Pillsbury Madison & Sutro LLP

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Internal Revenue Service Restructuring and Reform Act of 1998

On July 22, 1998, President Clinton signed into law the Internal Revenue Service Restructuring and Reform Act of 1998 (the "Act"). The Act makes significant structural changes in the management and oversight of the Internal Revenue Service (the "IRS" or "Service"), strengthens and enhances the rights of and protections applicable to taxpayers and makes other, unrelated changes to the Internal Revenue Code (the "Code"), such as elimination of the 18-month holding period for the preferential capital gains rates for individuals enacted by the Taxpayer Relief Act of 1997.

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Title I: Reorganization of Structure and Management of the Internal Revenue Service

Subtitle A: Reorganization of the Internal Revenue Service

The Act directs the Commissioner of Internal Revenue (the "Commissioner") to develop and to implement a plan to reorganize the IRS. Subject to various savings provisions, the plan shall:

- supersede any organization or reorganization under a currently applicable statute or reorganization plan,
- eliminate or substantially modify the existing national, regional and district structure,
- establish organizational units serving particular groups of taxpayers with similar needs and
- ensure an independent appeals function within the IRS, including the prohibition of *ex parte* communication between appeals officers and other IRS employees where those communications appear to compromise appeals officers' independence. *Act § 1001.*

In addition, the IRS is to revise its mission statement to provide greater emphasis on serving the public and meeting the needs of taxpayers. *Act § 1002.*

Subtitle B: Executive Branch Governance and Senior Management

Internal Revenue Service Oversight Board

The Act establishes the Internal Revenue Service Oversight Board (the "Oversight Board") within the U.S. Treasury Department. *Act § 1101 amending I.R.C. § 7802.* The Oversight Board is to oversee the IRS in its administration, management, conduct, direction and supervision of the execution and application of internal revenue laws. However, the Oversight Board will have no responsibility or authority with respect to:

- the development or formulation of federal tax policy relating to existing or proposed internal revenue laws,
- specific law enforcement activities of the IRS, including specific criminal investigations, examinations and collection activities,
- specific IRS procurement activities and
- specific personnel matters. *I.R.C. § 7802(c).*

The specific responsibilities of the Oversight Board are:

- to review and to approve annual and long-term strategic IRS plans,
- to review operational functions of the IRS,
- to recommend candidates for Commissioner and to review the Commissioner's selection, evaluation and compensation of senior IRS management,
- to review and to approve the Commissioner's plans for any major IRS reorganization,
- to review, to approve and to submit to the Secretary of the Treasury (the "Secretary") the IRS budget prepared by the Commissioner and
- to review IRS operations to ensure proper treatment of taxpayers. *I.R.C. § 7802(d).*

The Oversight Board is to be comprised of nine members, six members who are not otherwise federal officers or employees (the "Private Members"), one member who is a full-time federal employee or a representative of employees (the "Federal Employee Member"), the Secretary (or, if designated by the Secretary, the Deputy Secretary of the Treasury) and the Commissioner. The Private Members and Federal Employee Member are appointed by the President with the advice and consent of the Senate. Private Members of the Oversight Board are to be appointed solely on the basis of professional experience and expertise in:

- management of large service organizations,
- customer service,
- federal tax laws, including administration and compliance,
- information technology,
- organization development,
- the needs and concerns of taxpayers or
- the needs and concerns of small business.

The Private Members and Federal Employee Member serve five-year terms and can be reappointed no more than twice. Of the initial Private Members, two serve two-year terms and two serve four-year terms. *I.R.C. § 7802(b)(1), (2).* The President is to submit the initial nominations for the Oversight Board to the Senate no later than six months following July 22, 1998, the date of the Act's enactment. *Act § 1101(d)(2).*

It is expected that Private Members will generally be "special government employees," as defined under current law, for purposes of determining applicable ethical conduct rules. In addition, during his or her term a Private Member cannot represent any party (whether or not for compensation) with respect to (1) any matter before the Oversight Board or the IRS, (2) any tax-related matter before the Treasury Department or (3) any court proceeding with respect to a matter described in clause (1) or (2). For example, the day after appointment to the Oversight Board, a Private Member could not meet with representatives of the IRS or Treasury Department on behalf of a client or the Private Member's corporate employer with respect to proposed tax regulations. On the other hand, the Private Member could represent clients before the U.S. Customs Service. The special rules applicable to Private Members generally do not preclude a Private Member from sharing in compensation from representation of clients by another person (*e.g.*, a partner of the Private Member) before the IRS or Treasury Department. Private Members are subject to the one-year post-employment restriction and public financial disclosure rules applicable to federal government employees above certain pay grades who have served at least 60 days (irrespective of whether the Private Members are special government employees under current law). Thus, each Private Member is required to file a public financial disclosure report for purposes of confirmation, annually during his or her tenure on the Oversight Board and upon termination of appointment. The same rules generally apply to the Federal Employee Member, although the President may waive certain ethical rules otherwise applicable to the Federal Employee Member. *I.R.C. § 7802(b)(3).*

The Commissioner and Other Officials

The Commissioner is appointed by the President with the advice and consent of the Senate for a five-year term and may be reappointed an unlimited number of times. One qualification for appointment is demonstrated ability in management. The Commissioner is to have such powers and duties as the Secretary shall prescribe, including the power to administer, manage, conduct, direct and supervise the execution and application of the internal revenue laws and to make recommendations to the President regarding appointment and removal of the IRS Chief Counsel. *Act § 1102(a) amending I.R.C. § 7803(a).* Effective July 22, 1998, the date of enactment. *Act § 1102(f)(1).*

The IRS Chief Counsel will be appointed by the President with the advice and consent of the Senate. The Chief Counsel will report directly to the Commissioner (not the Treasury General Counsel as before) except that the Chief Counsel will report (1) to both the Commissioner and the Treasury General Counsel concerning legal advice or the interpretation of tax laws not relating solely to tax policy and concerning tax litigation and (2) only to the Treasury General Counsel with regard to legal advice or interpretation of the tax laws relating solely to tax policy. Chief Counsel personnel are to report only to the Chief Counsel. *Act § 1102(a) amending I.R.C. § 7803(b).* Effective 90 days after July 22, 1998, the date of enactment. *Act § 1102(f)(2).*

Effective July 22, 1998, the date of enactment, the Act eliminates the statutory requirement (former I.R.C. § 7802(b)(1)) that there be an Office of Employee Plans and Exempt Organizations ("EP/EO") under an Assistant Commissioner. The Senate Finance Committee believes that a comparable structure can be created administratively. The Act also eliminates the special funding mechanism (former I.R.C. § 7802(b)(2)) for EP/EO based upon private foundation investment income excise tax collections.

The Act renames the IRS' Taxpayer Advocate (originally established by the Taxpayer Bill of Rights 2 in 1996 as an outgrowth of the IRS Taxpayer Ombudsman established in 1979) the National Taxpayer Advocate (the "NTA"). The NTA is appointed by the Secretary after consultation with the Commissioner and the Oversight Board. The NTA cannot have been an IRS employee during the two years prior to appointment and must agree not to accept employment with the IRS for at least five years after ceasing to be the NTA. The NTA will appoint local taxpayer advocates (at least one per state) who will report to the NTA, not the IRS district directors. The NTA can issue Taxpayer Assistance Orders ("TAOs") if a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered. TAOs will be issued based on criteria contained in regulations which are to embody considerations of equity. The NTA will provide annual reports to the Senate Finance Committee and the House Ways and Means Committee. *Act § 1102(a) amending I.R.C. § 7803(c).* Effective July 22, 1998, the date of enactment. *Act § 1102(f)(1).* On August 11, 1998, Commissioner Charles O. Rossotti announced the appointment as NTA of W. Val Oveson, chair of the Utah State Tax Commission since 1993.

The Act eliminates the IRS office of Chief Inspector and transfers all its powers and duties to a new, independent Treasury Inspector General for Tax Administration within the Treasury Department. The role of existing Treasury Inspector General is redefined to exclude responsibility for the IRS. The Treasury Inspector General for Tax Administration is under the supervision of the Secretary with additional reporting to the Oversight Board and to Congress. The Treasury Inspector General for Tax Administration, appointed by the President with the advice and consent of the Senate, will have the powers formerly held by the IRS Chief Inspector and the Treasury Inspector General (as they related to the IRS) and will thus conduct audits, investigations and evaluation of IRS programs and operations (including the Oversight Board) to promote economic, efficient and effective administration of the tax laws and to detect and to defer fraud and abuse in IRS programs and operations. *Act § 1103 amending the Inspector General Act of 1978.* Effective 180 days after July 22, 1998, the date of enactment. *Act § 1103(c)(1) amending the Inspector General Act of 1978 § 9(a)(1)(L).*

Prohibition on Executive Branch Influence over Taxpayer Audits

Neither the President, Vice President, employees of either the executive office of the President or the Vice President nor cabinet members (except the Attorney General) may make any direct or indirect request to any IRS employee to conduct or terminate an audit or investigation of any particular taxpayer with respect to the tax liability of that taxpayer. Any IRS employee receiving such a request is required to report its receipt to the Treasury Inspector General for Tax Administration. Any willful violation of these rules is punishable by imprisonment for not more than five years, a fine of no more than $5,000 or both. *Act § 1105(a) adding I.R.C. § 7217.* These new rules are applicable to requests made after July 22, 1998, the date of enactment. *Act § 1105(c).*

Title II: Electronic Filing

Electronic Filing of Tax and Information Returns

The Act declares the policy of Congress that it should be the goal of the Service to have at least 80 percent of all federal tax and information returns filed electronically by 2007. To that end, the Act directs the Secretary, no later than 180 days following July 22, 1998, the date of enactment, to establish a strategic plan to eliminate barriers, to provide incentives and to use competitive market forces to increase the number of electronic returns being filed. The Act also mandates creation of an electronic commerce advisory group to include small business and tax practitioner, preparer and computerized tax processing representatives to provide private-sector input into the development and implementation of the plan. *Act § 2001.*

