TJAGSA Practice Notes

Faculty, The Judge Advocate General's School

Internal Revenue Service Restructuring and Reform Act of 1998

Introduction

On 22 July 1998, President Clinton signed into law the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998[1] (hereinafter the 1998 Act) which constitutes the most profound changes at the IRS in over four decades. In addition, the legislation includes the provisions of the Tax Technical Corrections Act of 1998[2] which contains technical, clerical, and conforming amendments to the Taxpayer Relief Act of 1997[3] [hereinafter the 1997 Act] and other recently enacted legislation. This legislation culminates a year of congressional investigations and hearings over the future of the IRS. The new law creates comprehensive changes in the IRS as it governs itself, institutes new taxpayer rights, increases supervision of the agency, and mandates emphasis on electronic tax filing. The 1998 Act contains over sixty provisions to fortify taxpayer rights and improve customer service. Technical corrections and changes were made in the areas of the supplemental child tax credit, educational credits, Individual Retirement Arrangements (IRAs), capital gains, Earned Income Credit (EIC), and the sale of principal residences. This note does not fully analyze the 1998 Act, but discusses the changes that are most likely to effect the military community and the practice of military law.

Electronic Filing of Tax and Information Returns[4]

Over the past decade, the number of taxpayers who filed their tax returns electronically has increased dramatically. An electronically filed return is a composite return (electronically transmitted data and certain paper documents mailed to the IRS) in lieu of a paper return. "During the 1997 tax filing season, the IRS received approximately 20 million individual income tax returns electronically."[5] In 1996, 192,233 federal tax returns were filed electronically by offices that were operating under the Army Legal Assistance Tax Program.[6] By 1997, the number of federal returns filed electronically by the Army Legal Assistance Tax Program had increased by seven percent to 205,117.[7] The 1998 Act sets a goal for the IRS to have at least eighty percent of all federal tax and information returns filed electronically by the year 2007.[8] Congressional policy requires the IRS to "cooperate with and encourage the private sector by encouraging competition to increase electronic filing."[9] The IRS can now implement procedures that provide for the payment of appropriate incentives for electronically filed returns.[10]

Currently, tax forms must be signed by taxpayers "as directed by the Secretary of the Treasury."[11] Although taxpayers have filed electronic returns for years, the IRS will not accept the return unless it also receives a signed Form 8453. The 1998 Act provides for the development of "procedures for the acceptance of signatures in digital or other electronic form."[12] Until these procedures are in place, the Secretary of

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1. Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 26 U.S.C.A.).

2. *Id.* §§ 6001-6024, 112 Stat. at 790-826.

3. Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 26 U.S.C.A.).

4. Internal Revenue Service Restructuring and Reform Act § 2001, 112 Stat. at 723 (codified at I.R.C. § 6011 (West 1998)).

5. H.R. Conf. Rep. No. 105-599, at 94 (1998).

6. Information Paper, DAJA-LA, subject: Tax Year 1997 Highlights & Trends, para. 2d (14 Aug. 1998).

7. *Id.*

8. Internal Revenue Service Restructuring and Reform Act § 2001(a)(2), 112 Stat. at 723.

9. *Id.* § 2001(a)(3).

10. I.R.C. § 6011(f)(2).

11. *Id.* § 6061.

12. Internal Revenue Service Restructuring and Reform Act § 2003(a), 112 Stat. at 724 (codified at I.R.C. § 6061(b)).

the Treasury can "waive the requirement of a signature or provide for alternative methods of signing returns."[13]

The 1998 Act mandates that beginning after 31 December 1998, the IRS will maintain "all tax forms, instructions, and publications from the past five years available for access on the [i]nternet in a searchable database."[14] The release on the internet is to correspond with the release of paper forms. Currently, the IRS provides access to all these documents on its internet site at www.irs.ustreas.gov. However, previously there was no requirement that mandated the timeliness of the document placement on the internet.

