

IRS Restructuring and Reform Act

The Internal Revenue Service Restructuring and Reform Act of 1998 made some noteworthy tax law changes that will have ongoing effects. Among them are:

Change in capital gains holding period.

IRS restructuring.

Spouses - joint tax return liabilities.

IRS encouraged to accept offers in compromise and installment agreements.

IRS Restructuring

IRS Reorganization - In an effort to eliminate perceived abuses by the IRS, the Act contains the Taxpayers Bill of Rights 3 which provides some of the most extensive taxpayer-protection provisions ever enacted. Most notable are provisions which shift the burden of proof from the taxpayer to the government in civil tax disputes and extend the attorney-client privilege to certain tax advisors other than attorneys.

The IRS has eliminated or substantially modified the present geographic structure and replaced it with an organizational structure that features operating units serving particular groups of taxpayers with similar needs.

Congress has called for this restructuring because it believed that the IRS's current structure was one of the factors contributing to its inability to serve taxpayers properly. Restructuring the IRS into separate units that serve particular groups of taxpayers with similar needs has enabled the IRS to serve them better. The IRS has identified four such groups, which are individual taxpayers, small businesses, large businesses and tax-exempt organizations.

IRS Burden of Proof - Under prior law, a rebuttable presumption always existed that the IRS's determination of tax liability was correct. This "presumption of correctness" in favor of the IRS placed the burden on the taxpayers to present evidence to support a finding contrary to the IRS's determination.

The Restructuring and Reform Act provides that, in any court proceeding, the IRS will have the burden of proof with respect to any factual issue if all of the following conditions are met:

The taxpayer introduces credible evidence with respect to the issue. Credible evidence means a quality of evidence which, after crucial analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted.

The taxpayer has complied with the requirements to substantiate any item under the Internal Revenue Code and Treasury Regulations.

The taxpayer has maintained all records required under the Internal Revenue Code.

The taxpayer has cooperated with reasonable IRS requests for witnesses, information, documents, meetings, and interviews.

In the case of a partnership, corporation, or trust, the net worth of the entity is \$7 million or less.

Expansion of Confidentiality Privilege - A common law privilege of confidentiality exists for communications between an attorney and client, or potential client, with respect to the legal advice the attorney gives the client. The privilege of confidentiality applies only where the attorney is advising the client, or potential client, on legal matters. It does not apply in situations where the attorney is acting in other capacities. For example, the attorney-client privilege will not automatically apply to communications and documents generated in the course of an attorney's preparation of a tax return. Attorney-client privilege is waived by any disclosure of the privileged information to a third party other than a third party who shares a common legal interest with the client or a third party necessary to the attorney-client consultation. Under pre-Act law, the attorney-client privilege was limited to communications between taxpayers and attorneys. No similar privilege existed for communications between taxpayers and other professionals, i.e., accountants and enrolled agents, practicing before the IRS.

The Act extends the application of the attorney-client privilege under the circumstances described below, to communicate between the taxpayer and any "federally authorized tax practitioner" (attorneys, certified public accountants, enrolled agents and enrolled actuaries) with respect to "tax advice," to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. The privilege may only be asserted in: (1) any non-criminal tax matter before IRS, and (2) any non-criminal tax proceeding in federal court brought by or against the United States.

The Restructuring and Reform Act provides that the privilege may be waived in the same manner as the attorney-client privilege. For example, if a taxpayer or federally authorized tax practitioner discloses to a third party the substance of a communication protected by the privilege, the privilege for that communication and any related communications is considered to be waived to the same extent and in the same manner as the privilege would be waived if the disclosure related to an attorney-client communication.

IRS Encouraged to Accept Offers-In-Compromise and Installment Agreements

The Restructuring and Reform Act encourages the IRS to adopt a more liberal acceptance policy for taxpayer Offers-in-Compromise and installment agreements. The Restructuring and Reform Act generally prohibits the IRS from levying on a taxpayer's property or rights to property to collect tax while an offer-in-compromise is pending or while an installment agreement is pending or in effect. A procedure to allow taxpayers to appeal any rejected offer will be implemented, and notification of the appeal right must appear on the IRS form used by the taxpayers to apply for an offer-in-compromise.

The Restructuring and Reform Act stipulates that taxpayer's can under certain circumstances require the IRS to enter into an installment agreement for the payment of the taxpayer's deficiency.

Our hope is that the IRS will now exhibit a further measure of flexibility in situations where the taxpayer is currently unable to pay as assessed deficiency.

Spouses-Joint Tax Return Liabilities

The Restructuring and Reform Act expands the relief from joint and several liability for tax deficiencies related to joint income tax returns, and makes it easier for a spouse to establish innocent spouse status. Under the Act, a spouse will be relieved of liability for a tax deficiency (including interest and penalties) if he or she established that (1) a joint return was filed for the tax year; and (2) there is an understatement of tax on the return that is attributable to erroneous items of the other spouse; and (3) the claimed innocent spouse established that, in signing the return, he or she did not know, and had no reason to know, that there was such an understatement; and (4) taking into account all of the facts and circumstances, it would be inequitable to hold the spouse liable for the tax deficiency attributable to the understatement; and (5) the spouse claims the benefits of the new rules no more than two years after the date on which the IRS has begun collection activities.

The Restructuring and Reform Act eliminates the requirement that the spouse show that the understatement exceeds the greater of \$55 or certain adjusted gross income (AGI) percentage thresholds. The spouse now need only show that there was an understatement. The Act also eliminates the requirement that the understatement be attributable to "grossly" erroneous items of the other spouse. Consequently, any disallowed claim of deduction, credit or basis can serve as the basis for innocent spouse relief; it is no longer necessary that the claim have "no basis in fact or law." Finally, if an individual who otherwise qualifies for innocent spouse relief fails to establish that he or she did not know or have reason to know of the extent of the understatement, then that individual will be relieved of liability for tax (including interest and penalties) to the extent that liability is attributable to the portion of the understatement of which he or she did not know or have reason to know.

These rules will significantly limit liability of the truly innocent spouse. The Restructuring and Reform Act also requires the IRS to establish procedures to clearly alert married taxpayers of their joint and several liabilities on all appropriate publications and instructions, and in any collection-related notices.

The Restructuring and Reform Act restrains the IRS from attempting to collect tax from a spouse who makes the innocent spouse election or separate liability election while that spouse petitions the Tax Court for a determination of the appropriate relief available under the rules for those elections.