Due Date for Certain Information Returns

Under present law, certain information returns (such as the amount of dividends, partnership distributions and interest paid during the calendar year) must be supplied to recipients by January 31 of the following calendar year. Payors must also file an information return with the IRS by February 28. Effective for certain information returns required to be filed after December 31, 1999, the Act extends their due date to March 31 if they are filed electronically. The Act also directs the Secretary to conduct a study on the effect of extending the deadline for providing statements to recipients from January 31 to February 15 and to submit a report to the Senate Finance Committee and House Ways and Means Committee by June 30, 1999. *Act § 2002.*

Paperless Electronic Filing

The Act directs the Secretary to develop procedures for acceptance of signatures in electronic form. Until those procedures are in place, the Secretary may waive the requirement of a signature on an electronically filed tax return or provide for alternative methods of signing. The Secretary must also:

- develop a method to establish *prima facie* evidence of delivery of electronically filed returns (comparable to the postmark date or return receipt for registered mail for paper returns),
- for taxable periods beginning after December 31, 1998, establish procedures for all tax forms, instructions and publications created in the most recent five-year period to be made available electronically on the Internet and
- establish procedures for taxpayers to authorize, on an electronically filed return, disclosure of confidential information to the preparer of the return. *Act § 2003.*

Return-Free Tax System

The Act directs the Secretary to develop procedures for the implementation of a return-free tax system for appropriate individuals for taxable years after 2007. Annual reports concerning this system are to be made to the Senate Finance Committee and House Ways and Means Committee no later than June 30 of each calendar year after 1999. *Act § 2004.*

Access to Account Information

No later than December 31, 2006, the Secretary is to develop procedures under which taxpayers filing electronic returns could review their IRS account information. A report to the Senate Finance Committee and House Ways and Means Committee on the progress made on developing these procedures is to be submitted no later than December 31, 2003. *Act § 2005.*

Title III: Taxpayer Protection and Rights

Subtitle A: Burden of Proof

In general, the burden of proof with respect to a factual issue in any court proceeding is shifted from the taxpayer to the Internal Revenue Service, provided the taxpayer first introduces credible evidence with respect to the factual issue and satisfies four conditions:

- The taxpayer has complied with any current requirements to substantiate any item;
- The taxpayer has maintained all records in accordance with then current requirements;
- The taxpayer has cooperated with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews; and
- If the taxpayer is not an individual, it does not have a net worth in excess of $7 million.

The burden of proof regarding a factual issue will not be shifted in cases where the Code provides for a specific burden of proof with respect to such issue. *Act § 3001(a) adding I.R.C. § 7491.*

The Conference Report (H.Rpt. 105-599) indicates that credible evidence is evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted. Implausible factual assertions, frivolous claims, tax protestor-type arguments and evidence not worthy of belief by the court should not be considered credible evidence. The Conference Report also notes that a taxpayer has cooperated with the IRS if the taxpayer has provided reasonable assistance to the IRS in obtaining access to and inspection of the items requested by the Service. Cooperation also includes exhaustion of the taxpayer's administrative remedies, including any appeal rights provided by the Service, but does not include the taxpayer's agreement to extend the statute of limitations.

In the case of an individual taxpayer, the IRS has the burden of proof in any court proceeding with respect to any item of income which was reconstructed by the Service solely through the use of statistical information on unrelated taxpayers. *I.R.C. § 7491(b).* In the case of an individual taxpayer, the Service also has the burden of production of evidence in any court proceeding with respect to the imposition of penalties or additions to tax. *I.R.C. § 7491(c).* The Conference Report indicates that taxpayers still have the responsibility for raising issues such as reasonable cause or substantial authority to refute application of such penalties.

These burden of proof provisions apply to court proceedings arising in connection with examinations that commence after July 22, 1998, the date of enactment. Where there is no examination, these provisions apply to court proceedings arising in connection with taxable periods or events beginning or occurring after the date of enactment. *Act § 3001(c).*

Subtitle B: Proceedings by Taxpayers

Expansion of Authority to Award Costs and Certain Fees

The Act broadens the scope and amount of administrative costs and attorney's fees that may be awarded to a taxpayer who substantially prevails in any action by or against the United States in connection with the determination, collection or refund of tax, interest or penalties. *Act § 3101 amending I.R.C. § 7430(c).*

The general maximum hourly rate for attorney's fees that may be awarded is increased from $110 to $125. Attorney's fees in excess of $125 per hour may be awarded where the difficulty of the issues presented in the case or the unavailability of local tax expertise justifies such higher rate. As under existing law, cost of living disparities or the limited availability of qualified attorneys also may justify a higher rate. The court may award market-rate, reasonable attorney's fees to an individual (or such individual's employer) who represents the taxpayer for no fee or a nominal fee, such as *pro bono* representation. The

date on or after which reasonable administrative costs are incurred is extended earlier in time to the date that the IRS sends the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals (*i.e.,* a “30-day letter”).

In determining whether the position of the United States is substantially justified such that the taxpayer has not “substantially prevailed” and thus is ineligible for an award of costs or fees, the court must take into account whether the United States has lost in other United States courts of appeal on substantially similar issues. If (1) a taxpayer timely makes a “qualified offer” that is rejected by the Service and (2) the IRS subsequently obtains a judgment against the taxpayer in an amount that equals or is less than such offer, then the taxpayer must be treated as a prevailing party eligible for an award of costs and fees. A qualified offer is a written offer for the amount of the taxpayer’s tax liability made by the taxpayer to the United States during the “qualified offer period,” where such offer is designated as a “qualified offer” and remains open until the earliest of (1) the date the offer is rejected, (2) the date the trial begins or (3) the 90th day after the date the offer is made. The “qualified offer period” begins on the date that the first 30-day letter is sent and ends on the date that is 30 days before the date the case is first set for trial.

Reasonable attorney’s fees also may be awarded to taxpayers in their actions for civil damages against the United States for the unauthorized inspection or disclosure of the taxpayer’s tax returns or return information. *Act § 3101(f) amending I.R.C. § 7431(c).*

These cost and fee award provisions apply to costs incurred and services performed more than 180 days after July 22, 1998, the date of enactment. *Act § 3101(g).*

Civil Damages for Collection Actions

Prior to the Act, a taxpayer was eligible to receive up to $1 million of civil damages against the United States as a result of an officer or employee of the Service recklessly or intentionally disregarding the provisions of the Code or Treasury Regulations in the collection of federal income tax from the taxpayer. The Act extends civil damages to the case of negligent acts by an officer or employee of the Service, subject to a cap of $100,000 in civil damages arising from such negligence. In addition, civil damages of up to $1 million are permitted for damages caused by an officer or employee of the Service who willfully violates the provisions of the Bankruptcy Code relating to automatic stays or discharges. Whereas prior to the Act, civil damages were subject to reduction if the taxpayer did not exhaust its administrative remedies within the Service, the Act now requires a taxpayer to exhaust such remedies before any civil damages are awarded. *Act § 3102(a), (c) amending I.R.C. § 7433.*

The Act also provides that persons other than the taxpayer may sue for civil damages for unauthorized collection actions. *Act § 3102(b) amending I.R.C. § 7426.*

These civil damages provisions apply to actions of officers or employees of the Service that occur after July 22, 1998, the date of enactment. *Act § 3102(d).*

Increase in Size of Cases Permitted on Small Case Calendar

Taxpayers currently have the option to use special small case procedures in proceedings before the Tax Court, subject to Tax Court concurrence. Prior to the Act, small case procedures applied to disputes involving $10,000 or less. The Act increases this limitation from $10,000 to $50,000, effective for proceedings that commence after July 22, 1998, the date of enactment. *Act § 3103 amending I.R.C. § 7463.*

Actions for Refund with Respect to Certain Estates Which have Elected the Installment Method of Payment

The Act grants the United States district courts and the United States Court of Federal Claims jurisdiction to determine the correct amount of estate tax liability (or refund) in any action brought by the executor of an estate, even if such liability has not been paid because of the executor’s election to make tax payments under the installment method provided for in section 6166 of the Code. To qualify for this provision, the following conditions must be met as of the date such action is filed:

- No portion of the installments payments due under section 6166 of the Code has been accelerated;
- All installments payable on or before the action is filed have been paid;
- No case is pending in the Tax Court with respect to estate tax liability;
- There are no outstanding deficiency notices against the estate; and
- There are no pending proceedings for declaratory judgment relating to the estate’s eligibility for installment payments of estate tax.