One of the goals of the 1998 Act is to strive for a "user-friendly" IRS. In the next nine years, the IRS will develop procedures to implement a "return-free tax system" whereby individuals will not have to file a tax return.[15] Within the next eight years, a taxpayer who files an electronic return will be able to examine his account electronically if all safeguards which protect the privacy of the account are in order.[16]

Taxpayer Protection and Rights

Relief from Joint and Several Liability on a Joint Tax Return: Innocent Spouse Relief

Under prior law, to secure relief from joint and several liability stemming from a joint federal tax return, taxpayers (referred to as the "innocent spouse") were required to meet strict requirements and "understatement of tax thresholds."[17] The 1998 Act makes innocent spouse relief easier to obtain. There are now three ways for an innocent spouse to obtain relief: by expanded innocent spouse relief,[18] a separate liability election,[19] and equitable relief.[20] Possible relief from joint and several liability on a joint return under these rules is allowed without concern to community property laws.[21]

The 1998 Act expands the application of innocent spouse relief by eliminating the requirement that the understatement of taxes be "substantial" and "grossly erroneous."[22] Simply specifying that the understatement of tax is attributable to an "erroneous item" instead of "grossly erroneous items" will now suffice.[23] The innocent spouse must demonstrate that in signing the return he "did not know, and had no reason to know, that there was an understatement."[24] A "separate liability election" is now available that allows the taxpayer to elect to have the responsibility for any deficiency restricted to the share of the shortage that is attributable to the items allocable to the taxpayer.[25] In effect, the return of the innocent spouse taxpayer is viewed as if the taxpayer had filed a separate return. In order to make the election, the innocent spouse taxpayer cannot be "married to or legally separated from, the individual with whom they filed the joint return." In addition, the innocent spouse must not be "a member of the same household as the individual with whom a joint return was filed at any time during the twelve month period ending on the date the election is filed."[26] The new election provision does have "fraudulent

13. *Id.* (codified at I.R.C. § 6061(b)(1)).

14. *Id.* § 2003(d), 112 Stat. at 725.

15. *Id.* § 2004(a), 112 Stat. at 726.

16. *Id.* § 2005(a).

17. Under prior law, relief of a spouse from joint tax liability could only be obtained if a joint return was filed, and there was a "substantial (in excess of $500) understatement of tax attributable to grossly erroneous items of one spouse; and the other spouse did not know and had no reason to know there was substantial understatement at the time the return was signed; and it would be inequitable to hold the innocent spouse liable for the deficiency attributable to the substantial understatement. Taking into account all the facts and circumstances, the spouse would be relieved of liability for the tax to the extent that the liability was attributable to the substantial understatement." Finally, the tax liability had to exceed a certain percentage of the innocent spouse's adjusted gross income. I.R.C. § 6013(e), *repealed by* Internal Revenue Service Restructuring and Reform Act § 3201(e), 112 Stat. at 740 (codified at I.R.C. § 6015(b)).

18. Internal Revenue Service Restructuring and Reform Act § 3201, 112 Stat. at 734 (codified at I.R.C. § 6015(b)).

19. *Id.* at 735 (codified at I.R.C. § 6015(c)).

20. *Id.* at 739 (codified at I.R.C. § 6015(f)).

21. *Id.* at 735 (codified at I.R.C. § 6015(a)(2)).

22. I.R.C. § 6013(e), *repealed by* Internal Revenue Service Restructuring and Reform Act § 3201(e), 112 Stat. at 740 (1998) (codified at I.R.C. § 6015(b)).

23. Internal Revenue Service Restructuring and Reform Act § 3201, 112 Stat. at 735 (codified at I.R.C. § 6015(b)(1)(B)).

24. *Id.* (codified at I.R.C. § 6015(b)(1)(C)).

25. *Id.* (codified at I.R.C. § 6015(b)(2)).

26. *Id.* at 736 (codified at I.R.C. § 6015(c)(3)(A)).

scheme" protections that make certain elections invalid.[27] Taxpayers who elect innocent spouse protection under the expanded rules[28] or the separate liability election[29] must make the election no later than two years after the IRS begins collection activities.

In addition to the two types of innocent spouse relief, a taxpayer may request "equitable relief."[30] Equitable relief is available if "taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency."[31] The Secretary of the Treasury has the authority to provide "equitable relief" when relief under the first two provisions is not available, but it would be inequitable to hold the individual liable for any unpaid tax or deficiency.[32]

The 1998 Act gives the Tax Court jurisdiction over disputes that involve innocent spouse relief.[33] An individual may petition[34] the Tax Court to determine the "appropriate relief available" under the innocent spouse provisions. The new law also requires the IRS to notify taxpayers of their rights under the "innocent spouse relief" provisions and whenever possible, send the notifications separately to each spouse.[35] One of the strongest features of the expansion of the innocent spouse provisions relates to its effective date. The expanded innocent spouse relief, separate liability election, and authority to provide equitable relief not only apply to liabilities for taxes that arise after the date of enactment, but are applicable for any liability beginning on or before the date of the act that remains unpaid on the date of enactment (22 July 1998).[36] Taxpayers who currently have unpaid tax liabilities and are undergoing collection actions will be able to seek the innocent spouse relief. Since the IRS has not yet issued implementing regulations and guidance, it is unknown under what situations the IRS will grant equitable relief when the other two provisions of the innocent spouse rules do not apply.

