What's New Supplement

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1998 Workbook

1998 Workbook

CORRECTIONS SHEET

p. 4. The Tax and Trade Relief Extension Act of 1998, which was passed after the book went to press, changes the answers to Examples 1 and 2. In each of these examples, the farm losses qualify for the new five-year Caribbean.

p. 48. **Item 21A:** The Act provides that the penalty to pay taxes is reduced by 50%, **cross out** is not imposed.

p. 72. **AMT** does not reduce the credit for 1998.

p. 72. Last sentence in Answer 4: See Chapter 15.

p. 82. Put (30,000) on Line 1b. Put (20,000) on Line 2a.

p. 83. Answer 21, 3rd paragraph, first sentence: change **or** after **both to–to.**

p. 85. Question 27: The contribution is in 1998.

Top of p. 221. Column (d) should be 1,575 rather than 4,400; column (e) should be 1,486.50 rather than 3,964; and column (f) should be 88.50 rather than 436.

p. 239. Figure 15. Schedule D instructions released after the book went to press indicate that the amount entered in column (f) should be $300,000. On the next line, a negative $150,000 should be entered in column (f), preceded by the following: "exclusion under IRC §1202."

Top of p. 242. Sold in 1998 **not** 1995.

p. 247. Line 13(g) should be $300 not $100.

p. 283. Answer 2–Second line $1880 **not** $620.

p. 299. Example 19 should be **19A.**

pp. 310, 311. Income averaging cannot use taxable income below zero for the starting point in using brackets from the three prior years. Therefore, Example 1-D is incorrect and should be omitted.

p. 313. Wuebker is being appealed by the IRS.

p. 442. Top of page–*Swain* has been affirmed by the 7th Cir.

p. 473. Top case name is *McNeil*.

p. 480. **Lemishow** not Lemi

p. 534. Change each partner to **each shareholder** in Line 2 and 4.

p. 565. Enter 90,000 on Line 6, 10,000 on Line 7, 100,000 on Line 8, and.05 on Line 9.

p. 603. **Facts,** third line: Change *decline* to *increase.*

pp. 620, 621. The $1,000 Threshold was increased to $1,100 for 1998.

p. 659. Example 11—November 15, 1996 **not** November 15, 1997.

p. 662. Second note—**$40,000** is subject to max rate of 25%; **$20,000** to max rate of 20%.

p. 699. #6 see Q6 on page 706.

p. 719. Example One—$1,690,000 **not** $690,000.

p. 748. 12-31-98 should be 12-31-90.

p. 749. Item 78. The instructions for Form 1099-Misc., which were released after the book went to press, indicate that the payments are reported on Form 1099-MISC rather than Form 1099-B as anticipated in the text. The instructions read as follows:

Payments to attorneys. Attorneys' fees of $600 or more paid in the course of your trade or business are and continue to be reportable in box 7 of Form 1099-MISC. However, for 1998 and later years, if you make a payment in the course of your trade or business to an attorney in connection with legal services and the attorney's fee cannot be determined, the total amount paid to the attorney (gross proceeds) must be reported in box 13 of new Code A. For example, an insurance company pays an attorney $100,000 to settle a claim. The attorney's fee cannot be determined by the insurance company. Therefore, the insurance company must report $100,000 in box 13 of Form 1099-MISC with Code A. If the insurance company knows that the attorney's fee is, for example, $34,000, the insurance company must report $34,000 in box 7 and nothing in box 13. These rules apply (a) whether or not the attorney is the exclusive payee (e.g., the attorney's and claimant's names on one check). However, these rules do not apply to profits distributed by a partnership to its partners that are reportable on **Schedule K-1 (Form 1065),** Partner's Share of Income, Credits, Deductions, etc., or to wages paid to attorneys that are reportable on **Form W-2**, Wage and Tax Statement. The term "attorney" includes a law firm or other provider of legal services.
Payments to corporations for legal services. The exemption from reporting payments made to corporations no longer applies to payments for legal services. Therefore, for 1998 and later years, you must report attorneys' fees (in box 7) or gross proceeds (in box 13) as described above to corporations that provide legal services.

Yellow Supplement p. 2. The preceding years seafarer for estimated payments made for year 2000 and 2001 is 106%.

RECENT RULINGS

Rev. Rul. 98-56
EIC - Disqualified Income

☞ **Gain that is treated as long-term capital gain under §1231(a)(1) of the Code is *not* disqualified income for purposes of the earned income credit.**

Section 32 of the Internal Revenue Code allows an earned income credit to eligible individuals whose income does not exceed certain limits. Section 32(i) denies the earned income credit to an otherwise eligible individual if the individual's "disqualified income" exceeds a specified level for the taxable year for which the credit is claimed. Disqualified income is income specified in §32(i)(2).

Gain that is treated as long-term capital gain under §1231(a)(1) is not disqualified income for purposes of §32(i).

In figuring the EITC, the IRS instructions take as capital gain net income the total from Schedule D, "Capital Gains and Losses." This includes certain gains reported on Form 4797, "Sales of Business Property," and carried over to the Schedule D. Under the ruling announced today, the gain reported on Form 4797 should be subtracted from the Schedule D total when figuring the EITC investment income limit.

The 1998 tax instructions, which have already gone to print, will not reflect this change. However, specific instructions for preparing 1998 returns will appear in Publication 596, "Earned Income Credit."

Taxpayers who were otherwise eligible to claim the EITC on their 1996 or 1997 returns–but had too much investment income because of the Form 4797 calculation–should claim a refund by filing an amended return on Form 1040X for each year that the new calculation lowers their investment income below the limit for that year.

Note: This is a reversal of an IRS position. Consider amended returns where appropriate.

T.D. 8798
EIC

☞ **EIC Due Diligence Explained**

The temporary regulations essentially adopt the four due diligence requirements in Notice 97-65. Thus, to avoid the penalty under section 6695(g), a preparer must: (1) **complete the Eligibility Checklist (Form 8876,** *Paid Preparer's Earned Income Credit Checklist,* **or such other form as may be prescribed by the IRS), or otherwise record in the preparer's files the information necessary to complete the Eligibility Checklist;** (2) **complete the Computation Worksheet (***Earned Income Credit Worksheet* **contained in the Form 1040 instructions), or otherwise record in the preparer's files the computation and information necessary to complete the Computation Worksheet;** (3) **have no knowledge, and have no reason to know, that any information used by the preparer in determining the eligibility for, and amount of, the EIC is incorrect; and** (4) **retain for three years the Eligibility Checklist and the Computation Worksheet (or alternative records), and a record of how and when the information used to determine eligibility for, and the amount of, the EIC was obtained by the preparer.**

The temporary regulations also provide that the income tax return preparer may avoid the section 6695(g) penalty with respect to a particular income tax return or claim for refund if the preparer can demonstrate to the satisfaction of the IRS that, considering all the facts and circumstances, the preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of the regulations, and that the particular failure was isolated and inadvertent.

> The temporary regulations will be effective for taxable years beginning after December 31, 1996. However, the Eligibility Checklist contained in Notice 97-65 has been expanded in Form 8867.

Form **8867** (December 1998) Department of the Treasury Internal Revenue Service

Paid Preparer's Earned Income Credit Checklist

▶ Do not send to the IRS. Keep for your records.

OMB No. 1545-1629

For the definitions of the following terms, see **Pub. 596** for the year for which you are completing this form.