Once the United States district court or Court of Federal Claims enters a final judgment, the IRS may not collect any amount disallowed by the court. The Service must refund any amounts previously paid by the taxpayer in excess of the amount of tax the court has determined to be due and payable. *Act § 3104(a) amending I.R.C. § 7422.*

The Act also suspends the two-year statute of limitations period for filing a refund suit during the pendency of any action brought by the taxpayer under section 7479 of the Code for declaratory judgment as to an estate's eligibility to make tax payments under the installment method. *Act § 3104(b) amending I.R.C. § 7479.*

These provisions are effective for claims for refund filed after July 22, 1998, the date of enactment. *Act § 3104(c).*

Administrative Appeal of Adverse IRS Determination of Tax-Exempt Status of Bond Issue

The Act directs the IRS to amend its administrative procedures to provide that a bond issuer has the right to an administrative appeal before a senior officer of the IRS Office of Appeals, if the Service, upon examination, proposes to the issuer that interest on bonds does not qualify for tax-exempt treatment. This provision is effective on July 22, 1998, the date of enactment. *Act § 3105.*

Civil Action for Release of Erroneous Lien

The Act provides for administrative procedures to permit third party owners of property against which a federal tax lien has been filed to obtain a certificate of discharge of property from the lien as a matter of right. This provision applies to property owners other than the person whose unsatisfied tax liability gave rise to the lien (*i.e.*, "third party owners"). To obtain such certificate, the third party owner must submit a request to the IRS and either deposit cash or furnish a bond that is satisfactory to the IRS. The Service must refund the amount deposited or release the bond, as the case may be, to the extent that the Service determines that either (1) a source other than the property can satisfy the liability that gave rise to the lien or (2) the value of the United States' interest in the property is less than the Service's prior determination of such value. *Act § 3106(a) amending I.R.C. § 6325.*

The Act also provides that third party owners of property may bring a civil action against the United States in a United States district court for a determination whether the value of the interests of the United States in such property is less than the value determined by the Service. The owner must initiate the civil action within 120 days after the day on which a certificate of discharge was issued. If the court finds in favor of the owner, the IRS must refund the amount deposited or release the bond, to the extent that the amount of the deposit or bond exceeds the value of the United States' interest in the property. The Service also must pay interest on such refund. *Act § 3106(b) amending I.R.C. § 7426.* If a third party owner does not initiate such civil action within the prescribed period, the IRS must, within 60 days after the expiration of such period (1) apply the amount deposited, or collect on such bond, to the extent necessary to satisfy the unsatisfied liability secured by the lien and (2) refund (with interest) any portion of the amount deposited that is not used to satisfy such liability. *Act § 3106(a) amending I.R.C. § 6325.*

The running of the statute of limitations for the IRS to collect on an assessment is suspended for a period equal to the period beginning on the date an owner becomes entitled to a certificate of discharge (as described above) and ending on the date that is 30 days after the earlier of (1) the earliest date on which the Service no longer holds any amount as a deposit or bond because such deposit or bond was used to satisfy unpaid tax or was refunded or released or (2) the date the court's judgment in the civil action described above becomes final. *Act § 3106(b) amending I.R.C. § 6503.*

This provision is effective on July 22, 1998, the date of enactment. *Act § 3106(c).*

Subtitle C: Relief for Innocent Spouses and for Taxpayers Unable to Manage Their Financial Affairs Due to Disabilities

Relief from Joint and Several Liability on Joint Return

The Act generally provides two forms of relief from joint and several liability for spouses in connection with the filing of a joint return, one applies to spouses who did not know that there was an understatement of tax attributable to the other spouse when signing the joint return ("innocent spouses") and the other provides for a separate liability election by certain former spouses. The Act also gives the Tax Court jurisdiction over disputes about innocent spouse relief and separate liability elections. *Act § 3201 adding I.R.C. § 6015.*

Innocent spouse relief. If the following conditions are satisfied and the innocent spouse timely elects relief, an innocent spouse will be relieved of liability for tax (including interest and penalties) to the extent such liability is attributable to an understatement of tax of the other spouse:

- A joint return was made;
- An understatement of tax on such return is attributable to erroneous items of the other spouse;
- In signing the return the innocent spouse did not know, and had no reason to know, that there was such understatement; and
- Taking into account all the facts and circumstances, it is inequitable to hold the innocent spouse liable for the deficiency in tax attributable to such understatement.

The innocent spouse must elect relief within two years after the date the IRS has begun collection activities with respect to the innocent spouse. An innocent spouse may be relieved of liability for the portion of an understatement about which such spouse had no knowledge or reason to know, even though such spouse knew or had reason to know of other understatements of tax on the same return. Determinations of the allocation of items to a particular spouse are made without regard to community property laws. *I.R.C. § 6015(b).*

Separate liability election. A spouse 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 such spouse originally filed a joint return may elect to limit his or her liability for any deficiency on such return to the portion of the deficiency that is attributable to items allocable to the electing spouse. Such election must be made no later than two years after the date the IRS has begun collection activities with respect to the electing spouse. *I.R.C. § 6015(e).*

Relief is denied to electing spouses under any of the following circumstances:

- The electing spouse was a member of the same household as the other spouse during the 12-month period prior to date the election is filed;
- The IRS demonstrates that the spouses filing the joint return fraudulently transferred assets between themselves;
- The IRS demonstrates that the electing spouse had actual knowledge that an item on a joint return was incorrect and was not under duress to sign the return, in which case relief will be denied to the extent any deficiency is attributable to such item; or
- The electing spouse receives "disqualified assets" from the other spouse to avoid tax, in which case the portion of the deficiency for which the electing spouse is liable will be increased by the value of any disqualified assets.

Disqualified assets include any property or right to property that was transferred to the electing spouse if the principal purpose of the transfer was the avoidance of tax or payment of tax. A rebuttable presumption exists that a transfer was made to avoid tax if the transfer was made less than one year before the 30-day letter was sent. The rebuttable presumption does not apply to transfers pursuant to a decree of divorce or separate maintenance.

In general, an electing spouse limits his or her separate liability for any deficiency on a joint return to the portion of the deficiency that is attributable to items allocable to the electing spouse. An item giving rise to a deficiency is generally allocated to a spouse in the same manner as it would have been allocated if the spouses had filed separate returns. For example, if an item of income is allocated to one spouse, the deficiency (or portion thereof) attributable to such item is allocated to that spouse. However, if a deficiency (or portion thereof) relates to the items of both spouses, the deficiency is allocated between the spouses in the same proportion as the net items taken into account in determining the deficiency. The following are exceptions to the general allocation rule:

- Under rules to be prescribed, an item otherwise allocable to one spouse may be allocated to the other spouse to the extent the item gave rise to a tax benefit on the joint return to the other spouse;
- If the IRS establishes fraud on the part of either or both spouses, the Service may provide for an appropriate alternative allocation;
- If an item of deduction or credit is disallowed in its entirety solely because a separate return is filed, such disallowance is disregarded and the item is computed as if a joint return had been filed and then allocated appropriately between the spouses; and

- If the liability of a child of a spouse 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.

Where a deficiency is attributable to the disallowance of a credit, or to any tax other than regular individual or alternative minimum tax, and such item is allocated to one spouse, the portion of the deficiency attributable to such credit or other tax is allocated to that spouse before making the allocations described above. *I.R.C. § 6015(d).*

Equitable relief. If both innocent spouse relief and the separate liability election are unavailable to a spouse and if, under all the facts and circumstances, it is inequitable to hold such spouse liable for any unpaid tax or deficiency, then under procedures to be prescribed the IRS may relieve such spouse of such liability. *I.R.C. § 6015(f).*

The innocent spouse relief, separate liability election and authority to provide equitable relief all apply to liabilities for tax arising after July 22, 1998, the date of enactment. *Act § 3201(g).*

Suspension of Statute of Limitations on Filing Refund Claims During Periods of Disability

The Act provides for the equitable tolling of the statute of limitations for refund claims of an individual taxpayer during periods of the taxpayer'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 at least 12 months. Tolling does not apply during periods in which the taxpayer's spouse or representative is authorized to act on the taxpayer's behalf in financial matters. This provision applies to periods of disability before, on or after July 22, 1998, the date of enactment, but does not apply to any claim for refund or credit that (without regard to this provision) is barred by the operation of any law as of that date. *Act § 3202 amending I.R.C. § 6511.*

Subtitle D: Provisions Relating to Interest and Penalties

Netting of Interest on Offsetting Overpayments and Underpayments

A net interest rate of zero is established when a taxpayer has an equivalent overpayment and underpayment outstanding during the same period. This rule applies even to large corporate underpayments or corporate overpayments in excess of $10,000, even though those particular underpayments and overpayments have special interest rate provisions. *Act § 3301(a) amending I.R.C. § 6621.* This provision is generally effective for interest for periods beginning after July 22, 1998, the date of the Act's amendment; however, it can apply to prior periods if the taxpayer so requests before December 31, 1999 and reasonably identifies and establishes periods of tax overpayments and underpayments for which the zero rate applies. *Act § 3301(c).*

Increase of Overpayment Rate

Previously the interest rate charged to taxpayers on underpaid taxes equaled the applicable federal short-term rate (the "short-term AFR") plus three percentage points, whereas the rate charged to the government on overpaid taxes equaled the short-term AFR plus two percentage points. The Act equalizes these rates at the short-term AFR plus three percentage points, except in the case of corporations, where the rate charged on overpaid amounts is unchanged. *Act § 3302(a) amending I.R.C. § 6621(a).* These changes are applicable to interest for the second and succeeding calendar quarters beginning after July 22, 1998, the date of enactment. *Act § 3302(b).*

Mitigation of Penalty for Taxpayer's Failure to Pay

A delinquency charge will generally be imposed where a taxpayer fails (1) to file a tax-return, (2) to pay the tax shown on the return or (3) to pay the amount which should have been (but was not) shown on the return. *I.R.C. § 6651(a).* The rate imposed is .50 percent for the first month, increasing .50 percent each additional month, to a ceiling rate of 25 percent. The Act provides that, so long as an individual has filed a return, the .50 percent rate will be lowered to .25 percent where the taxpayer and the Service have agreed to allow the taxpayer to pay taxes under an installment payment agreement. *Act § 3303(a) adding I.R.C. § 6651(h).* The amendment is effective for additions to tax for months beginning after December 31, 1999. *Act § 3303(b).*

Mitigation of Failure to Deposit

Taxpayers required to make deposits of taxes (*e.g.*, payroll taxes) are generally subject to a penalty whenever such deposits are not timely made. *I.R.C. § 6656(a).* The penalty increases as the deposit becomes more overdue. *I.R.C. § 6656(b).* The Act now allows such taxpayers to designate the period to which a deposit is to be applied.

