



RMC

IRS RESTRUCTURING AND REFORM ACT OF 1998

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INTRODUCTION

On July 22, 1998, President Clinton signed the IRS Restructuring And Reform Act Of 1998 -- the first major overhaul of the IRS in 45 years! As though major IRS reform was not enough, this tax bill also incorporates the Technical Corrections Act Of 1998 containing new rules revising many of your tax planning strategies for capital gains, Roth IRAs, education expenses, and more.

This letter highlights selected provisions of this mammoth 477-page tax bill that we believe will have the greatest impact on your tax liability (capital gains, Roth IRAs, etc.), or, your dealings with the IRS (IRS reorganization, relief from interest and penalties, pro-taxpayer settlement options, etc.).

We have not attempted to address every change under the Act. Consequently, if you are interested in a tax change that is not addressed here, or you want more information on topics discussed in this letter, please call our office.

CAUTION

This letter offers planning ideas. However, you cannot properly evaluate a particular planning strategy without careful attention to the effective dates of tax law changes, and without calculating your overall tax liability with and without the strategy. Please be careful! Call us before adopting any significant tax planning recommendation.

CHANGES THAT IMPACT YOUR TAX LIABILITY

CONGRESS CREATES ADDITIONAL TAX BREAK FOR CAPITAL GAINS

In 1997, Congress enacted a significant capital gains cut by reducing the maximum tax rate on long term capital gains from 28% to 20%. In 1997, your regular income was taxed at a rate up to 39.6%, while gain on the sale of a capital asset held over 18 months was taxed at a maximum 20% rate (10% rate if you were in the 15% tax bracket). These same rules were to apply for 1998. However, in a last minute change, the '98 tax bill sweetened the capital gains break even more by reducing the capital gain holding period from more than 18 months to more than one year. The more than 18-month holding period has been eliminated.

New Capital Gain Holding Period. Under this retroactive change, effective for capital gains "properly taken into account" after December 31, 1997, you only have to hold a capital asset over one year to get the 20% or the 10% rate. This new holding period converts 1998 gains from capital assets (e.g., stocks and bonds) held more than one year but not more than 18 months from a gain taxed at a maximum 28% (before the change) to a gain taxed at a maximum 20% (after the change).

Depreciable Real Estate Gets Same Break. Previously, gain on the sale of depreciable real estate held over 18 months (e.g., depreciable buildings) was taxed at a maximum 25% (not 39.6%) to the extent of the depreciation taken.

Effective for gains "properly taken into account" after December 31, 1997, the new law reduces the holding period to more than one year to obtain the 25% rate. Gain in excess of the total depreciation taken is taxed at a maximum 20% rate if the real estate is held more than one year.

Collectibles. Under the new law, capital gains from the sale of collectibles (e.g., artwork, rugs, stamps, coins) are taxed at a maximum rate of 28% (not 20%), if the collectible is held more than one year.

ROTH IRA CONVERSION AND WITHDRAWAL RULES MADE TRICKIER

Phase-Out Of Deduction On Separate Returns. The 1997 Act introduced a new type of IRA called the Roth IRA. You can contribute up to \$2,000 to a nondeductible Roth IRA. However, the allowable contribution is eliminated on a joint return from \$150,000 to \$160,000 of adjusted gross income. The phase-out range on a single return is from \$95,000 to \$110,000. The new law clarifies that the income phase-out range is \$0 to \$10,000 if you are married and file a separate return.

Conversion Of Regular IRAs To Roths. If your modified adjusted gross income is \$100,000 or less, you can convert your existing regular IRA to a Roth IRA, but you must pay tax on the taxable portion of your regular IRA when it is converted. However, if you convert your regular IRA to a Roth IRA before January 1, 1999, you can report the resulting income ratably over four years.

Tax Tip. What happens if you convert a regular IRA to a Roth in 1998 and then discover that your modified adjusted gross income for 1998 is more than \$100,000 and you may not convert to a Roth? Fortunately, the new law gives you until the due date (with extensions) of your tax return for 1998 to transfer the converted amounts (including earnings) back to your regular IRA, without tax or penalty.

Caution! Please call us before converting a regular IRA to a Roth or before correcting an erroneous conversion. These rules are very complex. Although many persons may benefit from converting a regular IRA to a Roth, some will not benefit and others may actually be hurt by converting. The only way to project the advantages or disadvantages of

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converting from a regular IRA to a Roth IRA is to carefully analyze your situation. We will gladly assist you with this determination.