- **Investment Income**
- **Qualifying Child**
- **Modified AGI**
- **Earned Income**

Caution: *Taxpayers who file* ***Form 2555*** *or* ***Form 2555-EZ cannot*** *claim the earned income credit (EIC). Taxpayers who were nonresident aliens for any part of the year* ***cannot*** *claim the EIC unless their filing status is married filing jointly.*

Part I For All Taxpayers

1 Enter the taxpayer's name ▶ ....
and the year for which you are completing this form . . . . ▶ ....

2 Is the taxpayer's filing status married filing jointly, head of household, qualifying widow(er), or single? ☐ Yes ☐ No

3 Does the taxpayer (and the taxpayer's spouse if filing jointly) have a social security number? See the instructions before answering . . . . ☐ Yes ☐ No

Note: *If you checked "No" on line 2* ***or*** *line 3,* ***stop;*** *the taxpayer* ***cannot*** *claim the EIC. Otherwise, continue.*

4 Is the taxpayer's **investment income** more than the limit that applies to the year on line 1? See Pub. 596 for the limit . . . . ☐ Yes ☐ No

5 Is the taxpayer (or the taxpayer's spouse if filing jointly) a **qualifying child** of another person? . . . ☐ Yes ☐ No

Note: *If you checked "Yes" on line 4* ***or*** *line 5,* ***stop;*** *the taxpayer* ***cannot*** *claim the EIC. Otherwise, go to Part II or Part III, whichever applies.*

Part II For Taxpayers Who Have a Qualifying Child

Caution: *If there are two children, complete lines 6–11 for one child before going to the next column.*

	Child 1	Child 2
6 Is the child— • the taxpayer's son, daughter, or adopted child, or • a descendant of the taxpayer's son, daughter, or adopted child, or • the taxpayer's stepchild, or • the taxpayer's eligible foster child?	☐ Yes ☐ No	☐ Yes ☐ No
7 If the child is married, is the taxpayer claiming the child as a dependent? (If the child is not married, check "Yes.")	☐ Yes ☐ No	☐ Yes ☐ No
8 Did the child live with the taxpayer in the United States for over half of the year (the full year if the child is an eligible foster child)?	☐ Yes ☐ No	☐ Yes ☐ No
9 Was the child (at the end of the year on line 1)— • under age 19, or • under age 24 and a full-time student, or • any age and permanently and totally disabled?	☐ Yes ☐ No	☐ Yes ☐ No
10 Does the child have a social security number? See the instructions before answering	☐ Yes ☐ No	☐ Yes ☐ No
Did you check "Yes" on lines 6 through 10? **Yes.** The child is the taxpayer's qualifying child. But the child may also be the qualifying child of one or more other taxpayers who could check "Yes" on lines 6 through 10. Go to line 11. **No.** The child is not the taxpayer's qualifying child. If the taxpayer does not have a qualifying child, go to Part III on the back to see if the taxpayer can claim the EIC for taxpayers who do not have a qualifying child.		
11 Is the taxpayer's **modified AGI** higher than the modified AGI of all other taxpayers for whom the child is a qualifying child?.	☐ Yes ☐ No	☐ Yes ☐ No

Did you check "Yes" on line 11?

Yes. The taxpayer can claim the EIC if the taxpayer's **earned income** and modified AGI are each less than the limit that applies to the year on line 1. See Pub. 596 for the limit. Complete **Schedule EIC** and attach it to the taxpayer's return. If there are two qualifying children, list them on Schedule EIC in the same order as they are listed here.

No. The taxpayer **cannot** claim the EIC, not even the credit for taxpayers who do not have a qualifying child.

For Paperwork Reduction Act Notice, see back. Cat. No. 26142H Form **8867** (12-98)

Part III **For Taxpayers Who Do Not Have a Qualifying Child**

12 Was the taxpayer's main home (and the taxpayer's spouse if filing jointly) in the United States for more than half the year? (Military personnel on extended active duty outside the United States are considered to be living in the United States during that duty period.). . . . . ☐ **Yes** ☐ **No**

13 Was the taxpayer (or the taxpayer's spouse if filing jointly) at least age 25 but under age 65 at the end of the year on line 1?. . . . . ☐ **Yes** ☐ **No**

Note: *If you checked "No" on line 12* **or** *line 13,* ***stop;*** *the taxpayer* ***cannot*** *claim the EIC. Otherwise, continue.*

14 Is the taxpayer (or the taxpayer's spouse if filing jointly) eligible to be claimed as a dependent on anyone else's Federal income tax return for the year on line 1?

☐ **No.** The taxpayer can claim the EIC if the taxpayer's **earned income** and **modified AGI** are each less than the limit that applies to the year on line 1. See Pub. 596 for the limit.

☐ **Yes.** The taxpayer **cannot** claim the EIC.

General Instructions

Purpose of Form

Paid preparers of Federal income tax returns or claims for refund involving the earned income credit (EIC) must meet the due diligence requirements in determining if the taxpayer is eligible for, and the amount of, the EIC. Failure to do so could result in a $100 penalty for each failure. See Internal Revenue Code section 6695(g).

Due Diligence Requirements. You will meet the due diligence requirements if **all four** of the following apply.

1. You complete Form 8867 (or your own form as long as it provides the same information as Form 8867).

2. You complete the EIC worksheet(s) in the Form 1040, 1040A, or 1040EZ instructions (or your own worksheet(s) as long as it provides the same information as the 1040, 1040A, or 1040EZ worksheet(s)).

3. You have no knowledge that any of the information used to determine if the taxpayer is eligible for, and the amount of, the EIC is incorrect.

4. You keep the following information for 3 years:

- Form 8867 (or your own form), **and**
- The EIC worksheet(s) (or your own worksheet(s)), **and**
- A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained.

Specific Instructions

Line 2

If the taxpayer was married at the end of the year, he or she must usually file a joint return to claim the EIC. However, if the taxpayer and his or her spouse were not living together at the end of the year, the taxpayer may be eligible to be treated as unmarried. See **Pub. 596,** Earned Income Credit, for details.

Line 3

For purposes of the EIC, a social security number means a number issued by the Social Security Administration to:

- A U.S. citizen, or
- A person who has permission from the Immigration and Naturalization Service to work in the United States.

You may find it useful to look at the social security card.

Line 6

An **adopted child** includes a child placed with the taxpayer by an authorized placement agency for legal adoption even if the adoption is not final.

A **descendant** usually refers to a grandchild or great-grandchild of the taxpayer.

An **eligible foster child** is a child the taxpayer cared for as his or her own child and who lived with the taxpayer for the whole year.

See Pub. 596 for more details on the relationship test for qualifying children.

Line 7

If the child is married and the child's other parent claimed him or her as a dependent under the special rules for children of divorced or separated parents, check "Yes."

Line 10

See the line 3 instructions for the definition of a social security number (SSN). If the child does not have an SSN because he or she was born and died in the year entered on line 1, check "Yes."

Line 11

If no one else lived with the taxpayer and the child, check "Yes." Also check "Yes" if the taxpayer is married filing jointly and the only other person who lived with the taxpayer and the child was the taxpayer's spouse.

You must ask the taxpayer if his or her modified AGI is higher than the modified AGI of any other taxpayer for whom the child is a qualifying child. If necessary, you must explain to the taxpayer what modified AGI means. However, you do not have to verify the amount of any other taxpayer's modified AGI.