Act § 3304(a) adding I.R.C. § 6656(e)(1). The designation may only be made during the 90 days after an IRS penalty notice has been received. *Act § 3304(a) adding I.R.C. § 6656(e)(2).* These changes are applicable to deposits required to be made 180 days after the date of enactment, July 22, 1998. *Act § 3304(d)(1).*

The Act also provides that any deposit required to be made after December 31, 2001 will be applied to the most recent period to which the deposit relates, unless a different period is designated. *Act § 3304(c) adding I.R.C. § 6656(e)(1).*

Suspension of Interest and Penalties

The Act calls for the suspension of any interest and penalties if the IRS fails, within 18 months of a taxpayer's filing of a return, to give notice which specifically states the amount of and the basis for any liability. *Act § 3305 adding I.R.C. 6404(g).* The 18-month period is reduced to a 1-year period starting January 1, 2004.

The notice requirement imposed on the Service is applied separately to each tax item or adjustment. *Act § 3305(a) adding I.R.C. § 6404(g)(1)(B).* Interest and penalties resume 21 days after provision of the notice. *Act § 3305(a) adding I.R.C. § 6404(g)(3)(B).*

A taxpayer must timely file a return in order to enjoy the protection of this amendment. Moreover, interest and penalties will not be suspended with respect to (1) amounts already shown on the return or (2) amounts relating to fraud or other criminal penalty. *Act § 3305(a) adding I.R.C. § 6404(g)(2).*

These changes are effective for taxable years ending after July 22, 1998, the date of enactment. *Act § 3305(b).*

Procedural Requirements for Imposition of Interest

The Act requires the IRS to include with each notice imposing a penalty (1) the name of the penalty, (2) the Code section authorizing the penalty and (3) an actual computation of the penalty. *Act § 3306(a) adding I.R.C. § 6751(a).* Moreover, a supervisor must personally approve, in writing, the initial penalty determination. *Act § 3306(a) adding I.R.C. § 6751(b)(1).*

This new notice and approval process does not apply to penalties associated with a taxpayer's failure (1) to file a return, (2) pay estimated tax or (3) pay amounts already shown on a return. *Act § 3306(a) adding I.R.C. § 6751(b)(2).*

These requirements apply to notices issued and penalties assessed after December 31, 2000. *Act § 3306(c).*

Notice of Interest Charges

Effective January 1, 2001, the Service must include in each notice sent to taxpayers with regard to interest owed (1) the amount of interest the taxpayer owes, (2) a citation of the Code provision justifying the request for payment and (3) an actual computation of the amount of interest. *Act § 6631 adding I.R.C. § 6631.*

Abatement of Interest on Underpayment

The Act provides for the abatement of interest for taxpayers located in a Presidentially declared disaster area who have been granted a filing extension by the Service. *Act § 3309(a) adding I.R.C. § 6404(h).* The period of abatement lasts the length of the extension. The amendment is effective for disasters declared after December 31, 1997. *Act § 3309(b).*

Subtitle E: Protections for Taxpayers Subject to Audit or Collection Activities

Due Process in Collection Activities

So as to insure due process, the Act affords taxpayers new procedural rights in cases involving the collection of taxes by levy. Specifically, the Service must send, not less than 30 days before the date of the first levy, notice to the taxpayer informing him or her of the right to an impartial hearing. *Act § 3401(b) adding I.R.C. § 6330(a).* The taxpayer has the right to request one such hearing within 30 days of the mailing of the notice. The hearing must be conducted by an officer who has had no prior involvement in the case. *Act § 3401(b) adding I.R.C. § 6330(b)(3).* At the hearing, the taxpayer may raise relevant defenses or suggest a collection method to be used instead of a levy (*i.e.*, substitution of assets or installment payment program). *Act § 3401(b) adding I.R.C. § 6330(c)(2)(A).* The new procedural rights do not apply in the case of jeopardy assessments. Rather, the taxpayer is only given an opportunity for a hearing "within a reasonable period of time" after the levy has been made. *Act § 3401(b) adding I.R.C. § 6330(f).* These new rules apply to collection activities initiated more than 180 days following July 22, 1998, the date of enactment. *Act § 3401(d).*

Extension of Attorney-Client Privilege

The attorney-client privilege is now applicable to communications between taxpayers and individuals

authorized to practice before the Service. The privilege is not extended to criminal tax matters or proceedings nor to communications regarding corporate tax shelters. *Act § 3411(a) adding I.R.C. § 7525(a)(2).* The amendment is effective with regard to communications made on or after, July 22, 1998, the date of enactment. *Act § 3411(c).*

Limitation on "Financial Status" Audit Technique

When auditing a taxpayer's return, the Service is authorized (1) to examine any relevant books or data, (2) to summon individuals to testify and provide information and (3) to take the testimony of the taxpayer. *I.R.C. § 7602(a).* Under this authority, the Service used to conduct "financial status" audits in which the Service would ask probing questions intended to determine the existence of unreported income. The Act now prohibits such audits unless there is a "reasonable indication that there is a likelihood of such unreported income." *Act § 3412 adding I.R.C. § 7602(d).*

Software Trade Secrets Protection

The Act imposes new standards with regard to the Service's ability to summons tax-related computer software source code. Specifically, the Secretary may force the taxpayer to produce the source code if (1) the Service is otherwise unable to reasonably ascertain a return's accuracy, (2) the Service specifically identifies the portion of the source code needed and (3) the Service determines that the need for the source code outweighs the risks of unauthorized disclosure of trade secrets. *Act § 3413(a) adding I.R.C. § 7612(b)(1)(A).* The new standards do not apply to software acquired or developed by the taxpayer primarily for internal use rather than commercial distribution. *Act § 3413(a) adding I.R.C. § 7612(b)(2)(B).*

The Act also restricts the Service's ability to view the source code after issuance of the summons. For instance, the Service generally may not make copies nor remove such code from the owner's place of business. *Act § 3413(a) adding I.R.C. § 7612(c)(2).* The new section provides for felony charges in the event an individual willfully divulges the software. *Act § 3413(b) adding I.R.C. § 7213(d).*

The amendment applies to summonses issued and software acquired after July 22, 1998, the date of enactment. *Act § 3413(e)(1).* As to software acquired on or before that date, the safeguards which ensure protection of trade secrets and other confidential information apply after the 90th day following July 22, 1998, the date of enactment. *Act § 3413(e)(2).*

Tip Reporting Alternative Commitment Agreements

Currently, restaurants may enter into Tip Reporting Alternative Commitment Agreements ("TRAC Agreements") wherein owners are obligated to pay taxes and educate employees on tip reporting. Under the Act, IRS employees are now instructed that they may not threaten to audit any taxpayer in an attempt to coerce such taxpayer to enter into a TRAC Agreement. *Act § 3414.*

Notice of IRS Contact of Third Parties

The Act prohibits IRS employees from contacting anyone other than the taxpayer with respect to a tax liability without first providing the taxpayer reasonable notice. This prohibition does not apply where (1) the taxpayer has authorized the contact, (2) the collection of tax would be jeopardized by the issuance of the notice or (3) a criminal investigation is involved. *Act § 3417(a) adding I.R.C. § 7602(c).* The changes are effective to contacts made more than 180 days following July 22, 1998, the date of enactment. *Act § 3417(b).*

Approval Process for Liens, Levies and Seizures

The Act directs the Commissioner to determine situations in which an employee's decision to levy or seize a taxpayer's property should be reviewed by a supervisor. The Commissioner is also directed to adopt procedures which provide for disciplinary action in the event the review process is not followed. *Act § 3421.* The section is effective on the date of enactment, July 22, 1998, except for actions under an automated collection system, where the section is applicable to actions initiated after December 31, 2000. *Act § 3421(c)(2).*

Modification of Certain Levy Exemption Amounts

The Code currently prohibits the Service from seizing personal belongings of the taxpayer up to certain dollar amounts. *I.R.C. § 6334.* The Act increases this dollar amount as to specific items. Effective for levies issued after July 22, 1998, the date of enactment, the Code now exempts from collection (1) fuel, provisions, furniture and personal effects valued up to $6,250 (previously $2,500) and (2) books and tools of the taxpayer's trade, business or profession valued up to $3,125 (previously $1,250). The new amounts are indexed for inflation. *Act § 3431 amending I.R.C. § 6334.*

Release of Levy upon Agreement

New section 6343(e) of the Code governs levies on taxpayer's salary or wages. It forces the Service to release such levies as soon as practicable when an agreement is reached with the taxpayer that the tax is not collectible. *Act § 3432 adding I.R.C. § 6343(e).* Applicable to levies imposed after December 31, 1999. *Act § 3432(b).*

Levy Prohibited During Pendency of Refund Proceedings

The Act prohibits the Service from collecting any tax by levy while a taxpayer's refund action is still pending, but only with regard to refund claims that can be brought without the full payment of taxes. The prohibition does not apply to collections the Secretary finds are in jeopardy. *Act § 3433(a) adding I.R.C. § 6331(i).* Applicable to unpaid taxes attributable to taxable periods after December 1, 1998. *Act § 3433(b).*

Approval for Jeopardy Assessment

Typically, taxpayers are provided no less than 30 days' notice before their property may be levied. *I.R.C. § 6331(d).* This 30-day period is not applicable where the collection of tax is in jeopardy, *i.e.*, a "jeopardy assessment." The Act now prohibits jeopardy assessments unless the Service's Chief Counsel or delegate personally approves such assessment. Within five days of such assessment, the taxpayer is now provided a statement listing information on which the Secretary relied. *Act § 3434 amending I.R.C. § 7429(a).* Applicable to jeopardy and termination assessments made after July 22, 1998, the date of enactment. *Act § 3434(b).*

Increase in Amount on which Lien not Valid

Section 6321 of the Code provides that where any person liable to pay a tax fails to do so, the amount due becomes a lien in favor of the United States upon all of such taxpayer's property. In order to perfect this lien, the Service must file a special notice. *I.R.C. § 6323(f).*