Determining Modified AGI. The 1998 Act clarifies the rules for determining whether you exceed the \$100,000 modified AGI threshold. For example, you deduct the income triggered by the Regular IRA-To-Roth IRA conversion for purposes of the modified AGI computation. However, you do not reduce the AGI threshold for contributions to a regular deductible IRA for the year of conversion. Furthermore, for tax years beginning after 2004, taxpayers over age 70½ exclude required minimum distributions from qualified retirement plans for purposes of computing the \$100,000 threshold. Determining your modified AGI is very complicated. Please call us and we will help you with this calculation.

New Law Creates Anti-Abuse Rules For IRA Conversions. Due to several technical glitches in the '97 Tax Act, Congress feared that taxpayers might get unintended tax benefits by converting their Regular IRA to a Roth IRA. First, Congress was concerned that taxpayers would convert a Regular IRA to a Roth IRA in 1998 and, shortly thereafter, take the funds out of the newly-converted Roth IRA (while still getting the 4-year income spread). This would have the effect of spreading out the taxation of the withdrawal over four years. Secondly, under the 1997 Act, as originally written, it was possible for someone under age 59½ to avoid the 10% early distribution penalty from a regular IRA by converting to a Roth and then making distributions.

Accelerating the 4-year spread. The new law still allows the 4-year income spread if you convert your regular IRA to a Roth in 1998. However, to curb potential abuse, the revised rules say that any withdrawals from your converted IRA during the 4-year period will be included in your income, to the extent not previously included under the 4-year spread rules.

New 10% penalty. Amounts rolled from your regular IRA to a Roth and withdrawn within 5 years, will be subject to a 10% premature distribution penalty, unless you meet a current law exception (e.g., you are over age 59½, disabled, etc.).

Planning Alert! These two new rules make it costly for you to convert your regular IRA to a Roth IRA in 1998, if you plan to withdraw funds from your new Roth IRA to pay the resulting taxes. If you do not have funds outside your IRA to pay the taxes on the conversion, you should consider not converting your regular IRA to a Roth unless there are other advantages of the conversion. We will gladly assist you with this analysis.

Tax Tip. The new law clarifies that the 4-year income spread is an elective. If you have little or no taxable income for 1998 or if you have net operating loss carryforwards, it might save you taxes to forego the 4-year spread in 1998 on a Regular-to-Roth IRA conversion. Please call our office if you believe this new election may benefit you.

Tax Tip. If someone dies during the 4-year spread period, any remaining deferral is normally accelerated and reported on their final income tax return. This trap can be avoided simply by naming your spouse as sole beneficiary of your Roth IRA. Your surviving spouse can elect to defer the income for the remainder of the 4-year period. The election by the surviving spouse must be made no later than the due date of the surviving spouse's return for the year the Roth IRA owner dies.

FIVE-YEAR ROTH IRA HOLDING PERIOD LIBERALIZED

One of the most popular features of the Roth IRA is the potential for tax-free withdrawals. You can take a qualified distribution from your Roth IRA tax free only if you have held the Roth IRA for at least five years and you meet certain other requirements (e.g., you reach age 59½, you are disabled, etc.). Also, as mentioned above, withdrawals from a Roth IRA within five years of converting a regular IRA to a Roth could create a 10% penalty on the amount of the withdrawal.

Tax Tip. The new law says the 5-year holding period for all of your Roth IRAs begins with your first contribution to your first Roth IRA. Therefore, even if you don't plan to convert your Regular IRA to a Roth IRA in 1998, but you think you might convert in some later year, you should consider contributing to a Roth IRA for 1998 if you qualify to make a contribution (even if the contribution is small). This will begin the running of the 5-year holding period for all of your future Roth IRAs -- even your future Roth IRAs created by conversion of a regular IRA.

NEW LAW CLARIFIES PRO-TAXPAYER RULES FOR HOME GAIN EXCLUSION

Current law allows you to exclude up to \$250,000 (\$500,000 for qualifying spouses filing a joint return) of the gain on the sale of your home. To qualify for the full exclusion amount, you must have owned and used your home at least two out of the last five years as your principal residence. Furthermore, you are allowed to prorate the exclusion if you sell before using or owning your home for two years due to employment change, health reasons, or other unforeseen circumstances approved by the IRS. Tax Tip. If you owned your home on August 5, 1997, and you sell your home within two years from August 5, 1997, you can prorate the exclusion regardless of your reason for selling.

Clarification Of Proration Rule. Effective for sales and exchanges after May 6, 1997, the new law clears up previous confusion on how this proration rule operates.