Paperwork Reduction Act Notice. We ask for you to obtain the information on this form to carry out the Internal Revenue laws of the United States. You are required to obtain this information.

You are not required to obtain the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping,** 13 min.; **Learning about the law or the form,** 8 min.; and **Preparing the form,** 21 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, keep it for your records.

Rev. Proc. 98-55
S Corporation Elections

☞ **This revenue procedure amplifies and supersedes the provisions of Rev. Proc. 94-23, 1994-1 C.B. 609, and Rev. Proc. 97-40, 1997-33 I.R.B. 50. This revenue procedure is intended to provide guidance for taxpayers requesting relief for late S corporation elections and certain untimely elections required to be filed by or with respect to an S corporation. Accompanying this document is a flowchart designed to aid taxpayers in applying this revenue procedure.**

Section 1. Scope.

.01 In general. This revenue procedure extends the special procedure for late S corporation elections described in Rev. Proc. 97-40 from 6 months to 12 months (but in no event later than the unextended due date of the tax return for the first year the corporation intended to be an S corporation), provides similar relief for certain QSub elections, and extends the application of Rev. Proc. 94-23 to ESBT elections.

Note. This is a very lengthy Rev. Proc. and should be studied by practitioners with this problem. It does contain valuable information.

Rev. Proc. 98-54
Deficiency Notices

☞ **This revenue procedure provides taxpayers with instructions for entering into an agreement with the Internal Revenue Service under §6212(d) of the Internal Revenue Code to rescind a notice of deficiency. This revenue procedure clarifies, modifies, and supersedes Rev. Proc. 88-17, 1988-1 C.B. 692.**

INTEREST

Rev. Rul. 98-50

APPLICABLE FEDERAL RATES (AFR) FOR OCTOBER 1998

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	5.06%	5.00%	4.97%	4.95%
110% AFR	5.58%	5.50%	5.46%	5.44%
120% AFR	6.09%	6.00%	5.96%	5.93%
130% AFR	6.61%	6.50%	6.45%	6.41%
Mid-Term				
AFR	5.12%	5.06%	5.03%	5.01%
110%AFR	5.65%	5.57%	5.53%	5.51%
120% AFR	6.16%	6.07%	6.02%	5.99%
130% AFR	6.69%	6.58%	6.53%	6.49%
150% AFR	7.73%	7.59%	7.52%	7.47%
175% AFR	9.06%	8.86%	8.76%	8.70%
Long-Term				
AFR	5.46%	5.39%	5.35%	5.33%
110% AFR	6.02%	5.93%	5.89%	5.86%
120% AFR	6.57%	6.47%	6.42%	6.38%
130% AFR	7.13%	7.01%	6.95%	6.94%

Rev. Rul. 98-57

APPLICABLE FEDERAL RATES (AFR) FOR NOVEMBER 1998

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	4.47%	4.42%	4.40%	4.38%
110% AFR	4.92%	4.86%	4.83%	4.81%
120% AFR	5.37%	5.30%	5.27%	5.24%
130% AFR	5.83%	5.75%	5.71%	5.68%
Mid-Term				
AFR	4.51%	4.46%	4.44%	4.42%
110% AFR	4.97%	4.91%	4.88%	4.86%
120% AFR	5.42%	5.35%	5.31%	5.29%
130% AFR	5.88%	5.80%	5.76%	5.73%
150% AFR	6.80%	6.69%	6.63%	6.60%
175% AFR	7.96%	7.81%	7.74%	7.69%
Long-Term				
AFR	5.10%	5.04%	5.01%	4.99%
110% AFR	5.62%	5.54%	5.50%	5.48%
120% AFR	6.14%	6.05%	6.00%	5.98%
130% AFR	6.66%	6.55%	6.50%	6.46%

Rev. Rul. 98-57

APPLICABLE FEDERAL RATES (AFR) FOR DECEMBER 1998

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	4.33%	4.28%	4.26%	4.24%
110% AFR	4.77%	4.71%	4.68%	4.66%
120% AFR	5.21%	5.14%	5.11%	5.09%
130% AFR	5.64%	5.56%	5.52%	5.50%
Mid-Term				
AFR	4.52%	4.47%	4.45%	4.43%
110% AFR	4.98%	4.92%	4.89%	4.87%
120% AFR	5.43%	5.36%	5.32%	5.30%
130% AFR	5.89%	5.81%	5.77%	5.74%
150% AFR	6.82%	6.71%	6.65%	6.62%
175% AFR	7.97%	7.82%	7.75%	7.70%
Long-Term				
AFR	5.25%	5.18%	5.15%	5.12%
110% AFR	5.78%	5.70%	5.66%	5.63%
120% AFR	6.32%	6.22%	6.17%	6.14%
130% AFR	6.84%	6.73%	6.67%	6.64%

Roth IRA Guidance Recharacterizations

Notice 98-50

Purpose. This notice responds to questions that have arisen regarding whether a taxpayer who has converted an amount from a traditional IRA to a Roth IRA may not only transfer the amount back to a traditional IRA in a recharacterization but also subsequently “reconvert” that amount from the traditional IRA to a Roth IRA.

Background. Section 408A(d)(6) of the Code and §1.408A-5 of the proposed regulations prescribe rules for “recharacterizations” of IRA contributions, including Roth IRA conversion contributions. Section 408A(d)(6) provides that, except as otherwise provided by the Secretary of the Treasury, an IRA contribution that is transferred to another IRA in a trustee-to-trustee transfer on or before the date prescribed by law for filing the taxpayer’s Federal income tax return, including extensions, (the “due date”) for the taxable year of the contribution is treated as made to the transferee IRA and not the transferor IRA. The proposed regulations interpret §408A(d)(6) to make its application elective by the taxpayer, permit the taxpayer to recharacterize most types of IRA contributions, and permit the taxpayer to recharacterize all or any portion of an IRA contribution.

Treatment of Reconversions. The question has arisen whether a taxpayer who has converted an amount from a traditional IRA to a Roth IRA may not only transfer the amount back to a traditional IRA in a recharacterization but also subsequently “reconvert” that amount from the traditional IRA to a Roth IRA. The proposed regulations do not specifically address this question, and the Service and Treasury are considering whether final regulations should permit reconversions under any circumstances. However, effective as of November 1, 1998, the interim rules set forth below will apply for 1998 and 1999. Any future guidance that either prohibits reconversions or imposes conditions on reconversions more restrictive than those imposed under this notice will not apply to reconversions completed before issuance of that guidance.

If a taxpayer converts (or reconverts) an amount, transfers that amount back to a traditional IRA by means of a recharacterization, and reconverts that amount in a transaction for which the taxpayer is not eligible under the interim rules set forth in this notice, the reconversion will be deemed an "excess reconversion." However, any reconversions that a taxpayer has made before November 1, 1998, will not be treated as excess reconversions and will not be taken into account in determining whether any later reconversion is an excess reconversion.

A taxpayer who converts an amount from a traditional IRA to a Roth IRA during 1998 and then transfers that amount back to a traditional IRA by means of a recharacterization is eligible to reconvert that amount to a Roth IRA once (but no more than once) on or after November 1, 1998, and on or before December 31, 1998; the taxpayer also is eligible to reconvert that amount once (but no more than once) during 1999. (Any conversion of that amount during 1999 would constitute a reconversion because the taxpayer previously converted that amount during 1998). This rule applies without regard to whether the taxpayer's initial conversion or recharacterization of the amount occurs before, on, or after November 1, 1998, and (as indicated above) even if the taxpayer has made one or more reconversions before November 1, 1998.