Section 6323 of the Code protects certain third parties who themselves have claims to a taxpayer's property and who perfected such claims before the Service filed notice. The protection of section 6323 has a ceiling dollar amount, which the Act increases. Specifically, a third party will be protected with respect to purchases for private use of household goods from the taxpayer for less than $1,000 (previously $250). Also, individuals holding a "mechanics lien" of up to $5,000 (previously $1,000) are protected for repairs or improvements made to a personal residence. Both these new limits are indexed for inflation. *Act § 3435(a) amending I.R.C. § 6323.* These changes are effective on July 22, 1998, the date of enactment. *Act § 3435(c).*

Early Withdrawals from Employer-Sponsored Plans or IRAs

Generally, where an individual receives an early distribution from a qualified retirement plan (*e.g.*, an individual retirement account or IRA), the tax on the amount of the distribution includible in gross income is automatically increased by ten percent. *I.R.C. § 72.* For distributions made after December 31, 1998, the Act provides an exception to this ten percent early withdrawal tax where distributions are made "on account of a levy" by the Service. *Act § 3436 amending I.R.C. § 72(t)(2)(A).*

Prohibitions Regarding Sales of Seized Property

After seizing a taxpayer's property, the Service must follow certain procedures before selling such property in satisfaction of a tax liability. *I.R.C. § 6335.* Previously, the Code required the IRS to determine the minimum price at which the property was to be sold. The Act now prohibits the Service from selling seized property below this minimum amount, effective for sales occurring after July 22, 1998, the date of enactment. *Act § 3441 amending I.R.C. § 6335(e)(1)(A)(i).*

Accounting of Sales of Seized Property

Section 6340 of the Code previously required the IRS to maintain specific records of all sales of seized real property. The Act extends this obligation to sales of all seized property, both real and personal. *Act § 3442(a)(1) amending I.R.C. § 6340.* Moreover, upon such sale, the IRS must now provide the taxpayer (1) the relevant records (excluding names of purchasers), (2) the amount from the sale applied to the taxpayer's liability and (3) the remaining balance of the liability. *Act § 3442(a)(1) adding I.R.C. § 6340(c).* These changes are applicable to seizures occurring after July 22, 1998, the date of enactment. *Act § 3442(b).*

Uniform Asset Disposal Mechanism

The IRS is to implement, within two years of enactment, a "uniform asset disposal mechanism" for sales of seized property. The mechanism should prevent

revenue officers from participating in such sales. The Act suggests that the IRS should consider outsourcing its responsibilities in seized property sales. *Act § 3443.*

Procedures for Seizure of Taxpayer's Property

The Act implements certain procedural safeguards which must be met before the IRS may seize an individual's property. Specifically, prior to any seizure the Service must now (1) verify the taxpayer's liability, (2) insure that the expenses associated with the property sale do not exceed the property's value, (3) determine that there is enough equity in the property to apply against the tax liability and (4) consider alternative collection methods. *Act § 3444(a) adding I.R.C. 6331(j).* Effective July 22, 1998, the date of enactment. *Act § 3444(b).*

Seizures of Residences and Businesses

Section 6334(a) of the Code lists specific property which may not be levied by the IRS. The Act expands this section to prohibit the Service from levying upon the taxpayer's real property which is used as a residence by either the taxpayer or, unless the property is rented, another individual, but only in either case if the amount of the levy does not exceed $5,000. *Act § 3445(a) amending I.R.C. § 6334(a)(13).*

The Act likewise includes a prohibition against levying upon the taxpayer's principal residence or tangible personal property or real property used in the taxpayer's trade or business, irrespective of the amount of the levy. *Act § 3445(a) amending § 6334(a)(13).* A principal residence is not exempt from levy if a U.S. district court judge or magistrate approves the levy; similarly, trade or business assets are not exempt from levy if an IRS district director or assistant district director personally approves the levy or where collection is in jeopardy, but only after a determination that the taxpayer's other assets are insufficient to satisfy the liability. *Act § 3445(b) amending I.R.C. § 6334(e).* Effective July 22, 1998, the date of enactment. *Act § 3445(d).*

Extension of Statute of Limitations

The IRS must generally assess taxes owed within three years of the filing of the taxpayer's return. *I.R.C. § 6501(a).* This three-year period can be extended by written agreement between the taxpayer and the Service. *I.R.C. § 6501(c)(4).* The Act now requires the IRS to notify the taxpayers specifically of their right to refuse to extend the three-year period, and their right to limit such extension to particular issues or to a particular period of time. *Act § 3461(b)(2) adding I.R.C. § 6501(c)(4)(B).* Applicable to requests for extensions made after December 31, 1999. *Act § 3461(c)(1).*

Generally, the IRS must collect taxes due within ten years of assessing them. *I.R.C. § 6502(a).* Previously, the Service and the taxpayer could agree to extend this ten-year period. *I.R.C. § 6502(a).* The Act eliminates this ability to extend the statute of limitations for collection by agreement, except in the case of installment payment agreements between the Service and the taxpayer. *Act § 3461(a) amending I.R.C. § 6502(a).* This change is generally effective for requests for extensions of the statute of limitations made after December 31, 1999. *Act § 3461(c)(1).* However, where a taxpayer agrees (or has agreed) before December 31 1999 to extend the ten-year period, such extension automatically expires on the latest of (1) the last day of the 10-year period, (2) December 31, 2002 or (3) the 90th day after the end of an extension in connection with an installment agreement. *Act § 3461(c)(2).*

Offers-in-Compromise

The Code provides the IRS authority to settle any civil or criminal case under the internal revenue laws. *I.R.C. § 7122.* Pursuant to this authority, taxpayers may make an "offer-in-compromise" setting forth a settlement proposal to resolve a dispute.

The Act now requires the Service to prescribe guidelines to its employees for determining whether such offers are adequate. These guidelines must be designed to insure that taxpayers entering into a compromise have adequate means to provide for basic living expenses. *Act § 3462 adding I.R.C. § 7122(c).*

The Act prohibits the IRS from seizing any of the taxpayer's property during the period that an offer-in-compromise is pending, and for the 30 days following a rejection of such offer. Comparable rules apply to proposed installment agreements and the termination of existing installment agreements. *Act § 3462(b) adding I.R.C. § 6331(k).* The IRS is now required to establish procedures to review independently rejections of offers-in-compromise before such rejections are sent to the taxpayer. Moreover, the taxpayer is to be provided a right to appeal such rejection within the IRS itself. *Act § 3462(c)(1) adding I.R.C. § 7122(d).*

These changes are applicable to proposed offers-in-compromise and installment agreements submitted after July 22, 1998, the date of enactment. *Act § 3462(e)(1).* The proscription against seizing property applies to offers-in-compromise pending on or submitted after December 31, 1999. *Act § 3462(e)(2).*

Notice of Deficiency

After receiving notice from the IRS regarding a deficiency of taxes paid, the taxpayer generally has 90 days in which to file a petition with the Tax Court for a redetermination of the deficiency. *I.R.C. § 6213(a).* The Act now requires the Service to include on each notice of deficiency the actual last date on which the taxpayer may file such a petition. *Act § 3463(a).* Any petition filed on or before the date specified is considered timely. *Act § 3463(b).* Applicable to notices of deficiency mailed after December 31, 1998. *Act § 3463(c).*

Refund of Overpayments Before Final Determination

Section 6213(a) of the Code generally prohibits the IRS from collecting a tax deficiency until either 90 days after a notice of deficiency has been mailed or a Tax Court decision has become final. Notwithstanding this general prohibition, only injunctive relief was available where the IRS seized property during this period as prior law provided the taxpayer no refund claim for property prematurely levied. Effective July 22, 1998, the date of enactment, the Tax Court (or other court with proper jurisdiction) now has the power to compel a refund of any such amounts wrongfully collected. *Act § 3464 amending I.R.C. §§ 6213, 6512.*

IRS Procedures Relating to Appeals of Examinations and Collections

The Act requires the Service to implement an alternative dispute resolution process whereby a taxpayer may request early resolution of one or more issues. The Service is required to provide for a non-binding mediation process, which may be requested by either a taxpayer or the IRS Office of Appeals following, for example, unsuccessful settlement attempts. The Service is likewise required to establish a pilot program for binding arbitration in similar situations. *Act § 3465(a) adding I.R.C. § 7123.* The IRS Commissioner is directed to ensure that an IRS appeals officer is available in each state and to consider the use of videoconferencing of appeals conferences for taxpayers in rural areas. *Act §§ 3465(b), (c).*

Fair Tax Collection Practices

The IRS is now prohibited from communicating with a taxpayer in connection with unpaid taxes (1) at any unusual time or place inconvenient to the taxpayer, (2) if the Service knows the taxpayer is represented by another individual and knows such individual's name and address or (3) at the taxpayer's place of employment if the IRS knows or has reason to know that taxpayer is prohibited from receiving such communication. The Service may assume, absent knowledge to the contrary, that the hours between 8:00 a.m. and 9:00 p.m. local time are convenient for the taxpayer. *Act § 3466(a) adding I.R.C. § 6304.*

In addition, when collecting any unpaid tax the Service may not engage in any conduct which harasses, oppresses or abuses any person. *Act § 3466(b) adding § 6304(b).* These new prohibitions are effective July 22, 1998, the date of enactment. *Act § 3466(c).*

Guaranteed Availability of Installment Agreements

Under section 6159 of the Code, the Service is authorized to enter into an agreement with a taxpayer whereby the taxpayer's liability may be satisfied in a series of installment payments. *I.R.C. § 6159.* The Act now provides the Service no discretion in certain circumstances when an installment agreement is proposed by the taxpayer. Specifically, effective July 22, 1998, the date of enactment, the Service must accept an installment agreement so long as:

- the amount of the liability (excluding interest and penalties) does not exceed $10,000,
- during the preceding five years, the taxpayer has not failed to file a return, failed to pay any tax required to be shown on such return or entered into an installment agreement,
- the Service determines that the taxpayer is unable to pay the liability in full when due,
- full payment of the liability will be made within three years and
- the taxpayer agrees to comply with the tax laws and provisions of the agreement. *Act § 3467 adding I.R.C. § 6159(c).*

Prohibition on Requests to Taxpayers

The Act prohibits any U.S. officer or employee from requesting that a taxpayer waive the right to bring a civil

action against the United States or any officer or employee thereof for any action taken in connection with the internal revenue laws. *Act § 3468(a)*. This prohibition does not apply where the taxpayer knowingly and voluntarily waives such right or where the request is made either in the presence of the taxpayer's attorney (or other federally authorized tax practitioner) or in writing to the taxpayer's attorney or other representative. *Act § 3468(b)*.