Example. Assume you are single and have used your principal residence for one year and you move because of a job transfer. You sell your house at a \$50,000 gain. The home gain exclusion rules allow you one half of the exclusion (i.e., 1 year + 2 years). Prior to the recent clarification, the law seemed to say that you could exclude only one-half of your gain (i.e., \$25,000). The new law makes it clear you can exclude up to one-half of the otherwise allowable exclusion amount. Consequently, on these facts, you could exclude up to \$125,000 of your gain ($\$250,000 \times \frac{1}{2}$). Joint Returns. The 1998 legislation makes it clear that the home gain exclusion on a joint return will never be less than the sum of the exclusions each spouse could have taken if they were single and filed separate returns. Thus, for example, assume Fred and Ethel were single, each separately owned a home, and each qualified for a \$250,000 exclusion. They could marry, each sell their separate homes, and exclude up to \$250,000 on each sale even if they file a joint return. This rule is a great benefit for taxpayers who each have their own homes when they marry.

CONGRESS LIMITS ROLLOVERS FROM §403(b) AND §401(k) PLANS

Current law generally allows you to withdraw funds from your IRA for "qualifying higher education expenses" or up to \$10,000 for "qualifying first-time home buyer expenses", without paying a 10% early withdrawal penalty. These exceptions from the 10% penalty generally do not apply to distributions from employer-sponsored retirement plans. Congress feared that taxpayers would take a "hardship distribution" from their §403(b) annuity or their §401(k) plan, roll it over into their IRA, and then use funds in the rollover IRA to make a penalty-free distribution for higher education expenses or for first time home buyer expenses. To prevent this tactic, effective for distributions occurring after 1998, you will not be able to roll over a "hardship distribution" from your §401(k) plan or a §403(b) annuity to an IRA.

Tax Tip. A hardship distribution may be rolled over to an IRA before 1999. If you wish to roll over a hardship distribution from a §403(b) annuity or a §401(k) plan to an IRA, it must occur in 1998.

EDUCATION IRA RULES CLARIFIED

Last year's tax bill introduced the new "Education IRA." Subject to income phaseouts starting at \$150,000 (\$95,000 on a single return), you can put up to \$500 annually for each beneficiary into a tax exempt Education IRA. You can later use these funds tax-free to pay for the beneficiary's qualified higher education expenses. No contributions can be made once the beneficiary reaches age 18.

Beneficiary Must Be Living. The new law confirms that the beneficiary of an Education IRA must be a "life-in-being" (i.e., can't be someone who is not yet born).

Maximum Contribution. The 1998 Act also clarifies that the maximum annual contribution is \$500 per beneficiary, not per donor. Consequently, if two family members each contribute \$500 in the same year for the same child, excess funding penalties are triggered. Beware! The 6% overfunding penalty applies for the year of the excess contribution and will continue to apply each year until the overfunding is withdrawn. A 10% distribution penalty can also apply if the excess contributions are withdrawn after the due date of the return for the year of the excess contribution.

Tax Tip. The new law clarifies that the overfunding can be withdrawn, without triggering the 10% excess distribution penalty or the 6% excess contribution penalty, if the withdrawal is made by the due date (including extensions) of the beneficiary's return for the year of the excess contribution. If the beneficiary is not required to file a return, the overfunding can be withdrawn by April 15 of the following year.

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Required Distributions. The Act also confirms that any balance remaining in an Education IRA will be deemed distributed within 30 days following the beneficiary's 30th birthday (or within 30 days following the beneficiary's death, if earlier).

Tax Tip. If a beneficiary approaches age 30 without using the Education IRA for qualifying education expenses, penalties and taxes can be avoided by timely rolling over the account to the Education IRA of a qualifying family member prior to the beneficiary's 30th birthday.

NEW LAW CLARIFIES WHO CAN DEDUCT STUDENT LOAN INTEREST

For 1998, you may deduct up to \$1,000 of your qualified student loan interest. However, the deduction is phased-out as your adjusted gross income goes from \$60,000 to \$75,000 on a joint return (\$40,000 to \$55,000 if single). Qualified student loan interest is, generally, interest on a loan used for higher education expenses for you, your spouse, or a dependent. You can only deduct interest for the first 60 months interest payments are required on the loan.

Must Be Obligated On The Loan. The Act makes it clear that only the taxpayer who is legally obligated on the loan is entitled to the interest deduction.

Planning Alert! You can normally deduct student loan interest when you borrow funds for your child's qualified education expenses. However, if your income exceeds the phase-out range (e.g., more than \$75,000 on a joint return), you will not be entitled to the deduction. Since your child has no legal obligation to pay the interest, your child would also be denied a deduction.