A taxpayer who converts an amount from a traditional IRA to a Roth IRA during 1999 that has not been converted previously and then transfers that amount back to a traditional IRA by means of a recharacterization is eligible to reconvert that amount to a Roth IRA once (but no more than once) on or before December 31, 1999. In determining whether a taxpayer has made a previous conversion for purposes of these interim rules, a failed conversion, as described in proposed regulations §1.408A-4, Q&A-3 (that is, an attempted conversion for which the taxpayer is not eligible for reasons set forth in proposed regulations §1.408A-4), will not be treated as a conversion.

Any excess reconversion of an amount during 1998 or 1999 will not change the taxpayer's taxable conversion amount (as defined in proposed regulations §1.408A-8, Q&A-1(b)(7)). Instead, the excess reconversion and the last preceding recharacterization will not be taken into account for purposes of determining the taxpayer's taxable conversion amount, and the taxpayer's taxable conversion amount will be based on the last reconversion that was not an excess reconversion (unless, after the excess reconversion, the amount is transferred back to a traditional IRA by means of a recharacterization). An excess reconversion will otherwise be treated as a valid reconversion.

Any conversion, recharacterization, or reconversion of an amount under this notice must satisfy the provisions of §408A and the proposed regulations. For example, a taxpayer making a conversion or reconversion must satisfy the $100,000 modified AGI limitation of §408A(c)(3)(B)(i) and proposed regulations §1.408A-4, Q&A-2, and a taxpayer transferring a contribution from one IRA to another IRA by means of a recharacterization must make the transfer on or before the due date for the taxable year of the contribution, as required by §408A(d)(6) and proposed regulations §1.408A-5, Q&A-1. In determining the portion of any amount held in a Roth IRA or a traditional IRA that a taxpayer is not eligible to reconvert under the interim rules set forth in this notice, any amount previously converted (or reconverted) is adjusted for subsequent net gains or losses thereon.

Example 1. On May 1, 1998, T converted an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). T did not contribute any other amount to Roth IRA 1. On October 15, 1998, T transferred the amount in Roth IRA 1 to a traditional IRA (Traditional IRA 2) by means of a recharacterization. T is eligible to reconvert the amount in Traditional IRA 2 to a Roth IRA once (but no more than once) at any time on or after November 1, 1998, and on or before December 31, 1998. Any additional reconversion during 1998 would be an excess reconversion. This result would not be different if the recharacterization had occurred on or after November 1, 1998, instead of before November 1, 1998.

Example 2. The facts are the same as in Example 1, except that, on November 25, 1998, T reconverts the amount in Traditional IRA 2 to a Roth IRA (Roth IRA 2). After that reconversion, T may transfer the amount from Roth IRA 2 back to a traditional IRA by means of a recharacterization, but any subsequent reconversion of that amount to a Roth IRA before January 1, 1999, would be an excess reconversion. If T does transfer the amount from Roth IRA 2 back to a traditional IRA by means of a recharacterization, T is eligible to reconvert that amount once (but no more than once) during 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 3. The facts are the same as in Example 2, except that, on December 4, 1998, T transfers the amount from Roth IRA 2 back to a traditional IRA (Traditional IRA 3) by means of a recharacterization. If T does not reconvert that amount to a Roth IRA on or before December 31, 1998, T cannot use the 4-year spread available for 1998 conversions.

Example 4. The facts are the same as in Example 3. The value of the amount converted on May 1, 1998, was $X, and the value of the amount converted on November 25, 1998, was $Y. On December 8, 1998, T reconverts the amount in Traditional IRA 3 (which then has a value of $Z) to a Roth IRA (Roth IRA 3). Under the interim rules set forth in this notice, T is not eligible to make the December 8, 1998, reconversion, and that excess reconversion will not be taken into account for purposes of determining T's taxable conversion amount (although it is otherwise treated as a valid conversion). Instead, T's taxable conversion amount will be based on T's November 25, 1998, reconversion. Therefore, T's taxable conversion amount will be $Y. Because it is a 1998 conversion, the November 25, 1998, reconversion is eligible for the 4-year spread (unless T again transfers the amount from Roth IRA 3 to a traditional IRA by means of a recharacterization.

Example 5. The facts are the same as in Example 2, except that T's modified AGI for 1998 was $110,000. Therefore, T was not eligible to convert an amount from a traditional IRA to a Roth IRA in 1998, and T's attempted conversion (on May 1, 1998) and reconversion (on November 25, 1998) are failed conversions, as described in proposed regulations §1.408A-4, Q&A-3. Therefore, if T transfers the amount of the failed conversion in Roth IRA 2 back to a traditional IRA by means of a recharacterization and converts that amount from the traditional IRA to a Roth IRA during 1999, T will be eligible to reconvert that amount once (but no more than once) on or before December 31, 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 6. On November 5, 1998, R converts an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). On November 25, 1998, R transfers the amount in Roth IRA 1 back to a traditional IRA (Traditional IRA 2) by means of a recharacterization. R is then eligible to reconvert the amount in Traditional IRA 2 to a Roth IRA at any time on or before December 31, 1998. After that reconversion, R may transfer the amount back to a traditional IRA by means of a recharacterization, but any subsequent reconversion of that amount to a Roth IRA before January 1, 1999, would be an excess reconversion. If R does transfer the amount in Traditional IRA 2 to a Roth IRA at any time on or before December 31, 1998. After that reconversion, R may transfer the amount back to a traditional IRA by means of a recharacterization (whether before or after the end of 1998), R will be eligible to reconvert that amount once (but no more than once) during 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 7. On January 5, 1999, S converts an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). S had not previously converted that amount. On February 17, 1999, S transfers the amount in Roth IRA 1 back to a traditional IRA (Traditional IRA 2) by means of a recharacterization. After the recharacterization, S is eligible to reconvert the amount in Traditional IRA 2 once (but no more than once) at any time on or before December 31, 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

This notice is intended to clarify and supplement the guidance provided in the proposed regulations under §408A and may be relied upon as if it were incorporated in those regulations. In accordance with the procedures for submitting comments on the proposed regulations, interested parties are invited to submit comments on whether final regulations should permit reconversions (and, if so, under what circumstances and conditions). Possible approaches to reconversions in final regulations might include providing that a taxpayer is not eligible to reconvert an amount before the end of the taxable year in which the amount was first converted (or the due date for that taxable year) or that a taxpayer who transfers a converted amount back to a traditional IRA in a recharacterization must wait until the passage of a fixed number of days (e.g., 30 or 60 days) before reconverting. Additionally, such approaches might include providing that an excess reconversion would be treated as a failed conversion that would be subject to the consequences described in proposed regulations §1.408A-4, Q&A-3, and that could be remedied as described therein.

Changes to Codes for Roth IRAs on Form 1099-R

Announcement 98-106

Purpose The purpose of this announcement is to advise payers making distributions from Roth IRAs of changes to the distributions codes on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

Background The Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206) amended Internal Revenue Code section 408A, dealing with Roth IRAs. Because of these amendments, the Service has concluded that code K (Distribution from a 1998 Roth conversion IRA in the first 5 years) on the 1998 Form 1099-R may not be needed. In addition, a new code for recharacterizations is needed.