Subtitle F: Disclosures to Taxpayers

Explanation of Joint and Several Liability

The Act directs the IRS to establish procedures no later than 180 days after July 22, 1998, the date of enactment, to alert married taxpayers, on all appropriate publications, of their joint and several liability. *Act § 3501(a)*. The Service must also notify spouses of the "innocent spouse" relief afforded by section 6015 of the Code. *Act § 3501(b)*.

Explanation of Taxpayer's Rights in Interviews

The IRS must, within 180 days after July 22, 1998, the date of enactment, revise its Publication 1 ("Your Rights as a Taxpayer") to inform taxpayers more clearly of their rights to be represented at an interview and to suspend an interview. *Act § 3502*.

Disclosure of Criteria of Examination Selection

Within 180 days of July 22, 1998, the date of enactment, the Service must include in its Publication 1 a simple and nontechnical statement describing the criteria and procedures used for selecting taxpayers for audit. Although this statement need not disclose any information "detrimental to law enforcement," it must specify the general procedures used by the Service, including whether taxpayers are selected for examination on the basis of information available in the media or provided to the IRS by informants. *Act § 3503(a)*.

Explanation of Appeals and Collection Process

Within 180 days of July 22, 1998, the date of enactment, the IRS must include with any first letter of proposed deficiency an explanation of the entire tax audit and collection process. *Act § 3504*.

Explanation of Reason for Refund Disallowance

The Act requires the Service to provide, in connection with a claim for refund of an overpayment, an explanation of any disallowance of such claim. *Act § 3505(a) adding I.R.C. § 6402(j)*. Applicable to disallowances more than 180 days following July 22, 1998, the date of the Act's enactment. *Act § 3505(b)*.

Statements Regarding Installment Agreements

By July 1, 2000 the IRS must provide each taxpayer with an installment agreement in effect an annual statement setting forth balance and payment information. *Act § 3506*.

Notification in Change in Tax Matters Partner

In certain circumstances, the IRS may select a partnership's "tax matters partner." *I.R.C. § 6231(a)(7)*. In such a circumstance, the Service must now inform all other partners of the name and address of the person selected within 30 days of such selection. *Act § 3507(a) amending I.R.C. § 6231(a)(7)*. Effective as to selections made after July 22, 1998, the date of enactment. *Act § 3507(b)*.

Disclosure to Taxpayers

The Act requires the IRS to ensure that all instruction booklets accompanying individual federal tax forms (including IRS Forms 1040, 1040A and 1040EZ) include a simple and conspicuous description of the conditions under which information shown on the return may be disclosed to any party outside the IRS. *Act § 3508*.

Disclosure of Chief Counsel Advice

Under current law, many IRS publications are open to public inspection. The Act expands the list of such publicly accessible documents to include "Chief Counsel advice," defined as any written advice or instruction prepared by the Office of Chief Counsel which (1) is issued to field or service center employees of the Service or regional or district employees of the Office of Chief Counsel and (2) conveys a legal interpretation, policy or position of an internal revenue law. *Act § 3509(b) adding I.R.C. § 6110(i)(1)(A)*.

Where the document released pertains to specific taxpayers, the IRS within 60 days of issuing the advice must mail those taxpayers a notice of intention to disclose such document. *Act § 3509(b) adding I.R.C. § 6110(i)(4).* The Service must delete from the text of the released document any information which could identify specific taxpayers.

These new disclosure requirements are applicable to any Chief Counsel advice issued more than 90 days after July 22, 1998, the date of enactment. *Act § 3509(d).* The Act also contains a schedule for the release of Chief Counsel advice issued after December 31, 1985 but before this general effective date. *Act § 3509(d)(2).*

Subtitle G: Low Income Taxpayer Clinics

The Act authorizes the Secretary to make grants of up to $6 million per year to provide matching funds for the development, expansion or continuation of qualified low income taxpayer clinics. An individual clinic can receive up to $100,000 under the program. Multi-year grants of up to three years can also be awarded to qualified low income taxpayer clinics. Each clinic awarded funds under the program must provide matching funds on a dollar-for-dollar basis, but these funds can include salaries to individuals performing services for the clinic and the cost of equipment used by the clinic.

A clinic providing taxpayer assistance may qualify for these matching grants if it (1) charges only a nominal fee for its services and (2) either represents low income taxpayers in controversies with the IRS or operates informational programs to assist persons for whom English is a second language about their rights under the Code. A program may qualify as a clinic if it is operated by an accredited business, accounting or law school or an organization exempt under section 501(c)(3) of the Code which represents taxpayers or refers taxpayers to qualified representatives.

The factors to be consider in awarding these grants include:

- the number of taxpayers who will be assisted by the clinic, including persons for whom English is a second language,
- the number of existing low income taxpayer clinics in the area,
- the quality of the program and
- alternative funding available to the clinic. *Act § 3601 adding I.R.C. § 7526.*

Subtitle H: Other Matters

Cataloging Complaints

Under present law, the IRS must make an annual report to Congress regarding allegations of misconduct by IRS employees, whether arising internally, from taxpayers or from third parties. No later than January 1, 2000, records of taxpayer complaints must be maintained on an individual IRS employee basis. *Act § 3701.*

Archive of IRS Records

The IRS is required to transfer agency records to the National Archives and Records Administration ("NARA") for retention or disposal. The IRS is also required to keep confidential taxpayer records from disclosure. In the past the IRS has determined which records are confidential and NARA could not examine them. NARA has been concerned that the IRS is improperly concealing significant agency records. However, under prior law, any improper disclosure to NARA would be considered a felony and subject to civil suits under section 6103 of the Code.

Effective for requests of the Archivist of the United States (the "Archivist") made after July 22, 1998, the date of enactment, the IRS is authorized to disclose any return information to NARA officers and employees upon written request of the Archivist solely for the purpose of appraisal of records for destruction or retention. *Act § 3702 adding I.R.C. § 6103(l)(17).*

Payment of Taxes

Under prior law, checks or money orders for the payment of taxes were required to be made payable to the Internal Revenue Service. The Act directs the Secretary to establish rules to provide for payment of taxes by check or money order made payable to the United States Treasury. *Act § 3703.*

Clarification of Authority Relating to Elections

Where the Code is silent as to the time and manner of making an election, the Act provides that the Secretary may prescribe such time and manner by any reasonable means, not just by regulations or forms. *Act § 3704 amending I.R.C. § 7805(d).*

IRS Employee Contacts

Effective 60 days (six months in the case of unique identifying numbers) following July 22, 1998, the date of enactment,

- manually generated correspondence from the IRS to a taxpayer must include the name, telephone number and unique identifying number of an IRS employee the taxpayer may contact regrading the correspondence,
- any other IRS correspondence or notice to a taxpayer must contain a telephone number that the taxpayer may contact,
- an IRS employee shall give a taxpayer during a telephone or personal contact the employee's name and unique identifying number and
- Procedures are to be developed under which, to the extent practicable, one IRS employee will be assigned to handle a taxpayer's matter until it is resolved.

In addition, effective January 1, 2000, the IRS is to provide Spanish speakers on its helplines and an option for helpline callers to speak to an IRS employee during normal business hours. *Act § 3705.*

Use of Pseudonyms by IRS Employees

In certain circumstances, federal employees may use pseudonyms "registered" with their supervisors. Effective for requests made after July 22, 1998, the date of enactment, an IRS employee may use a pseudonym only if adequate justification is provided, including the protection of personal safety, and the use is approved in advance by the employee's supervisor. *Act § 3706.*

Illegal Tax Protestor Designations

Effective July 22, 1998, the date of enactment, the IRS may no longer designate a taxpayer an "illegal tax protestor" and must remove any such existing designations from its master file and elsewhere; these removals need not begin before January 1, 1999. The IRS is permitted to designate taxpayers as nonfilers, but must remove such designation once the taxpayer has filed income tax returns for two consecutive years and paid all taxes shown on those returns. *Act § 3707.*

Whistleblowers

Effective July 22, 1998, the date of enactment, any person (*i.e.*, a whistleblower) who otherwise has or had access to any return or return information may disclose such return or return information to the House Ways and Means Committee, the Senate Finance Committee or the Joint Committee on Taxation (the "Joint Committee") or to any individual authorized by one of those committees to receive or inspect any return or return information if such person (the whistleblower) believes such return or return information may relate to evidence of possible misconduct, maladministration or taxpayer abuse. *Act § 3708 adding I.R.C. 6103(f)(5).*

Local IRS Telephone Numbers and Addresses

As soon as practicable, local telephone numbers and addresses of IRS offices in a particular area are to be listed in a telephone book for that area. *Act § 3709.*

Tax Return Preparer Identification

Effective July 22, 1998, the IRS is authorized to develop alternatives to social security numbers to be provided on returns by tax return preparers who are individuals. *Act § 3710.*

