers in filling out their returns,

C areas of law which frequently result in disagreements between taxpayers and the Internal Revenue Service,

D major areas of law in which there is no (or incomplete) published guidance or in which the law is uncertain,

E areas in which revenue officers make frequent errors interpreting or applying the law,

F the impact of recent legislation on complexity, and

G forms supplied by the Internal Revenue Service, including the time it takes for taxpayers to complete and review forms, the number of taxpayers who use each form, and how recent legislation has affected the time it takes to complete and review forms.

2 **Report.** The Commissioner shall not later than March 1 of each year report the results of the analysis conducted under paragraph (1) for the preceding year to the Committee of Ways and Means of the House of Representatives and the Committee on Finance of the Senate. The report shall include any recommendations–

A for reducing the complexity of the administration of Federal tax laws, and

B for repeal or modification of any provision the Commissioner believes adds undue and unnecessary complexity to the administration of the Federal tax laws.

C Analysis To Accompany Certain Legislation.–

1 **In General**. The Joint Committee on Taxation, in consultation with the Internal Revenue Service and the Department of the Treasury, shall include a tax complexity analysis in each report for legislation, or provide such analysis to members of the committee reporting the legislation as soon as practicable after the report is filed, if–

40. ADMINISTRATION OF INTEREST AND PENALTIES

The Joint Committee on Taxation and the Treasury Department studies will examine whether the current penalty and interest provisions encourage voluntary compliance. The studies will also consider whether the provisions operate fairly, whether they are effective deterrents to undesired behavior, and whether they are designed in a manner that promotes efficient and effective administration of the provisions by the IRS. The

Joint Committee on Taxation and the Treasury Department will consider comments from taxpayers and practitioners on issues relevant to the studies.

Effective Date. The reports must be provided not later than one year after 7-22-98.

INTEREST

41. ABATEMENT OF INTEREST ON UNDERPAYMENTS BY TAXPAYERS IN PRESIDENTIALLY DECLARED DISASTER AREAS

[Act §3309]

New Law. The Act provides that taxpayers located in a Presidentially declared disaster area do not have to pay interest on taxes due for the length of any extension for filing their tax returns granted by the Secretary of the Treasury.

Effective Date. Disasters declared after December 31, 1997, with respect to taxable years beginning after December 31, 1997.

MISCELLANEOUS

42. BURDEN OF PROOF—LITIGATION

The Act provides that the Secretary shall have the burden of proof in any **court proceeding** with respect to a factual issue if the taxpayer introduces credible evidence with respect to the factual issue relevant to ascertaining the taxpayer's income tax liability.

Four conditions apply.

1. **First**, the taxpayer must comply with the requirements of the Internal Revenue Code and the regulations issued thereunder to substantiate any item (as under present law).
2. **Second**, the taxpayer must maintain records required by the Code and regulations (as under present law).
3. **Third**, the taxpayer must cooperate with reasonable requests by the Secretary for meetings, interviews, witnesses, information, and documents (including providing, within a reasonable period of time, access to and inspection of witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the Secretary).

Cooperation also includes providing reasonable assistance to the Secretary in obtaining access to and inspection of witnesses, information, or documents not within the control of the taxpayer (including any witnesses, information, or documents located in foreign countries).

A necessary element of cooperating with the Secretary is that the taxpayer must exhaust his or her administrative remedies (including any appeal rights provided by the IRS). The taxpayer is not required to agree to extend the statute of limitations to be considered to have cooperated with the Secretary. Cooperating also means that the taxpayer must establish the applicability of any privilege.

4. **Fourth**, taxpayers other than individuals must meet the net worth limitations that apply for awarding attorney's fees (accordingly, no net worth limitation would be applicable to individuals). Corporations, trusts, and partnerships whose net worth exceeds $7 million **are not eligible** for the benefit of the provision. Taxpayer has the burden of proving that it meets each of these conditions, because they are necessary prerequisites to establishing that the burden of proof is on the Secretary.

Effective Date. The provision applies to court proceedings arising in connection with examinations commencing **after** 7-22-98.