1998 Form 1099-R Code K, to be used in box 7 on the 1998 Form 1099-R, is now optional. All distributions from a Roth IRA or Roth conversion IRA can be reported using code J, Distribution from a Roth IRA in first 5 years, in box 7.

1999 Form 1099-R Code K will be eliminated on the 1999 Form 1099-R. Code J will be changed to "Distribution from a Roth IRA." Use Code J when reporting any distribution from a Roth IRA or Roth conversion IRA. Code R, Recharacterized IRA contribution, will be added to identify a recharacterization of an IRA contribution.

Returns Relating to Interest on Education Loans

Notice 98-54

☞ **This notice modifies Notice 98-7, 1998-3 I.R.B. 54, which describes the information reporting requirements under §6050S of the Internal Revenue Code for 1998 that apply in the case of payments of interest on qualified education loans. Specifically, this notice provides that *no* information reporting is required with respect to "mixed use" loans. This notice also provides that the Internal Revenue Service and the Treasury Department are extending the application of Notice 98-7 to information reporting required under §6050S for 1999.**

The requirements for reporting qualified education loan interest under §6050S are generally described in Notice 98-7, along with specific information reporting requirements for 1998. Section D of the Discussion portion of Notice 98-7 provides a rule for reporting payments of interest made on or after January 1, 1998, on mixed use loans or revolving accounts, such as credit card accounts. Payments of interest on these loans are treated under Notice 98-7 as interest paid with respect to a qualified education loan (and must be reported as such) only if the mixed use loan or revolving account is certified by the payor to be, in part, a qualified education loan, and the payee has a reasonable method for allocating the interest payments to the part of the loan that is certified to be a qualified education loan. In addition, Section E of the Discussion provides that, with respect to loans made on or after January 1, 1998, that are secured by real property, if a payor certifies all or part of such a loan as a qualified education loan, only the certified portion of the loan may be treated as a qualified education loan for purposes of information reporting. The remaining portion must be treated as a mortgage subject to information reporting under §6050H.

Discussion. Section 221(e)(1), as amended by RRA 1998, provides that the term "qualified education loan" means any indebtedness incurred by the taxpayer *solely* to pay qualified higher education expenses. The amendment to §221(e)(1) is effective as if included in the Taxpayer Relief Act of 1997 and applies to interest payments due and paid after December 31, 1997. **Thus, the payee must not report under §6050S information on mixed use loans (whether or not secured by real property) because they are not qualified education loans under §221(e)(1) as amended.** However, information reporting under §6050S continues to be required for any loan (including a loan secured by real property) or revolving account, such as credit card account, that the payor certifies is used *solely* for the purpose of paying qualified higher education expenses. The payee may rely on this certification when filing Form 1098-E, Student Loan Interest Statement, for 1998 and need not verify the payor's actual use of the funds. **In all other respects, the requirements of §6050S with respect to qualified education loan interest reporting for 1998 remain the same as described in Notice 98-7.**

The Service is currently revising Form W-9S, Request for Student's or Borrower's Social Security Number and Certification, to **remove** the certification for mixed use loans. In addition, payees should **disregard** the instructions regarding mixed use loans and revolving accounts, which are found in the Form 1098-E section of the 1998 Instructions for Forms 1099, 1098, 5498, and W-2G. Those instructions will be revised for 1999.

[Also see p. 731 of the Tax Book for **Notice** 97-73].

Notice 98-59, I.R.B. 1998-49, November 18, 1998.

☞ **Educational Institution Reporting**

This notice modifies Notice 97-73, 1997-2 C.B. 335, and Notice 98-46. 1998-36 I.R.B. 21, by providing that the Internal Revenue Service will not require an eligible educational institution to file information returns under §6050S of the Internal Revenue Code for 1998 or 1999 with respect to students who are enrolled during the year only in courses for which the student receives no academic credit from the institution. In addition, this notice modifies Notice 97-73 and Notice 98-46 by providing that eligible educational institutions are not required to file information returns for 1998 for 1999 with respect to nonresident alien students, unless requested to do so by the student.

[Also see p. 725 of the Tax Book]

Interim Guidance for Equitable Relief From Joint and Several Liability

Notice 98-61

☞ **The Treasury Department and the Internal Revenue Service are in the process of developing guidance for taxpayers seeking equitable relief from federal tax liability under §6015(f) or 66(c) of the Internal Revenue Code. This notice provides interim guidance.**

Form **8857**
(Rev. December 1998)
Department of the Treasury
Internal Revenue Service

Request for Innocent Spouse Relief

(And Separation of Liability and Equitable Relief)

▶ **Do not file with your tax return.** ▶ **See instructions.**

OMB No. 1545-1596

Your name	**Your social security number**
Your current address	Apt. no.
City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Daytime phone no. (optional) ( )

Before you begin, you need to understand the following terms. See instructions for descriptions.

- Separation of Liability
- Joint and Several Liability
- Innocent Spouse Relief
- Understatement of Tax
- Equitable Relief
- Underpayment of Tax

TIP *The IRS can help you with your request. If you are working with an IRS employee, you can ask that employee, or you can call 1-800-829-1040.*

1 Enter the year(s) for which you are requesting relief from liability of tax (see instructions) . . ▶ ....

2 Information about your spouse (or former spouse) to whom you were married at the end of the year(s) on line 1.

Name	**Social security number**
Current home address (number and street). If a P.O. box, see instructions.	Apt. no.
City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Daytime phone no. (if known) ( )

TIP *If you only have an **underpayment of tax** (tax shown on your joint return that was not paid), you may only request **equitable relief.** Skip lines 3 and 4 and see line 5 and its instructions.*

3 If you have an **understatement of tax,** you may request **Separation of Liability.** You may be relieved of liability for your spouse's (or former spouse's) part of the liability. However, this relief is available only if you and your spouse (or former spouse):

- Are no longer married, or
- Are legally separated, or
- Have lived apart at all times during the 12-month period prior to the date you file this form.

If one of the above conditions apply, attach a statement as explained on page 3 and check here . . . ▶ ☐

4 If you have an **understatement of tax** due to erroneous items of your spouse (or former spouse), you may be allowed **Innocent Spouse Relief.** Attach a statement as explained on page 4 and check here . . . . . ▶ ☐

5 If you have an **underpayment of tax** or you do not qualify for relief under **3** or **4** above, we will automatically consider whether you qualify for **Equitable Relief.** Attach a statement as explained on page 4 and check here . . . . ▶ ☐

Where To File: Generally, send this form to: **Internal Revenue Service Center, Cincinnati, OH 45999-0857.** But if you are meeting with an IRS employee or you received an IRS notice of deficiency, see page 2.

Under penalties of perjury, I declare that I have examined this form and any accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here Keep a copy of this form for your records.	Your signature			Date
Paid Preparer's Use Only	Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's social security no.
	Firm's name (or yours if self-employed) and address ▶			EIN
				ZIP code

For Privacy Act and Paperwork Reduction Act Notice, see page 4. Cat. No. 24647V Form **8857** (Rev. 12-98)

General Instructions

A Change To Note

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 made it easier to be relieved from liability of tax related to your spouse (or former spouse). You can now request innocent spouse relief for an understatement of tax no matter how small the amount. If you are divorced, separated, or no longer living with your spouse, you may now request separation of liability between you and your spouse (or former spouse) for an understatement of tax on a joint return. Also, the IRS will consider your request for equitable relief in situations where it would be unfair to hold you liable for tax that should be paid only by your spouse (or former spouse).