Disclosures to Taxpayers

Several sections of the 1998 Act require the IRS to provide disclosures or explanations to taxpayers about rights or procedures that benefit taxpayers.[37] The IRS is now required to inform taxpayers who filed a joint return of joint and several liability. Now the IRS is required to redraft various forms, publications, and notices to alert joint filers of its ability to assert joint and several liability for taxes.[38] In addition, the IRS is now specifically required to provide information to taxpayers about the availability of "innocent spouse relief" under new Internal Revenue Code sections of the 1998 Act (the Code).[39] These notification procedures must be in place by 18 January 1999.[40]

Presently, the IRS is required to provide information to taxpayers explaining their rights regarding audits, appeals, refund claims, and complaints.[41] The 1998 Act requires the IRS to revise Publication 1, "Your Rights as a Taxpayer," to notify taxpayers more clearly of their rights to be represented at interviews with the IRS by any person authorized to practice before the IRS, and to have the interview suspended if the taxpayer

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27. *Id.* (codified at I.R.C. § 6015(c)(3)(A)(ii)).

28. *Id.* at 735 (codified at I.R.C. § 6015(b)(1)(E)).

29. *Id.* at 736 (codified at I.R.C. § 6015(c)(3)(B)).

30. *Id.* at 739 (codified at I.R.C. § 6015(f)).

31. *Id.*

32. *Id.*

33. *Id.* at 738 (codified at I.R.C. § 6015(e)).

34. *Id.* The petition should be filed within ninety days after the IRS mails a notice to the taxpayer denying innocent spouse relief. If the IRS does not act upon the filing of a request for innocent spouse relief within six months, the taxpayer may file the petition after the close of the six-month period. *Id.*

35. *Id.* § 3201(d), 112 Stat. at 737.

36. *Id.* § 3201(f), 112 Stat. at 739.

37. *See id.* §§ 3501–3509, 112 Stat. at 770-72.

38. *Id.* § 3501(a), 112 Stat. at 770.

39. *Id.* § 3501(b) (codified at I.R.C. § 6015).

40. *Id.* § 3501(a).

41. I.R.C. § 7521 (West 1998).

requests to consult with such a person.[42] The revision of Publication 1 will be complete by 18 January 1999.[43]

Currently, the IRS is not required to explain why or how certain taxpayers are picked for examinations. The 1998 Act requires the IRS to include information in Publication 1 in "nontechnical terms" about the criteria and methods it uses to select taxpayers for an examination.[44] This provision, however, does not require the IRS to notify individual taxpayers of the basis for their selection for examination. In addition, the new provision does not require the IRS to disclose information that would be harmful to law enforcement.[45]

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

Generally, a taxpayer has to file a tax refund claim within three years of the date of filing a return or two years from the payment of a tax.[46] As a practical matter, the IRS would automatically reject as untimely a refund claim that is not filed within the time period. Previously, the Code contained special provisions that related to certain credits and special limitations, but the law did not contain any special provisions or exceptions about the tolling of the statute of limitations during periods of disability of the taxpayer.[47] Under the 1998 Act, the running of periods of limitation for credits or refunds is "suspended while the taxpayer is unable to manage financial affairs due to disability."[48] The running of the statute of limitations is now suspended during periods that a taxpayer is "financially disabled."[49] The practical effect of the change allows the statute of limitations to be suspended during the period of financial disability and allows refund claims outside the normal time periods as specified in the Code. Despite the change, a taxpayer will not be considered "financially disabled" during "any period that the individual's spouse or any other person is authorized to act on their behalf in financial matters."[50]

The IRS must implement new regulations and further guidance before taxpayers can apply this provision. Presently, there is no clear guidance for taxpayers on how they can comply with this new provision. The IRS will have to establish procedures for the submission of claims for suspension of the statute of limitations during periods of "financial disability" that include a claim and review process. Claimants who request suspension of the statute of limitations will undoubtedly have to submit documentary evidence or proof to the IRS in order to establish that they have a disability.[51] It is unclear who in the IRS will process these claims and exactly what documentary proof will be required. Despite the uncertainty in applying this new provision, the changes are effective and apply to "periods of disability before, on, or after the date of enactment" (22 July 1998).[52]

Suspension of Interest and Certain Penalties Where the IRS Fails to Contact an Individual Taxpayer

Generally, interest and penalties accrue during periods when taxes remain unpaid, regardless of whether the IRS notifies the taxpayer about the outstanding taxes.[53] The 1998 Act amends prior law in the case of taxpayers who file their income tax

42. Internal Revenue Service Restructuring and Reform Act § 3502, 112 Stat. at 770 (codified at I.R.C. § 7521(b)(2)).

43. *Id*.