43. ACTIONS FOR REFUND WITH RESPECT TO CERTAIN ESTATES WHICH HAVE ELECTED THE INSTALLMENT METHOD OF PAYMENT

[I.R.C. §§7422 and 7479]

Present Law. In general, the U.S. Court of Federal Claims and the U.S. district courts have jurisdiction over suits for the refund of taxes, as long as full payment of the assessed tax liability has been made. Under Code §6166, if certain conditions are met, the executor of a decedent's estate may elect to pay the estate tax attributable to certain closely held businesses over a 14-year period. Courts have held that U.S. district courts and the U.S. Court of Federal Claims do not have jurisdiction over claims for refunds by taxpayers deferring estate tax payments pursuant to §6166 unless the entire estate tax liability has been paid. Under Section7479, the U.S. Tax Court has limited authority to provide declaratory judgments regarding initial or continuing eligibility for deferral under §6166.

New Law. The Act grants the U.S. Court of Federal Claims and the U.S. district courts jurisdiction to determine the correct amount of estate tax liability (or refund) in actions brought by taxpayers deferring estate tax payments under §6166, **as long as certain conditions are met**.

To qualify for the provision:

1. The estate must have made an election pursuant to §6166;
2. The estate must have fully paid each installment of principal and/or interest due (and all non-6166-related estate taxes due) before the date the suit is filed;
3. No portion of the payments due may have been accelerated;
4. There must be no suits for declaratory judgment pursuant to §7479 pending; and
5. There must be no outstanding deficiency notices against the estate.

In general, to the extent that a taxpayer has previously litigated its estate tax liability, the taxpayer would not be able to take advantage of this procedure under principles of res judicata. Taxpayers are not relieved of the liability to make any installment payments that become due during the pendency of the suits; in other words, failure to make such payments would subject the taxpayer to the existing provisions of §6166(g)(3).

The Act further provides that once a final judgment has been entered by a district court or the U.S. Court of Federal Claims, the IRS is not permitted to collect any amount disallowed by the court, and any amounts paid by the taxpayer in excess of the amount the court finds to be currently due and payable are refunded to the taxpayer, with interest.

Lastly, the provision provides that the two-year statute of limitations for filing a refund action is suspended during the pendency of any action brought by a taxpayer pursuant to §7479 for a declaratory judgment as to an estate's eligibility for §6166.

Effective Date. Claims for refunds filed after 7-22-98.

44. INCREASE IN OVERPAYMENT RATE PAYABLE TO TAXPAYERS OTHER THAN CORPORATIONS

[I.R.C. §6621(a)(1)]

Present Law. A taxpayer that underpays its taxes is required to pay interest on the underpayment at a rate equal to Federal short-term interest rate (AFR) plus three percentage points. A taxpayer that overpays its taxes receives interest on the overpayment at a rate equal to the Federal short-term interest rate (AFR) plus two percentage points.

New Law. The Act provides that the overpayment interest rate will be AFR plus three percentage points, except that for corporations the rate remains at AFR plus two percentage points.

Effective Date. Interest for the second and succeeding calendar quarters beginning after 7-22-98.

45. THREAT OF AUDIT PROHIBITED TO COERCE TIP REPORTING ALTERNATIVE COMMITMENT AGREEMENTS

[I.R.C. §3414]

Present Law. Restaurants may enter into Tip Reporting Alternative Commitment (TRAC) agreements. A restaurant entering into a TRAC agreement is obligated to educate its employees on their tip reporting obligations, to institute formal tip reporting procedures, to fulfill all filing and record keeping requirements, and to pay and deposit taxes. In return, the IRS agrees to base the restaurant's liability for employment taxes solely on reported tips and any unreported tips discovered during an IRS audit of an employee.

New Law. The Act requires the IRS to instruct its employees that they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer to enter into a TRAC Agreement.

Effective Date. 7-22-98.

46. IDENTIFICATION OF RETURN PREPARERS

[Act §3710]

The Act authorizes the IRS to approve alternatives to Social Security numbers to identify tax return preparers.

Effective Date. The provision is effective 7-28-98.

47. PAYMENT OF TAXES

[Act §3703]

The Act requires the Secretary or his delegate to establish such rules, regulations, and procedures as are necessary to allow payment of taxes by check or money order to be made payable to the United States Treasury.

Effective Date. 7-22-98.

48. CLARIFICATION OF AUTHORITY OF SECRETARY RELATING TO THE MAKING OF ELECTIONS

[Act §3704]

The Act clarifies that, except as otherwise provided, the Secretary may prescribe the manner of making of any election by any reasonable means.

Effective Date. The provision is effective 7-22-98.

1998 Workbook