The new law applies to any tax liability arising after July 22, 1998, or any tax liability that was unpaid as of that date. For relief of liability for amounts that were paid as of that date, check the box on line 4 and attach the requested statement.

Purpose of Form

Use Form 8857 to request relief from liability for tax, plus related penalties and interest, that you believe should be paid only by your spouse (or former spouse). You generally must have filed a joint return for the year(s) for which you are requesting relief (but see **Community Property Laws** on page 3). The IRS will evaluate your request and tell you if you qualify.

You may be allowed one or more of these three types of relief:

- Separation of liability (see page 3),
- Innocent spouse relief (see page 4), or
- Equitable relief (see page 4).

Attach a statement to Form 8857 explaining why you qualify for relief. Complete the statement using the best information you have available. The IRS will ask you for additional information if needed, or you may provide additional information at any time.

Additional Information

See Pub. 971 for more details.

When and Where To File

When to file. Generally, you should file Form 8857 as soon as you become aware of an unpaid tax liability that you believe should be paid only by your spouse (or former spouse). The following are some of the ways you may become aware of such a liability.

- The IRS has examined your tax return.
- The IRS sends you a notice.

You must file Form 8857 no later than 2 years after the first IRS attempt to collect the tax from you. However, you may file it any time up to 2 years after the first IRS attempt to collect the tax from you that occurs after July 22, 1998. Examples of attempts to collect the tax from you include garnishment of your wages or a notice of intent to levy against your wages or property you own.

Where to file. Do not file Form 8857 with your tax return. Instead, see below.

IF . . .	THEN file Form 8857 with . . .
You are meeting with an IRS employee for an examination, examination appeal, or collection,	That IRS employee.
You received an IRS notice of deficiency, and the 90-day period specified in the notice has not expired,*	The IRS employee named in the notice. Attach a copy of the notice.
None of the situations above apply to you,	**Internal Revenue Service Center Cincinnati, OH 45999-0857**

*Before the end of the 90-day period, you should file a petition with the Tax Court, as explained in the notice. By doing so, you preserve your rights if the IRS is unable to properly consider your request before the end of the 90-day period. Include the information that supports your position, including when and why you filed Form 8857, in your petition to the Tax Court. The time for filing with the Tax Court is **not** extended while the IRS is considering your request.

Tax Court Review of Request

You may petition (ask) the Tax Court to review your request for innocent spouse relief or separation of liability (but not equitable relief) if:

- The IRS sends you a determination notice denying, in whole or in part, your request for relief, **or**
- You do not receive a determination notice from the IRS within 6 months from the date you filed Form 8857.

You may petition the Tax Court to review your case no later than the end of the 90-day period that begins on the date the IRS mails you a determination notice. See Pub. 971 for details on petitioning the Tax Court to review your request.

Joint and Several Liability

Generally, joint and several liability applies to all joint returns. This means that both you and your spouse (or former spouse) are liable for any **underpayment of tax** (tax shown on a return but not paid) plus any **understatement of tax** (defined next) that may become due later. This is true even if a divorce decree states that your former spouse will be responsible for any amounts due on previously filed joint returns. Form 8857 allows you to request that joint and several liability not apply to part or all of any unpaid tax.

Understatement of Tax

An understatement of tax, or deficiency, is generally the difference between the total amount of tax that the IRS determines should have been shown on the return, and the amount that actually was shown on the return.

Example. You and your spouse (or former spouse) file a joint return showing $5,000 of tax, which was fully paid. The IRS later audits the return and finds $10,000 of income that your spouse earned but did not report. With the additional income, the total tax becomes $6,500. You and your spouse are both liable for the $1,500 understatement of tax.

Underpayment of Tax

An underpayment is tax that is properly shown on the return, but has not been paid.

Example. You filed a joint return that properly reflects your income and deductions, but showed an unpaid balance due of $5,000. You and your spouse were getting divorced. You gave your spouse $2,500 and your spouse promised to pay the full $5,000, but did not. You and your spouse are both liable for the $5,000 underpayment of tax.

Community Property Laws

You must generally follow community property laws when filing a tax return if you are married and live in a community property state. Community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Generally, community property laws require you to allocate community income and expenses equally between both spouses. However, state community property laws are not taken into account in determining whether an item belongs to you or to your spouse (or former spouse) for purposes of requesting any relief from liability.

Note: *If you were married and filed a separate return in a community property state and are now liable for an underpayment or understatement of tax you believe should be paid only by your spouse (or former spouse), you may be allowed equitable relief.*

Specific Instructions

Your Current Home Address

Foreign address. Enter the information in the following order: city, province or state, and country. Follow the country's practice for entering the postal code. Please do not abbreviate the country name.

Line 1

If you want to request relief for more than one tax year, you only need to file one Form 8857. If you are filing Form 8857 for multiple years, clearly indicate in the statement(s) you attach the type(s) of relief you are requesting for each year.

Line 2—Information About Your Spouse (or Former Spouse)

Enter the current name and social security number (SSN) of the person to whom you were married at the end of the year(s) listed on line 1. If the name of your spouse (or former spouse) shown on that year's tax return(s) is different from the current name, enter it in parentheses after the current name. For example: Jane Maple (formerly Jane Oak). Enter the current address and phone number if you know it.

P.O. box. Enter the box number instead of the street address **only** if you do not know the street address.

Foreign address. Enter the information as explained under **Your Current Home Address.**

Note: *The IRS is required to inform your spouse (or former spouse) if you request separation of liability or innocent spouse relief, and to allow your spouse (or former spouse) to participate in the determination of the amount of relief from liability.*

Line 3—Separation of Liability

If you filed a joint return for the year(s) entered on line 1, you may be able to separate liability for any understatement of tax on the return(s) between you and your spouse (or former spouse). Generally, you can request to do so if you and that person:

- Are no longer married, or
- Are legally separated, or
- Have lived apart at all times during the 12-month period prior to the date you file Form 8857.

Note: *A widow or widower is considered no longer married.*

Requesting Separation of Liability

Check the box on line 3 and attach a statement to Form 8857. Show the total amount of the understatement of tax. For each item that resulted in an understatement of tax, explain whether the item is attributable to you, your spouse (or former spouse), or both of you. For example, unreported income earned by your spouse (or former spouse), plus any related self-employment tax, would be allocated to that person. An overstated deduction of home mortgage interest on a home you owned jointly that was paid from a joint checking account would generally be allocated equally between both of you. See Pub. 971 for more details.

Exception. If, at the time you signed the joint return, you knew about any item that would result in part or all of the understatement, then your request will not apply to that part of the understatement.

Line 4—Innocent Spouse Relief

TIP *If you qualify for separation of liability, you may not need to request innocent spouse relief. The amount of relief allowed by requesting separation of liability will usually be equal to or greater than the amount allowed by requesting innocent spouse relief. However, you may still request innocent spouse relief if you wish.*

You may be allowed innocent spouse relief if:

- You filed a joint return for the year(s) entered on line 1,
- There is an understatement of tax on the return(s) that is due to erroneous items of your spouse (or former spouse),
- You can show that when you signed the return(s) you did not know and had no reason to know that the understatement of tax existed (or the extent to which the understatement existed), and
- Taking into account all the facts and circumstances, it would be unfair to hold you liable for the understatement of tax.