Offset of Past Due State Income Tax Obligations

Currently, overpayments of federal income tax may be used to pay overdue child support and debts owed to federal agencies without the consent of the taxpayer. Effective for refunds payable after December 31, 1999, the Act includes state income tax debts in this offset scheme. Upon notification by any state that a taxpayer owes a past due, legally enforceable state income tax obligation, the IRS may reduce any refund to such taxpayer, pay the past due amount to the state and notify the state of the taxpayer's address. If there is more than one past due state tax debt, they are paid in the order accrued. The federal income tax return for the taxable year of the refund must show an address for the taxpayer within the state seeking the offset. Certain procedural notice requirements must

also be met by the state prior to any offset. *Act § 3711 adding I.R.C. 6402(e).*

Education Tax Credit Reporting

Effective for returns with respect to taxable years beginning after December 31, 1998, the Act adds the amount of any grant received for the payment of costs of attendance at an eligible educational institution to the items subject to information reporting in connection with education tax credits. *Act § 3712.*

Subtitle I: Studies

Administration of Penalties and Interest

Not later than one year following July 22, 1998, the date of enactment, the Joint Committee and the Secretary shall each submit to the Senate Finance Committee and the House Ways and Means Committee a separate study on the administration of the interest and penalty provisions of the Code by the IRS, making recommendations on ways to simplify penalty or interest administration and to reduce taxpayer burdens. *Act § 3801.*

Confidentiality of Tax Return Information

No later than 18 months following July 22, 1998, the date of enactment, the Joint Committee and the Secretary shall each submit to Congress a separate study, including legislative proposals, on taxpayer confidentiality. Each study is to examine:

- the present protections for taxpayer privacy,
- any need for third parties to use tax return information,
- whether greater levels of voluntary compliance may be achieved by allowing the public to know who is legally required to file tax returns but does not file returns,
- the interrelationship of the taxpayer confidentiality provisions of the Code and other federal privacy statutes, including the Freedom of Information Act,
- the impact on taxpayer privacy of the sharing of income tax return information for purposes of state and local tax law enforcement and
- whether greater disclosure of information concerning organizations exempt from tax under section 501 of the Code would be in the public interest. *Act § 3802.*

Study of Noncompliance

No later than one year after July 22, 1998, the date of enactment, the Secretary and the Commissioner are to submit to Congress a joint study, conducted in consultation with the Joint Committee, of noncompliance with the tax laws (including willful noncompliance and noncompliance due to tax law complexity). *Act § 3803.*

Study of Payments Made for Detection of Underpayments and Fraud

No later than one year following July 22, 1998, the date of enactment, the Secretary shall conduct a study and report to Congress on the use of section 7623 of the Code, which authorizes the Secretary to make payments to informants. *Act § 3804.*

Title IV: Congressional Accountability for the Internal Revenue Service

Oversight

The Joint Committee will now review and approve requests for Government Accounting Office ("GAO") investigations of the IRS other than requests by the chairman of the Joint Committee or a ranking member of any congressional committee or subcommittee. This provision is intended to eliminate overlapping investigations, to ensure the GAO has the capability to conduct the investigation and to ensure a focus on areas of primary importance. *Act § 4001 adding I.R.C. § 8021(e).*

In addition, for the years 1999 through 2003 there will be an annual joint review of the IRS plans and budget by the various congressional committees with IRS oversight responsibility. This review will consider IRS progress in (1) its strategic and business plan (2) improving taxpayer service and compliance and (3) technology modernization as well as the annual filing season. *Act § 4001 adding I.R.C. § 8021(f).* The Joint Committee will report annually to various committees the results of ths review and, if funded, will provide a report each Congress on the overall federal tax system. *Act § 4002 amending I.R.C. § 8022(3).*

Year 2000 Issues

The IRS is to place high priority on resolving Year 2000 problems and its efforts to resolve "certain" problems should be fully funded. *Act § 4011.*

Tax Law Complexity

Beginning in 1999, the IRS will conduct an analysis and provide an annual report on the sources of complexity in the tax laws including the following areas:

- frequent taxpayer questions,
- common taxpayer errors,
- areas of frequent disagreement over the law,
- major areas where the law is uncertain or there is insufficient published guidance,
- frequent revenue agent errors in interpretation or application of the law,
- impact of recent legislation and
- impact on the number and complexity of forms required and how many taxpayers will be affected.

The annual report is to include recommendations for reducing complexity.

Legislation affecting the Code considered on or after January 1, 1999 will require a "Tax Complexity Analysis" by the Joint Committee in consultation with the IRS and Treasury. The analysis is to include the estimated number of affected taxpayers and, if applicable, their income levels. If determinable, the analysis should also include:

- the impact on existing and need for new forms,
- identification of additional taxpayer recordkeeping,
- estimated costs of compliance,
- the impact on regulatory guidance (new or revised),
- the extent to which taxpayers and the IRS may disagree and
- the impact on the IRS.

Failure to include the analysis will be subject to a point of order in the House, subject to waiver by majority vote. *Act §§ 4021, 4022.*

Title V: Additional Provisions

Elimination of 18-Month Holding Period for Special Capital Gains Rates

Property held more than one year (rather than more than 18 months required by the Taxpayer Relief Act of 1997 (the "1997 Act")) will be eligible for the 10, 20 and 25 percent capital gain tax rates provided for individuals by the 1997 Act. *Act § 5001(a) amending I.R.C. §§ 1(h)(5), 1(h)(6), 1(h)(7)(A)(i), (ii), 1(h)(13), 1223(11), 1223(12), 1235(a).* This long-term holding period applies for taxable years ending after December 31, 1997, except with regard to the special rules applicable to sales of property acquired from a decedent (I.R.C. § 1223(10)), sales by certain qualified heirs (I.R.C. § 1223(11)) and sales of patents (I.R.C. § 1235), where it applies on and after January 1, 1998. *Act § 5001(b).*

Meals Exclusion Clarification

If more than half of all meals furnished on the employer's premises by the employer to its employees are for the convenience of the employer, then all of the meals so furnished are treated as furnished for the convenience of the employer. The most significant impact of this provision is that the cost of all of such meals will be fully deductible by the employer under section 274(n) of the Code. This change applies to taxable years beginning on or after July 22, 1998, the date of enactment. *Act § 5002 adding I.R.C. § 119(b)(4).*

Elimination of "Most-Favored-Nation" Terminology

In U.S. trade statutes, the term "most-favored-nation" ("MFN") is changed to "normal trade relations" to reflect more correctly the nature of the relationship defined which, in fact, represents ordinary or normal treatment rather than any implied preferential treatment. Afghanistan, Cuba, Laos, North Korea, Serbia and Montenegro and Vietnam are currently the only countries which are not treated at least as well as those countries currently designated with MFN status. *Act § 5003.*

Title VI: Tax Technical Corrections

Unless specifically mentioned otherwise, all technical corrections to the 1997 Act are effective as if included in the 1997 Act as originally enacted. *Act § 6024.*

Child Credit Provisions of the 1997 Act

Under current law, the earned income credit contains a supplemental child credit. The Act clarifies the computation of the supplemental child credit which reduces the allowable credit under the child credit provisions of section 24 of the Code, but which does not reduce a taxpayer's overall tax credits. *Act § 6003.*

Education Incentives of the 1997 Act

Education IRAs

The Act clarifies that:

- the excise tax under section 4973 of the Code applies to each year that excess contributions remain in an education IRA,
- a beneficiary of an education IRA must be a life-in-being,
- the excise tax under section 530(d)(4) of the Code will not apply to distributions from an education IRA which are included in gross income solely because a taxpayer elects the HOPE or Lifetime Learning credit with respect to the beneficiary,
- in the event of the death of the beneficiary, the balance in an education IRA may be distributed to any other beneficiary or to the estate of the deceased beneficiary, and a tax-free rollover of the account will be allowed if any member of the family becomes the new beneficiary,
- expenses taken into account in determining the amount of education IRA distributions to be excluded from gross income are not entitled to a separate deduction, exclusion or credit under the Code and
- with respect to tax-free rollovers and changes in beneficiaries, the new beneficiary must be under the age of 30. *Act § 6004.*

Student Loan Interest

A "qualified education loan" means any indebtedness incurred solely to pay for qualified higher education expenses; a revolving line of credit will not be considered to be a qualified education loan unless the line of credit is used solely for qualified higher education expenses. In addition, only a taxpayer who is required to make interest payments under the loan may deduct such interest payments as student loan interest. The Treasury Department is authorized to promulgate regulations regarding the calculation of the 60-month period in the case of consolidated loans, collapsed loans and loans made before the date of the enactment of the 1997 Act (August 5, 1997) for purposes of determining the deductibility of interest paid on such loans. *Act § 6004.* It is expected that the regulations will mirror the provisions of Notice 98-7.

Enhanced Deduction for Corporate Donations of Computers

The Act clarifies the requirements applicable to organizations to which computers may be donated and extends the expiration of the enhanced deduction to December 31, 2000. *Act § 6004.*

Qualified State Tuition Programs

For purposes of a qualified state tuition program, the original beneficiary's spouse is included within the definition of "a member of the family." *Act § 6004.*

Qualified Zone Academy Bonds

The Act clarifies the treatment of this credit for purposes of the estimated tax and overpayment rules. *Act § 6004.*

Savings and Investment Incentives of the 1997 Act

Conversion of IRAs into Roth IRAs

The Act provides that a taxpayer converting an IRA into a Roth IRA may elect to have the amount converted includible in income in the year of conversion (or the year of withdrawal if conversion is accomplished by rollover) rather than over a four-year period. In the event that the tax is spread over a four-year period and amounts are withdrawn before the entire amount is included in income, the amount withdrawn is included in income (in addition to any amount required to be included under the four-year spread). The amount prematurely withdrawn is not subject to a 10 percent recapture tax. However, the amount includible in income cannot exceed the amount converted.