44. *Id.* § 3503(a), 112 Stat. at 771.

45. *Id.*

46. I.R.C. § 6511(a) (West 1998).

47. *See generally id.* § 6511.

48. Internal Revenue Service Restructuring and Reform Act § 3202 (a), 112 Stat. at 740 (codified at I.R.C. § 6511(h)).

49. *Id.* (codified at I.R.C. § 6511(h)(2)(A)).

> An individual is financially disabled if such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. An individual shall not be considered to have such an impairment unless proof of the existence thereof is furnished in such form and manner as the secretary may require.

Id.

50. *Id.* (codified at I.R.C. § 6511(h)).

51. *Id.* (codified at I.R.C. § 6511(h)(2)(A)).

52. *Id.* § 3202(b), 112 Stat. at 741.

53. H.R. Conf. Rep. No. 105-599, at 124 (1998).

returns in a timely fashion, but the IRS fails to furnish notice to the taxpayer regarding an alleged tax liability.[54] Now, if the IRS fails to notify taxpayers of their liability and the basis for their liability, the "imposition of interest, penalties, addition to tax, or additional amounts with respect to any failure relating to the return" will be suspended.[55] The suspension of interest and penalties for the failure of the IRS to contact an individual taxpayer does not apply in some situations, particularly regarding penalties for failure to file a tax return or failure to pay a tax.[56] Unlike many other provisions of the 1998 Act, this provision does not apply until tax years after 1998.[57]

Abatement of Interest on Underpayments by Taxpayers in Presidentially Declared Disaster Areas

Previously, taxpayers who lived in "Presidentially declared disasters areas" would not receive an abatement of interest for underpayments[58] even if they were granted an extension in time to file and pay taxes because of a catastrophe or disaster. The 1998 Act adds a new subsection to the Code that allows the IRS to abate the levy of interest for taxpayers in "Presidentially declared disaster areas."[59] The change provides that if the IRS extends the date for filing income tax returns[60] and the time for paying income taxes,[61] the IRS will "abate" the levy of any interest for the same time as the extension period.[62] The change applies to disasters declared after 31 December 1997,[63] and will provide immediate relief and tax assistance to taxpayers.

Notice and Computation of Interest Charges

Presently, the Code does require the IRS to incorporate in its notice a point by point computation of the interest that it charges, nor a reference to the Code section supporting the interest charge. The 1998 Act adds a new section to the Code that relates to notice requirements for interest.[64] All notices that are sent by the IRS after 31 December 2000, that include the levy of interest against a taxpayer must include a precise calculation of the interest charged and a citation to the Code section that supports the charge.[65]

Procedural Requirements for Imposition of Penalties and Interest

Currently, the IRS is not required to provide notice to taxpayers that details the computation of penalties. In addition, several penalties exacted are devoid of any supervisory control or approval process. The 1998 Act added a new section to the Code that deals specifically with "procedural requirements" that demand compliance by the IRS in the area of penalties and interest.[66] The new law requires that the notice designate the penalty name, the Code section under which there is an assessment of a penalty, and a numeration of the penalty.[67] Additionally, the 1998 Act explicitly mandates approval by IRS management to charge all "non-computer" generated penalties

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54. Internal Revenue Service Restructuring and Reform Act § 3305, 112 Stat. at 743 (codified at I.R.C. § 6404(g)).

55. *Id.* § 3305, 112 Stat. at 743 (codified at I.R.C. § 6404(g)(1)(A)). The suspension period begins eighteen months (twelve months for taxable years beginning after 31 December 2003) after the date on which the return is timely filed, or the due date of the return without regard to extensions whichever is later. The suspension period ceases twenty-one days after the day the requisite notice is issued by the IRS. *Id.*

56. *Id.* § 3305(a), 112 Stat. at 743; I.R.C. § 6404(g)(1)(B)(2). Exceptions to the suspension include any penalties imposed pursuant to I.R.C. § 6651. Specifically, exceptions include cases involving fraud, relating to tax liabilities shown on the return, and any criminal penalties. *Id.*

57. Internal Revenue Service Restructuring and Reform Act § 3305(b), 112 Stat. at 743.

58. *Id.* § 3309, 112 Stat. at 745 (1998) (codified at I.R.C. § 6404(h)(2)). A "Presidentially Declared Disaster Area," for purposes of this section, means "with respect to any taxpayer, any area which the President has determined warrants assistance by the [f]ederal [g]overnment under the Disaster Relief and Emergency Assistance Act." *Id.*

59. *Id.* (codified at I.R.C. § 6404(h)).