Erroneous Items

Any income, deduction, or credit is an erroneous item if:

- It is omitted from or incorrectly reported on the joint return,
- It is attributable to your spouse (or former spouse),
- It results in an understatement of tax, **and**
- You either did not know and had no reason to know about the understatement or the extent of it (see **Partial Innocent Spouse Relief** next).

Partial Innocent Spouse Relief

If you knew about any of the erroneous items, but not the full extent of the item(s), you may be allowed relief for part of the understatement. Explain in the statement you attach to Form 8857 how much you knew and why you did not know, and had no reason to know, the full extent of the item(s).

Requesting Innocent Spouse Relief

Check the box on line 4 and attach a statement to Form 8857 explaining why you believe you qualify. The statement will vary depending on your circumstances, but should include the following:

- The amount and a detailed description of each erroneous item, including why you had no reason to know about the item or the extent to which you knew about the item,
- The amount of the understatement of tax for which you are liable and are seeking relief, **and**
- Why you believe it would be unfair to hold you liable for the understatement of tax.

Line 5—Equitable Relief

You may be allowed equitable relief if, taking into account all the facts and circumstances, it would be unfair to hold you liable for any understatement or underpayment of tax that should be paid only by your spouse (or former spouse).

You can only be allowed equitable relief for an underpayment of tax, or part or all of any understatement of tax, that does not qualify for either separation of liability or innocent spouse relief. You should request separation of liability or innocent spouse relief for any understatement of tax, unless you are sure you are not eligible. The IRS will consider equitable relief if it determines that innocent spouse relief and separation of liability do not apply.

Requesting Equitable Relief

Attach an explanation of why you believe it would be unfair to hold **you** liable for the tax instead of your spouse (or former spouse). If you are attaching a statement for separation of liability or innocent spouse relief, include only any additional information you believe supports your request for equitable relief.

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need it to determine the amount of liability, if any, of which you may be relieved. Internal Revenue Code section 6015 allows relief of liability. If you request relief of liability, you must give us the information requested on this form. Code section 6109 requires you to provide your social security number. Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation, and to cities, states, and the District of Columbia for use in administering their tax laws. If you do not provide all the information in a timely manner, we may not be able to process your request.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Learning about the law or the form,** 17 min.; **Preparing the form,** 17 min.; and **Copying, assembling, and sending the form to the IRS,** 20 min.

If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, see **When and Where To File** on page 2.

Rev. Rul. 98-47
Residential Rental Property

☞ **Residential rental property. For purposes of §142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property.**

Announcement 98-89

☞ **IRS announced new procedures for handling matters in bankruptcy**

The Internal Revenue Service has undertaken a new initiative to improve its procedures for handling bankruptcy cases. The new procedures are intended to minimize the likelihood that IRS collection actions will inadvertently violate the bankruptcy laws, to facilitate prompt correction of any violations that do occur, and to provide an administrative process for handling any claims for damages against the IRS that arise from such violations.

Alternative Identifying Numbers for Income Tax Return Preparers

Notice 98-63

PURPOSE

This notice informs income tax return preparers of the Service's intention to develop a system of providing alternative identifying numbers for preparers. Individual preparers are reminded of their continuing responsibility to furnish their social security numbers ("SSNs") on returns or claims for refund prepared by them.

LAW PRIOR TO AMENDMENT BY THE ACT

Section 6109(a)(4) of the Internal Revenue Code provides that any return or claim for refund prepared by an income tax return preparer must bear the indentifying number of the preparer as required under regulations prescribed by the Secretary. Prior to its amendment by §3710 of the Act, §6109(a) of the Code provided that the identifying number of an individual preparer was that individual's SSN.

Section 1.6109-2 of the Income Tax Regulations provides that each return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, which, for an individual preparer, is that individual's SSN.

EFFECT OF THE ACT

Under §6109(a), as amended by §3710 of the Act, the identifying number required for a return preparer need not be the preparer's SSN. Instead, the Secretary may issue regulations providing alternatives to the SSN for purposes of identifying individual preparers. See §6109(d).

To implement this change, the Service intends to develop a system for assigning alternative identifying numbers to individual preparers. These alternative identifying numbers are scheduled to be available for the filing season **beginning January 1, 2000.** The Secretary intends to amend §1.6109-2 to allow individual preparers the option of electing alternative identifying numbers in lieu of their SSNs.

Until the alternative identifying numbers are available, §1.6109-2 requires that individual preparers continue to furnish their SSNs as their identifying numbers. However, as provided by **Rev. Rul. 78-317,** 1978-2 C.B. 335, preparers may omit their SSNs from copies of returns furnished to taxpayers under §6107(a).

The Service will continue to monitor returns and claims for refund for the presence of preparer SSNs. Income tax return preparers failing to furnish their SSNs on returns or claims for refund are subject to a penalty of $50 for each such failure, as provided by §6695(c).

T.D. 8785

Classification of Certain Transactions Involving Computer Programs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains regulations relating to the tax treatment of certain transactions involving the transfer of computer programs. The regulations provide rules for classifying such transactions as sales or licenses of copyright rights, sales or leases of copyrighted articles, or the provision of services, or of know-how, under certain provisions of the Internal Revenue Code and tax treaties. These regulations are necessary to give taxpayers guidance on the taxation of computer program transactions. These regulations affect taxpayers engaging in certain transactions involving computer programs.

DATES: *Effective date.* These regulations are effective October 2, 1998.

THE WALL STREET JOURNAL TUESDAY, DECEMBER 29, 1998

IRS Postpones Effective Date for Cut In Tax Deduction for Business Driving

By ALEJANDRO BODIPO-MEMBA
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – The Internal Revenue Service postponed the effective date of its first-ever cut in the tax deduction for business driving following complaints from several companies.

The tax agency said that effective April 1, 1999, employees can deduct 31 cents for every mile they drive their own car for work purposes, down from the current rate of 32.5 cents a mile.

Originally, the cut was to take effect Jan. 1, but that wouldn't leave some companies enough time to convert their computer programs to reflect the change. Although the tax deduction is only for employees, many companies use the IRS rate to reimburse workers for using their autos on business.

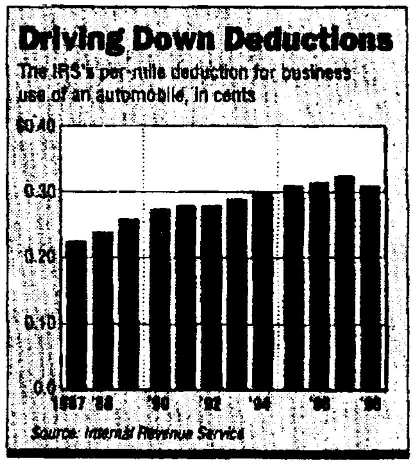
Some companies complained that the change – a reduction instead of the usual increase – would make it difficult to reprogram their payroll software. Besides, "employee manuals need to be revised and that takes time,' said Scott Mezistrano, manager of government relations for the American Payroll Association.

For some large corporations, the change won't be as taxing. Pharmaceutical giant Merck & Co., for example, doesn't foresee any major difficulties in switching over to the new rate.

"We had planned to follow whatever the IRS did," said Anita Kawatra, director of public affairs. "I doubt it will really affect us at all."

The IRS said it reduced the tax break to 31 cents – the lowest since 1995 – because of declines in two factors used to calculate the deduction. "The price of gasoline has declined and cars are retaining their value much more and not depreciating as they have in the past," said Edwin B. Cleverdon, an official at the IRS chief counsel's office.