Tax Tip. In this situation, if the lender would agree, perhaps your child could formally assume the education loan and become the primary obligor when the interest becomes due. This may allow your child the interest deduction (if your child is under the income threshold).

Loans Must Be Solely For Education Expenses. In the 1998 Act, Congress indicates that qualified education loans include only indebtedness incurred solely to pay qualified higher education expenses.

Tax Tip. Revolving lines of credit generally will not be qualified education loans unless the borrower agrees to use the line of credit solely to pay qualified education expenses. You should not use a portion of loan proceeds for personal reasons and the remainder for education purposes.

FILING GIFT TAX RETURNS BECOMES MORE IMPORTANT

Prior to the '97 Tax Act, the IRS attempted to re-value lifetime gifts for estate tax computation purposes, even though the statute of limitations had expired on the previously-filed gift tax returns. This created a potential tax trap for many estate plans that included lifetime gifts. The '97 Tax Act eliminated this problem by requiring that once the statute of limitations expires on gifts adequately disclosed on a gift tax return, the gifted property may not be re-valued for estate tax purposes. This rule applies only to gifts made after August 5, 1997. The 1998 Act now makes it clear that this rule applies even if no gift tax was assessed or paid on the original gift. However, it appears that a gift tax return must be filled (e.g., the gift is more than \$10,000) and the details of the gift must be adequately disclosed.

Tax Tip. These changes make it important for you to file all required gift tax returns timely, and to fully disclose the nature and value of your gifts. The IRS has recently announced that it will begin auditing more gift tax returns than in the past. Please call our office if you need additional information regarding these rules.

REDUCTION IN ESTATE TAXES FOR FAMILY-OWNED BUSINESSES

The 1997 Act provides for a reduction in estate taxes for a limited amount of the value of a qualified family-owned business. The 1997 Act allowed an estate tax exclusion for the qualifying business interest. The 1998 Act converts the exclusion to a deduction and makes other technical changes to the rules. Changing the exclusion to a deduction ensures that the value of the family-owned business "benefit" is not diminished as the value of the unified credit increases over the next several years.

MORE CORPORATIONS MAY BE EXEMPT FROM MINIMUM TAX

Under the 1997 Act, corporations with average gross receipts under a specified amount are exempt from the alternative minimum tax rules (AMT) beginning in 1998. The 1998 Act changes the calculation of average gross receipts for purposes of this small corporation exemption from AMT. In order for a corporation to be exempt for its tax year beginning in 1998 (the first year the exemption is available), the corporation must have average gross receipts of \$5,000,000 or less for its tax years beginning in 1994, 1995, and 1996 and must have average gross receipts of \$7,500,000 or less for its tax years beginning in 1995, 1996, and 1997. To be exempt in subsequent years, the average gross receipts for the three previous tax years must be \$7,500,000 or less. Previously, to be exempt for 1998, average gross receipts for tax years beginning in 1995, 1996 and 1997 were required to be \$5,000,000 or less (rather than \$7,500,000 or less).

NEW LEGISLATION CONFIRMS TAX BREAK FOR MEALS PROVIDED TO EMPLOYEES

Under current rules, if an employer furnishes meals to employees on its business premises (for the convenience of the employer), the full value of the meals is generally excludable from the employee's income. In several recent cases, the IRS has argued that the employer can deduct only one-half of the cost of these meals. The new law generally provides that if over one-half of the employees who receive meals on the employer's business premises satisfy the "convenience of employer" test, then the employer can fully deduct all meals provided to all its employees on the employer's premises.

Tax Tip. The effective date of this new law is for tax years "beginning before, on, or after July 22, 1998." In other words, it appears, this provision is retroactive to all years for which the statute of limitations is open. If you believe this retroactive change may benefit your business and the period for filing an amended return has not expired, please call our office. You might be entitled to a tax refund.

CHANGES THAT IMPACT YOUR DEALINGS WITH THE IRS

IRS RESTRUCTURING BEGINS AT THE TOP

New IRS Structure. The IRS Reform Act of 1998 is the most significant IRS reorganization in 45 years. Many of the changes in the Act were inspired by the testimony of taxpayers during months of Congressional hearings concerning IRS abuses. The objective of the Act, clearly, is to make the IRS a more taxpayer-friendly organization. The changes begin with a new IRS mission statement that emphasizes "serving the public and meeting the needs of taxpayers." The '98 Tax Act also directs the IRS Commissioner to develop a new IRS organization structure that is no longer based on geographical regions but, instead, is designed to help groups of taxpayers having similar needs (e.g., individuals, small businesses, large sector corporations, and tax exempts). After much debate, Congress also decided that the IRS should answer to a permanent 9-member oversight board. Six members of this Board will come from the private sector with expertise in management, customer service, tax law, information technology, and needs of small businesses. The other three members will be the Treasury Secretary, the IRS Commissioner, and an IRS employees' representative.