60. I.R.C. § 6081.

61. I.R.C. § 6161.

62. Internal Revenue Restructuring and Reform Act § 3309, 112 Stat. at 745 (codified at I.R.C. § 6404(h)).

63. *Id*.

64. *Id.* § 3308(a), 112 Stat. at 744 (codified at I.R.C. § 6631).

65. *Id.* § 3308.

66. *Id.* § 3306 (codified at I.R.C. § 6751).

67. *Id.* § 3306(a) (codified at I.R.C. § 6751(a)).

unless specifically excepted by the Code.[68] These changes will be phased into operation by the IRS and become effective for the issue of notices and the assessment of penalties after 31 December 2000.[69]

Notice of IRS Contact of Third Parties

Formerly, the IRS could contact people other than the taxpayer to gather information in pursuit of collecting taxes without notifying the taxpayer of whom they intended to contact or did contact. The 1998 Act prohibits contacts by the IRS with any person other than the taxpayer regarding the collection of taxes and determinations of tax liability unless they provide "reasonable notice to the taxpayer."[70] The new provision requires the IRS to warn a taxpayer that it might contact third parties about tax liabilities. The IRS must keep accurate records of who they contact, and provide the information regarding any third party contacts to the taxpayer systematically and whenever the taxpayer requests the information.[71] Exceptions to the notice requirements include: a prior authorization by the taxpayer,[72] a showing by the IRS that the notice would jeopardize collection,[73] and criminal investigations.[74] The new notice requirements are effective 18 January 1999.[75]

Prohibition on Executive Branch Influence over Taxpayer Audits

Historically, there were no code provisions that explicitly prohibited high-level Executive Branch influence over taxpayer audits and collection activities. A new provision makes it unlawful[76] for certain Executive Branch officers[77] and employees to request (directly or indirectly) any IRS employee to conduct or terminate a tax audit or other investigation of any particular taxpayer (subject to three exceptions).[78]

Application of Certain Fair Debt Collection Procedures to IRS Communications with Taxpayers

The 1998 Act adds a new section to the Code aimed at eliminating concerns that the IRS has used or would use abusive or harassing techniques in its communications with taxpayers.[79] The addition, entitled "Fair Tax Collection Practices," aims to apply restrictions that are similar to the a Fair Debt Collection Practices Act[80] to tax collection communications with taxpayers.[81] Similar to debt collection practices rules, the new Code section limits the time, place, and manner in which the IRS can

68. I.R.C. § 6751(b)(2) (West 1998). The assessment of all penalties must be approved by IRS management except penalties under I.R.C. § 6651 for failure to file and pay. I.R.C. § 6651 (West 1998). *See* I.R.C. § 6654 (West 1998) (regarding individual estimated tax); I.R.C. § 6655 (West 1998) (regarding corporate estimated tax, and "any other penalty automatically calculated through electronic means").

69. Internal Revenue Service Restructuring and Reform Act § 3306(c), 112 Stat. at 744.

70. *Id.* § 3417(a), 112 Stat. at 757 (codified at I.R.C. § 7602(c)).

71. *Id.* § 3417.

72. *Id.* § 3417(a) (codified at I.R.C. § 7602(c)(3)(A)).

73. *Id.* (codified at I.R.C. § 7602(c)(3)(B)).

74. *Id.* (codified at I.R.C. § 7602(c)(3)(C)).

75. *Id.* § 3417(b), 112 Stat. at 758.

76. *Id.* § 1105, 112 Stat. at 711 (codified at I.R.C. § 7217(d)). A willful violation or failure to report a prohibited request shall be punished by a maximum fine of $500, or imprisonment of not more than five years. *Id.*

77. *Id.* (codified at I.R.C. § 7217(e)). The prohibition applies to the President, the Vice President, and employees of the executive office of both, as well as any individual serving in a cabinet level position (which includes the Secretary of Defense, Secretary of Veterans Affairs, and the Director of National Drug Control Policy).