Ordering rules are adopted to determine the character of withdrawals from IRAs. The five-year holding period for determining whether distributions from Roth IRAs are qualified distributions begins with the year in which the contribution (including a rollover contribution) is made. Finally, the Act clarifies that for purposes of determining the $100,000 adjusted gross income ("AGI") limit on IRA conversions to Roth IRAs, the conversion amount is not

taken into account. However, for purposes of determining taxable income for the year of conversion, the conversion amount (to the extent otherwise includible in AGI) is taken into account in determining AGI-based phaseout amounts. *Act § 6005.*

Penalty-Free Distributions for Education Expenses and Purchase of First Homes

Hardship distributions from qualified cash or deferred arrangements and tax-sheltered annuities are not eligible rollover distributions (and are not subject to 20 percent withholding), applicable to distributions after December 31, 1998. *Act § 6005.*

Small Business Stock Rollover

The small business stock rollover rules of section 1045 of the Code are conformed to the provisions of subsections (f) through (k) of section 1202 of the Code. For example, the benefit of a tax-free rollover with respect to the sale of small business stock by a partnership will flow through to a partner who is not a corporation if the partner held its partnership interest at all times that the partnership held the small business stock. The Act does not limit the types of partners that a partnership may have for the benefits of section 1045 of the Code to apply to a noncorporate partner. *Act § 6005.*

Capital Gains Provisions

The Act clarifies the amount of exclusion permitted for married couples who are not entitled to the full $500,000 of exclusion on the sale of their principal residence. *Act § 6005.*

Alternative Minimum Tax ("AMT") Provisions of the 1997 Act

The regular tax election to use AMT depreciation is conformed to modifications made to the AMT depreciation by the 1997 Act and the availability of the small corporation exemption is clarified. *Act § 6006.*

Estate and Gift Tax Provisions of the 1997 Act

The Act clarifies that allocation of the inflation adjustment for the generation-skipping transfer tax exemption amount may only be made for transfers made during or after the calendar year for which the inflation adjustment is made, except that no inflation adjustment for years after the calendar year in which the transferor dies shall apply to transfers by such transferor. In addition,

- The Act coordinates the unified credit and the qualified family-owned business exclusion;
- The rules governing the revaluation of gifts are clarified;
- The Act clarifies that interests eligible for the family-owned business exclusion must be passed to a qualified heir;
- The Act converts the family-owned business exclusion to a deduction;
- The Act clarifies the "active trade or business" requirement for the family-owned business deduction and specifies that an interest in property will not be disqualified, in whole or in part, as an interest in a family-owned business where the decedent leases that interest on a net cash basis to a member of the decedent's family who uses the leased property in an active business and that the rental income derived by the decedent from such net cash lease is not treated as personal holding company income for purposes of section 2057 of the Code; and
- The treatment of post-mortem conservation contributions is clarified. *Act § 6007.*

Miscellaneous Provisions of the 1997 Act

The Act (1) clarifies the requirements for the reduced rate of tax on hard ciders, (2) clarifies the treatment of the tax paid by electing publicly traded partnerships, (3) modifies the depreciation limitation for electric vehicles and (4) modifies the definition of "non-Amtrak State" for purposes of the Amtrak net operating loss provision. *Act § 6009.*

Revenue-Increase Provisions of the 1997 Act

The Act clarifies that the positions in straight debt exception to the constructive sales rules does not apply to positions that are convertible into stock. It coordinates the basis adjustment rules under section 1059 of the Code with respect to extraordinary dividends with similar rules in the consolidated return regulations so that section 1059 cannot cause basis to be adjusted to the extent that the consolidated return regulations require that an excess loss be created. The definition of "control" for purposes of sections 351, 368(a)(1)(D) and 368(a)(2)(H) of the Code now explicitly disregards a subsequent disposition of stock by shareholders receiving such stock in a section 355 transaction.

The Act authorizes the Treasury Department to promulgate regulations which prevent multiple inclusion of any item due to the applicability of section 304 of the Code to a transaction involving a foreign corporation and clarifies the treatment of prepaid telephone cards for telephone excise tax purposes.

Section 901(k) of the Code generally denies a shareholder foreign tax credits normally available with respect to a dividend if the shareholder has not held the stock for a minimum period during which it is not protected form risk of loss. The Act clarifies that the exception to the general rule under section 901(k)(4) of the Code is only available for dividends received on stock that the shareholder holds in its capacity as a dealer in securities. The Act modifies the interaction between section 901(k) and foreign tax credit flow-through rules for regulated investment companies ("RICs") and clarifies:

- the treatment of additional covered lives under a master contract for purposes of the effective date for company owned life insurance,
- the definition of wages under the earned income credit,
- the allocation of basis with respect to properties distributed by a partnership and
- the rules by which aviation grade kerosene may be removed for use as aviation fuel without payment of the highway excise tax. *Act § 6010.*

Foreign Provisions of the 1997 Act

The Act provides that stock in a passive foreign investment company ("PFIC") constructively owned by an optionholder will not be eligible for the PFIC and controlled foreign corporation ("CFC") overlap provisions unless the stock is owned within the meaning of section 958(a) of the Code by a United States shareholder who is not exempt from tax. The Act clarifies the application of the PFIC mark-to-market rules with respect to RICs and the interaction between the PFIC and other mark-to-market regimes is clarified. Finally, the Treasury Department is authorized to provide guidance with respect to information reporting by CFCs and foreign partnerships under section 6038 of the Code. *Act § 6011.*

Simplification Provisions of the 1997 Act

The Act specifies that distributions from a real estate investment trust ("REIT") are deemed to come first from any non-REIT earnings. Under present law, partnerships with more than 100 partners are required to file returns on magnetic media and a penalty is imposed in the case of failure to meet the magnetic media requirements. The Act clarifies that the penalty (under section 6724(c) of the Code) applies to the extent such a failure occurs with respect to more than 100 information returns. *Act § 6012*

Estate, Gift and Trust Simplification Provisions of the 1997 Act

Provisions are added that clarify the treatment of revocable trusts for purposes of the generation-skipping transfer tax and authorize the promulgation of regulations for simplified reporting of funeral trusts terminated during the taxable year. *Act § 6013.*

Technical Corrections to the Taxpayer Bill of Rights 2 (1996)

In the case of a deficiency with respect to a joint return of individuals who are no longer married or no longer living in the same household, under certain circumstances the IRS may disclose the return to one of the individuals. Effective July 22, 1998, the date of enactment, the Act clarifies that this disclosure may be made to the duly authorized attorney-in-fact of the person making the disclosure request. *Act § 6019.*

Title VII: Revenue Provisions

Timing of Deduction for Deferred Compensation

For purposes of determining under section 404 of the Code whether (1) compensation of an employee is deferred compensation and (2) when deferred compensation is paid, actual receipt by the employee is required before the amount is treated as paid or received. *Act § 7001 adding I.R.C. § 404(a)(11).* This change applies for taxable years ending after July 22, 1998, the date of enactment, to all covered deferred compensation, including vacation and severance pay, and is intended to overrule *Schmidt Baking* where the employer funded vacation and severance pay with a letter of credit, causing the income to be includable in income of the employees and therefore deductible by the employer. *Act § 7001.*

Freeze of Grandfathered Status of Stapled REITs

A "stapled REIT" is a REIT, the stock of which is traded with the stock of another entity as a single investment unit. The Tax Reform Act of 1984 (the "1984 Act") required that in applying four tests for REIT status all so-called stapled entities are treated as one entity. The four tests relate to (1) organizational structure, (2) source

of income, (3) nature of assets and (4) distribution of income. The grandfather rule excepted REITs that were part of a group of stapled entities which included a REIT on June 30, 1983.

The Act has frozen this grandfather rule by rendering it applicable only to property interests held on March 26, 1998 for certain purposes including the "75 percent" and "95 percent" requirements of the REIT source of income test. A stapled group includes an existing stapled REIT, a stapled entity or a subsidiary or partnership in which a 10 percent or greater interest is owned by an existing stapled REIT or stapled entity. For partnership interests the ownership test is measured by the greater of the interest in the partnership's assets or profits and for interests in corporations the test is the greater of vote or value. Property interests acquired by the stapled group which are treated as activities and income of the REIT for the source of income tests are, subject to several exceptions and special rules, interests acquired by a member of the group after March 26, 1998. *Act § 7002.*

Certain Trade Receivables Ineligible for Mark-to-Market Treatment

Effective for taxable years ending after July 22, 1998, the date of enactment, "nonfinancial customer paper" is excluded from mark-to-market treatment under section 475 of the Code. Nonfinancial customer paper is any note, bond, debenture or other evidence of indebtedness which arises out of the sale of nonfinancial goods or services by a person whose principal activity is selling or providing nonfinancial goods or services and which is held by such person or a related party at all times. *Act § 7003 adding I.R.C. §§ 475(c)(4), 475(g)(3).*

Exclusion of Minimum Required Distributions from AGI for Roth IRA Conversions

Only taxpayers having AGI of no more than $100,000 may convert an IRA into a Roth IRA. The Act excludes from AGI, but solely for this purpose, minimum required distributions from IRAs. This change applies to taxable years beginning after December 21, 2004. *Act § 7004 amending I.R.C. § 408A(c)(3)(C)(i).*

Title VIII: Limited Tax Benefits under the Line Item Veto Act

The only provisions of the Act subject to presidential line item veto are (1) section 3105 (relating to administrative appeal of adverse IRS determination of tax-exempt status of bonds) and (2) section 3445(c) (relating to state fish and wildlife permits). *Act § 8001.* The presidential line item veto was declared unconstitutional by the U.S. Supreme Court in *Clinton v. The City of New York*, __ U.S. __, 118 S.Ct. 2091 (Jun. 25, 1998).