No Politically-Motivated IRS Audits. The Act prohibits anyone in the Executive Office of the President or Vice President from requesting the IRS to conduct or terminate an audit, or otherwise investigate a particular taxpayer. This prohibition also applies to Cabinet-level positions (other than the Attorney General).

DEALING WITH IRS SHOULD BECOME EASIER

Congress has enacted a laundry list of new provisions designed to give taxpayers more power when dealing with the IRS. The changes begin with making the IRS more accessible to the average taxpayer. For example, the new law requires the IRS to list the phone numbers and addresses of IRS local offices in local telephone books, including the office of the local taxpayer advocate. During a telephone or personal contact with a taxpayer, IRS employees must provide their name and their special I. D. number.

New "National Taxpayer Advocate." There will be a newly-appointed "National Taxpayer Advocate" whose purpose is to make sure that you, as a taxpayer, have convenient access to your local IRS office. The new law also instructs the IRS to establish a system of local taxpayer advocates who will be largely independent from the IRS audit and collections functions. Each state will be required to have at least one advocate.

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Tax Tip. If you can establish that an IRS action would create a "significant hardship," you can request that the taxpayer advocate issue a taxpayer assistance order (TAO). If issued, the TAO may require the IRS to release your property, or suspend other specified actions against you. This is a technical issue and required forms must be filed. Contact us if we can help you with an IRS problem.

New Limits On "Financial Status Audits", Etc. The IRS has previously utilized a particularly invasive audit technique known as the "financial status" or "economic reality" examination. This technique goes beyond a taxpayer's books and records, and looks at a taxpayer's spending habits, lifestyle, etc., in search of unreported income. Effective July 22, 1998, the IRS is prohibited from using these types of audits unless they have a "reasonable indication that there is a likelihood of unreported income." Moreover, the IRS is directed to publish its criteria and procedures for selecting taxpayers for an IRS audit.

Tax Tip. If you are in the restaurant business, you may enter into a Tip Reporting Alternative Commitment (TRAC) agreement with the IRS to satisfy your tip reporting obligations. Some restaurants have avoided joining this program because it imposes significant compliance obligations on the business. You will be glad to know that, effective July 22, 1998, IRS employees can no longer threaten to audit your restaurant if you choose not to enter into a TRAC agreement. New Limits On Third Party Contacts. If you are audited, it is not uncommon for the IRS to contact and/or solicit information from your business associates, banker, broker, professional advisor, etc. Effective for contacts made after 180 days following July 22, 1998, the IRS will generally not be entitled to contact those persons without first notifying you that third party contacts may occur.

EASIER ACCESS TO OFFERS-IN-COMPROMISE

If you have an unpaid tax liability, and there is doubt whether you really owe the taxes, or whether you have resources to pay them, the IRS sometimes allows you to pay less than the full amount. This procedure is known as an "Offer-In-Compromise." Generally, effective for offers-in-compromise submitted after July 22, 1998, the new law liberalizes the criteria for the IRS to accept an offer-in-compromise. Congress has directed the IRS to "be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations -- the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements."

INSTALLMENT AGREEMENTS EASIER TO OBTAIN

If you are having trouble paying your taxes, penalties, and interest, the IRS (at its discretion) may agree to allow you to pay by installments. These so-called installment agreements do not reduce the amount of taxes, interest, and penalties you owe, they just extend the time you have to pay. Under the new law, effective on July 22, 1998, the IRS will be "required" to enter an installment agreement if you meet the following requirements: (1) your liability is \$10,000 or less (excluding penalties and interest), (2) you have filed your returns and paid your taxes for the previous 5 years, (3) you provide the IRS with requested financial statements (and the IRS determines you can't pay in full), (4) the installment agreement provides for full payment within 3 years, (5) you agree to comply with all tax laws while the installment agreement is in place and (6) you have not entered into another installment agreement in the last 5 years.

Tax Tip. Even if you fail the above requirements, the IRS still has the discretion to enter into an installment agreement. Historically, the IRS approves taxpayer requests if the amount owed is not large (generally below \$10,000) and the taxpayer has filed timely tax returns in the past. It is clear that these rules place a premium on filing timely tax returns.