The federal government ties tax rates and deductions to the rate of inflation to make sure that the government doesn't inadvertently benefit from rising prices at taxpayers' expense. So if the government didn't increase the mileage deduction at the pace of inflation, then taxpayers would end up getting a lower tax break in inflation-adjusted dollars.



But with inflation now at 1960s lows – and, with prices for some products falling – the formulas are working in reverse. The mileage deduction is being reduced to prevent citizens from reaping any extra gains from low inflation.

The same thing is happening with government-benefit payments, which also rise and fall with the pace of inflation. In September, the Social Security Administration said that Social Security and Supplemental Security Income benefits will rise just 1.3% in 1999, the smallest increase in benefits since 1986.

The American Association of Retired Persons suggested the smaller increase could hurt many elderly people. "While general inflation is low," AARP said in a statement, "national health-care spending is growing at about 5% a year and is expected to grow even faster."

The lower mileage reimbursement could mean savings for companies, which would end up paying less to employees. "Theoretically, it will save employers some money," said Martin Nissenbaum, national director of personal income-tax planning for Ernst & Young in New York. "If they follow the IRS rate, as many companies do, they will have to pay out fewer dollars."

T.D. 8787

> ☞ **Basis Reduction Due to Discharge of Indebtedness**

Action. Final and temporary regulations

Dates. *Effective Date:* These regulations are effective, October 22, 1998.

Applicability Date: These regulations apply to discharges of indebtedness occurring on or after, October 22, 1998 and to elections under §108(b)(5) concerning discharges of indebtedness occurring on or after, October 22, 1998.

Explanation of Revisions and Summary of Comments.

1. Basis reduction. The statute, in §1017(b)(2), provides only one limitation on basis reduction for insolvent and bankrupt taxpayers who do not make an election under §108(b)(5). **Under that rule, the basis reduction may not exceed the excess of the aggregate of the bases of the property held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge.**

2. Section 108(c)(2)(A) limitation. Section 1.108–5(a) of the proposed regulations described the limitation under §108(c)(2)(A) and provided that the amount excluded under §108(a)(1)(D) (concerning discharges of qualified real property business indebtedness) could not exceed the excess of the outstanding principal amount of that indebtedness immediately before the discharge over the net fair market value of the qualifying real property (as defined under §1.1017–1(c)(1)) immediately before the discharge. **The final regulations provide that, for purposes of §108(c)(2)(A) and §1.108–6 only, outstanding principal amount means the principal amount of an indebtedness and all additional amounts owed that, immediately before the discharge, are equivalent to principal, in that interest on such amounts would accrue and compound in the future.** Amounts that are subject to §108(e)(2) are excepted from the definition of principal amount. In addition, principal amount must be adjusted to account for unamortized premium and discount consistent with §108(e)(3).

3. Allocation of basis reduction of multiple properties within the same class. The proposed regulation incorporate the limitation described in §1017(b)(2) which provides that the basis reduction for bankrupt and insolvent taxpayers may not exceed the excess of the aggregate of the bases of the property held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge.

The overall limitation on basis reduction is determined by reference to the adjusted basis of property and the amount of money held by the taxpayer over the liabilities of the taxpayer "immediately after the discharge." By contrast, under the basis reduction rules applicable for purposes of §108(b)(2)(E), the taxpayer must reduce the adjusted basis of property "held by the taxpayer at the beginning of the taxable year following the year in which the discharge occurs." Section 1017(a).

The proposed regulations also provided that a taxpayer must treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's interest in that partnership. The rule in the proposed regulations for allocating basis reduction among multiple properties under §108(b)(2)(E) contained parenthetical language cross-referencing the partnership provision for the property classes that included secured real and personal property used in a trade or business or held for investment. This parenthetical language was intended to remind taxpayers that partnership indebtedness is treated as indebtedness secured by the taxpayer's interest in the partnership.

One commentator stated that the cross-reference with respect to secured real property was confusing since a partnership interest presumably should be treated as personal property in reducing basis under §108(b)(2)(E). This is contrasted with the modified basis reduction rules under sections 108(b)(5) and 108(c) which, assuming the appropriate requests are made and consents are granted, apply a look-through rule to reduce the inside basis of depreciable property or depreciable real property held by a partnership.

> As under the proposed regulations, the final regulations continue to treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's partnership interest.

4. Meaning of "in connection with" in section 108(c)(3). Section 108(c)(3)(A) defines *qualified real property business indebtedness* as indebtedness which "was incurred or assumed by the taxpayer in-connection with real property used in a trade or business and is secured by such real property." The IRS and Treasury Department do not believe that this sentence should be interpreted to mean only that the debt must be secured by real property used in a trade or business as of January 1, 1993.

5. Basis reduction with respect to a residence. Section 1034 was repealed by the Taxpayer Relief Act of 1997. New §121, enacted by the Taxpayer Relief Act of 1997, exempts certain gain on the sale of a residence, but does not provide that the potential gain will be transferred to a replacement residence. Therefore, under the new law, there is no mechanism to preserve the potential recapture income with respect to a new residence, and the potential recapture income must be recognized on the sale of the residence under §1245.

6. Mandatory request and consent. The proposed regulations provided that a partner may treat a partnership interest as depreciable property under §108(b)(5) (or as depreciable real property under §108(c)) only if the partnership consents to make corresponding adjustments to the basis of the partnership's depreciable property (or depreciable real property). The IRS and Treasury Department generally believe, in this context, that whether or not a partnership consents to make the corresponding adjustments to the basis of its property should be a matter of agreement between the partner and the partnership. Therefore, the proposed regulations generally provided that a partner is free to choose whether or not to request that a partnership reduce the basis of partnership property and that the partnership is free to grant or withhold its consent.

As in the proposed regulations, **the final regulations do not require a partnership** to reduce the basis of its depreciable property (or depreciable real property) in all situations where the partnership is the source of the COD income. However, where a partnership is the source of the COD income and partners elect to exclude such income, such partners are required to request that the partnership reduce its basis in such property. **Accordingly, if partners meeting certain regulatory requirements elect** to exclude such income, the partnership must consent to reduce the basis of its depreciable property (or depreciable real property).

7. Timing and reporting. The proposed regulations provided that a partner requesting a reduction in inside basis must make the request and receive consent before the due date (including extensions) for filing the partner's Federal income tax return for the taxable year in which the partner has COD income. The proposed regulations also provided that a partnership that consents to a basis reduction must include a consent statement with its Form 1065, U.S. Partnership Return of Income, and provide a copy of that statement to the affected partner on or before the date the Form 1065 is filed. One commentator stated that the final regulations should provide that: (i) partners should not be required to request consent, and (ii) neither the partner nor the partnership should be required to attach statements to their returns, until the filing date of their respective returns for the taxable year following the year that the partner excludes COD income.

The IRS and Treasury Department continue to believe that a partner electing under sections 108(b)(5) or 108(c) must receive the consent of the partnership before the partner excludes the COD income. **Therefore, the final regulations provide that the partner must request and receive the consent of the partnership prior to the due date (including extensions) for filing the partner's Federal income tax return for the taxable year in which the partner has COD income.** The final regulations do, however, adopt the suggestion that the partnership is not required to attach a statement to its return until the filing date of its Federal income tax return for the taxable year following the year that ends with or within the taxable year that the partner excludes the COD income.

Income averaging regulations for farmers have not been released by the IRS yet.

The Social Security Wagebase is $72,600 for 1999.