CONGRESS EXPANDS RELIEF FOR INNOCENT SPOUSES

If you file a joint return with your spouse, you and your spouse are each fully responsible for the accuracy of the tax return and for the full tax obligation. Under current law, you can be relieved of this liability only if you satisfy the rigid requirements of the 'innocent spouse' rules. The new law makes it easier for you to qualify for this relief, and should make eligibility simpler and fairer. These rules are too lengthy to discuss in detail in this letter. The following "tax tip", however, gives you a good example of how beneficial this new provision may be for unsuspecting spouses who have signed joint returns.

Tax Tip. If you have been living apart from your spouse for at least 12 months, are no longer married, or are legally separated, the new law allows you to "elect" to be responsible only for items on the joint return that are allocable to

you. You must make this election no later than two years following the date the IRS begins collection activities. This new election is great news for divorced spouses who want to avoid tax liability from actions of their former spouses. These expanded rules are generally effective for tax arising after July 22, 1998, and for tax that remains unpaid on July 22, 1998, even though the tax arose under prior law. The two-year election period does not expire before two years after the first collection activity taken by the IRS after July 22, 1998. Therefore, the new relief for "innocent spouses" is available for old as well as new assessments.

NEW LAW GIVES TAXPAYER RELIEF FROM INTEREST AND PENALTIES

Congress recognizes that, under current law, the interest and penalties added to a tax assessment can overwhelm a taxpayer's ability to pay the assessment. The Act provides a new set of rules that may significantly reduce the impact of interest and penalties.

New Interest Rules. If you underpay your taxes, the IRS charges you interest on the underpayment. If you overpay your taxes, IRS, generally, pays you interest on the overpayment. Previously, the interest rate you paid the IRS on tax underpayments was higher than the interest rate the IRS paid you on tax overpayments. Effective for interest for periods beginning after July 22, 1998, if you owe taxes to the IRS, they will offset the amount due with any refund they owe you before calculating any interest.

Tax Tip. This netting of interest applies to the overpayment and underpayment of "any taxes" (not just income taxes). Thus, your business could presumably benefit from this rule by netting overpaid income taxes against underpaid FICA taxes. In addition, this new rule can actually apply to periods beginning on or before July 22, 1998, provided: (1) the statute of limitations has not expired, (2) you identify the periods of underpayment, and (3) you ask the IRS to apply the netting rule no later than December 31, 1999. Furthermore, beginning January 1, 1999, the new law will increase the interest rate the IRS pays individuals on tax overpayments to equal the interest rate for underpayments.

Congress Fixes Payroll Tax Deposit Trap. If your business misses a payroll deposit, the IRS automatically applies any later deposit to the earliest period for which a deposit was due. This method frequently results in your business being assessed multiple "failure to deposit" penalties -- instead of just one. For payroll tax deposits due after 180 days following July 22, 1998, you will be able to designate the period to which the deposit is applied (i.e., generally the most recent period), and thus avoid multiple or cascading penalties. You can make this designation within 90 days following the date the IRS sends you its penalty notice.

Interest And Penalties Suspended If IRS Fails To Act Timely. In a major change from prior law, interest and penalties on a tax assessment will be suspended if the return is timely filed and if the IRS does not notify you of your additional taxes within 18 months of (1) the original due date of your return (without regard to extensions), or (2) the date you timely filed your return, whichever is later. Interest and penalties begin accruing again, however, 21 days after you receive a notice of assessment from the IRS. This rule is effective beginning in 1998.

Planning Alert! This rule applies only to individual income taxes and does not apply in cases involving fraud. Penalties for failing to pay income taxes and criminal penalties are not waived under this rule.

New Relief For Taxpayers In "Presidentially Declared Disaster Areas." For disasters resulting in a "Disaster Area" declaration by the President after 1997, the President can provide that no interest is charged for the period the IRS extends an income tax payment deadline because of the disaster.

TAXPAYERS GIVEN EXPANDED RIGHTS UNDER IRS COLLECTION PROCEDURES

Prior to the 1998 Act, the IRS could generally seize your property by levy if: (1) a tax had been assessed against you, (2) you were given a notice of the tax and a demand for payment, and (3) you failed to pay the assessment within 10 days of the notice. Also, in certain situations where IRS felt the tax was in jeopardy, it could levy your property without notice. The Act includes many taxpayer protections against improper seizures of property. The following is a summary of some of these new taxpayer protections.

Due Process Procedures Established For Levy And Seizure. For all collection actions initiated 180 days after July 22, 1998, the IRS must give you notice within 5 days of any lien being filed on your property. You will then, generally, be given the right to demand a hearing concerning the appropriateness of the lien. You must ask for the hearing within a 30-day period beginning on the sixth day after the lien is filed. The IRS must also provide you a "Notice Of Intent To Levy", before it can levy against your property. Subject to certain exceptions, they cannot levy your property for 30 days after mailing this Notice. During this 30-day period, you may request a hearing concerning the levy. In addition,

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the IRS, normally, cannot seize your residence (or your business property) unless there is a judicial hearing where the court determines the IRS has no reasonable alternative for collecting your tax debts. Moreover, effective for levies issued after July 22, 1998, the IRS cannot seize your residence or any of your nonrental real estate used by others as a residence, unless your unpaid liability is \$5,000 or more.

Tax Tip. If you purchase personal property at a casual sale from a taxpayer or you have a mechanic's lien on the repair or improvement of an owner-occupied personal residence, the new law gives you increased priority over tax liens. Effective July 22, 1998, purchases of personal property of up to \$1,000 (increased from \$250) at a casual sale have priority over an IRS lien imposed on the seller. Likewise, if you have a mechanic's lien on additions to an owner-occupied personal residence of up to \$5,000 (increased from \$1,000), you have priority over an IRS lien imposed on the owner of the personal residence.

CONGRESS BEEFS UP TAXPAYERS' RIGHTS DURING TAX LITIGATION

Congress recognizes that often taxpayers have no other option but to litigate their tax issues in court. In an attempt to level the playing field, the new law gives taxpayers more power in tax litigation.

Burden Of Proof May Shift To IRS. Historically, the courts have required taxpayers to prove that the IRS's determination of tax liability was incorrect. In other words, unless the taxpayer could prove the IRS was wrong, the IRS was presumed correct. This is still the general rule. However under the new law, if taxpayers satisfy the following criteria, they will be presumed correct, except in criminal cases, unless the IRS can prove otherwise: (1) taxpayer has maintained substantiation and records as required by the Internal Revenue Code and Regulations, (2) taxpayer complies with reasonable requests by the IRS to cooperate with the IRS investigation, and (3) if the taxpayer is a corporation, trust, or partnership, its net worth does not exceed \$7 million. There is no net worth limitation for individual taxpayers. This new burden of proof rule is, generally, effective for court proceedings arising from examinations beginning after July 22, 1998.

Planning Alert! The IRS may become more aggressive with taxpayers having poor documentation in order to shift the burden of proof back to the taxpayer. However, for taxpayers who maintain good books and records, their chances of prevailing over the IRS should improve under this new provision.

New Tax Advisor/Client Confidentiality Privilege. You are probably aware that certain information you give to your attorney is privileged, and generally cannot be obtained by outside authorities. This privilege, traditionally, has not applied to other advisors. Effective for communications on or after July 22, 1998, this privilege is, generally, extended for tax advice provided by CPAs and others authorized to practice before the IRS. This privilege applies only to proceedings before the IRS or federal courts where the government is a party to the proceeding. This privilege is not available on matters before any regulatory body other than the IRS and only applies if the attorney/client privilege would apply under prior law if the advisor were an attorney.

Tax Tip. Before discussing confidential tax matters, make sure that your tax advisor is authorized to practice before the IRS. Otherwise, the new law gives you no basis to assert this new privilege.

Planning Alert! Privileged communication cannot be claimed if it involves the commission of a crime or tort. Privileged communication does not include a communication made for further communication to third parties. Thus, for example, information given to a tax advisor for inclusion in your tax return is not privileged because it is communicated for disclosure to the IRS. Furthermore, this privilege does not apply to any written communication by any director, shareholder, officer, employee, agent, or representative of a corporation in the promotion of any corporate tax shelter. It is not yet clear whether this privilege applies to the work product prepared by a covered tax advisor, the accountant's opinion on financial statements, or audit work papers.

More Liberal Rules For Reimbursing Litigation Cost And Obtaining Damage Awards. For litigation costs incurred and services performed more than 180 days after July 22, 1998, if your net worth does not exceed certain levels, you may find it easier to get costs reimbursed if you prevail over the IRS. For example, if at a certain stage of the audit you make a qualified offer to settle the case, the IRS rejects your offer, and later the IRS obtains a judgment no greater than your original offer, you may automatically be entitled to reasonable costs (including attorney's fees) incurred after the date of your offer.

Tax Tip. This rule, combined with the IRS's new burden of proof requirements, should give us more leverage to settle cases before the IRS.

Civil Damages. Effective for IRS actions occurring after July 22, 1998, the Act permits you to sue for civil damages up to \$100,000 caused by an IRS employee's "negligent disregard" of the Internal Revenue Code or Regulations. Before

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this change, to receive damages, you had to show that the employee's actions were "reckless or intentional" -- a much higher standard of proof.

Expanded Access To Small Case Proceedings. For years, the Tax Court has provided a "Small Case" procedure for tax disputes of \$10,000 or less. Many taxpayers choose this procedure because it expedites the tax litigation, the rules are simpler, and the litigation costs are generally much less. For tax proceedings begun after July 22, 1998, the "Small Case" procedure is available where the amount involved is \$50,000, or less.

DISABLED TAXPAYERS HAVE LONGER TO GET REFUNDS

Generally, if you discover you have overpaid your taxes, you must file for a refund within 3 years of filing your return (or, if later, within 2 years from the date you paid the tax). After that time period, you forfeit your refund. Under the new law, a taxpayer who has certain mental and/or physical disabilities may be entitled to a tax refund for overpayments even if the claim is filed after the 2 or 3 year period mentioned above. This new rule, generally, applies retroactively.

Tax Tip. If an elderly or disabled individual has overpaid their taxes in the past, this provision may provide welcome relief and enable them to obtain a refund of prior year taxes even where the normal 3 year statute of limitations has expired. Please call us if you need more information or assistance.

HIGHLIGHTS OF OTHER SELECTED TAX CHANGES

We have not attempted to address all of the new tax provisions in this 477-page tax bill. Instead, we have covered the provisions, we believe, affect the most people. The following lists several changes made by the IRS Restructuring and Reform Act of 1998 (many of which were technical corrections) that are not covered in this letter. Please call us if you have an interest in any of these areas:

- Ordering Rules For Child Credit
- Education Expense Reporting By Educational Institutions
- Distributions From "Qualified State Tuition Programs"
- Using Interest On U.S. Savings Bonds for Higher Education Costs
- Cancellation Of Student Loans
- Transportation Fringe Benefits
- Travel Expenses For Federal Employees On Temporary Duty Status
- Generation Skipping Tax
- Interest Rate On Estate Tax Installment Payments
- Conservation Easements
- Qualified Small Business Stock Gain Rollover Provisions
- Exemption From SECA Tax For Traders In Securities Electing Mark-To-Market Rules
- Mark-To-Market Treatment Denied For Customer Receivables
- District of Columbia Tax Incentives
- Deduction For Deferred Compensation (Overturning Result In "Schmidt Baking Co.")
- Postponing Magnetic Media Returns For Large Partnerships
- Requests To Give Up Your Right To Sue The IRS
- Notification Of Appointment Of Tax Matters Partner
- Tax Exempt Status Of Bond Issues
- Protection For Software Trade Secrets
- Protection Against IRS Extending The Statute Of Limitations
- Stapled REITs

At this point, the only information we have regarding these new tax rules is the statutory language and Congressional Committee Reports. Consequently, as we study the tax bill more closely, many questions will inevitably arise that are not currently addressed in the law or the committee reports. We anticipate the IRS will issue information addressing some of these questions. Our firm will monitor these future developments.

ABOUT RICHARD M. COLOMBIK

Richard M. Colombik is a tax partner in the Schaumburg headquartered firm of Richard M. Colombik & Associates, P.C. Mr. Colombik concentrates his practice in Federal Taxation, Estate Planning and Asset Protection Plans for individuals as well as corporate clients. He received his B.S. Degree in Business from the University of Colorado his J.D., Cum Laude, from the John Marshall Law School and his Certified Public Accountant certificate from the University of Illinois. Mr. Colombik has spoken at numerous engagements, radio television and is a well publicized author regarding Income Tax, Estate Tax and Asset Protection Planning. His work, Business Entity Selection Within Illinois, has been published by the Illinois Institute of Continuing Legal Education. He is the former chair of the Illinois State Bar's Federal Taxation Committee, Northwest Suburban Bar's Estate Planning and Taxation Committee, the American Bar Association's Taxation Sub-Committee of the General Practice Council, a former officer of both the Northwest Suburban Bar Association, the American Association of Attorney CPAs, and is currently a member in the Offshore Institute. Mr. Colombik is also the current liaison to the Internal Revenue Service for the American Association of Attorney-CPA", Inc.

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If you have any questions, please feel free to contact us.

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