78. *Id.* (codified at I.R.C. § 7217(c)). Executive Branch employees can make three types of written requests to the IRS. First, the prohibition does not apply to a written request made to an Executive Branch employee by a taxpayer or on behalf of a taxpayer that is then forwarded by that employee to the IRS. Second, an audit or investigation by the IRS of a presidential nominee for appointed positions as part of a background check. Finally, a written request can be made by the Secretary of the Treasury because of the implementation of a change in tax policy. *Id.*

79. Internal Revenue Service Restructuring and Reform Act § 3466, 112 Stat. at 768 (codified at I.R.C. § 6304).

80. 15 U.S.C.A. § 1692b (West 1998).

81. Internal Revenue Restructuring and Reform Act § 3466, 112 Stat. at 768 (codified at I.R.C. § 6304).

contact the taxpayer.[82] The IRS is restricted from engaging in "any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of any unpaid tax."[83] There are specific prohibitions regarding harassment, abuse, and the type of conduct that violates the new section.[84] Violations of the new Code section can form the basis of a civil action for "unauthorized collections actions."[85]

IRS Employee Contacts

Under the 1998 Act, the IRS must provide taxpayers with the name, telephone number, and "unique identifying number" of an employee whom they may contact regarding any manually prepared correspondence.[86] The IRS is now required, to the extent practicable, to assign one IRS employee to handle a taxpayer's matter until it is resolved.[87]

Due Process in IRS Collection Actions

The 1998 Act attempts to protect taxpayer rights by enacting statutory protections that safeguard "due process" requirements whenever the IRS seeks to collect taxes by levy, lien, and the seizure of property. The Act adds several new sections to the Code that relate to "notice and opportunity for a hearing upon the filing of a lien,[88] notice and opportunity for a hearing before levy,[89] and the review of levy and lien proceedings by special trial judges."[90] Previously, there was no requirement for the IRS to notify a taxpayer of the filing of a tax lien. Now, the IRS must notify a taxpayer in writing that it filed a tax lien.[91] The notice must contain information on the amount of the lien, the right to request a hearing, appeals, and the process for the release of liens.[92] Taxpayers now have a right to "notice and opportunity for a hearing before the levy" of property or assets.[93] No levy is permitted unless the IRS notifies the taxpayer in writing prior to the levy.[94] The notice is required to contain information that relates to the "amount of unpaid tax, the right to request a hearing, recitations of applicable Code provisions relating to levy and sale, appeals, alternatives available to the taxpayer, and the applicable law relating to redemption of property and release of liens."[95] The due process protections included in the 1998 Act apply to collection actions initiated after 18 January 1999.[96]

Civil Damages for Collection Actions

The 1998 Act permits the award of civil damages if there is a finding that any employee of the IRS negligently, recklessly, or intentionally disregarded provisions of the Internal Revenue

82. *Id.* § 3466(a) (codified at I.R.C. § 6304(a)). Without the prior consent of the taxpayer, the IRS cannot contact a taxpayer at "any unusual time or place or a time or place known or which should be known to be inconvenient to the taxpayer." Likewise, the IRS cannot contact a taxpayer when someone authorized to practice before the IRS represents him. The IRS cannot contact a taxpayers at his place of employment if they "know or have reason to know that the taxpayer's employer prohibits the taxpayer from receiving such communication." Convenient times for communicating with taxpayers are defined as "after 8 a.m. and before 9 p.m., local time at the taxpayer's location." *Id.*

83. *Id.*

84. *Id.* (codified at I.R.C. § 6304(b)). The IRS cannot "use or threaten to use violence or other criminal means to harm the physical person, reputation, or property of any person." Restrictions apply to the use of "obscene or profane language or language the natural consequence of which is to abuse the hearer or reader." Excessive telephone calls or "causing the telephone to ring" excessively or repeatedly, along with engaging in telephone conversation which would annoy, abuse or harass the person called is prohibited. *Id.*

85. *Id.* (codified at I.R.C. §§ 6304(c), 7433).

86. *Id.* § 3705(a), 112 Stat. at 777.

87. *Id.* § 3705(b).

88. *Id.* § 3401(a), 112 Stat. at 746 (codified at I.R.C. § 6320).

89. *Id.* § 3401(b), 112 Stat. at 747 (codified at I.R.C. § 6330).

90. *Id.* § 3401(c), 112 Stat. at 749 (codified at I.R.C. § 7443(b), (c)).

91. *Id.* § 3401(a), 112 Stat. at 746 (1998) (codified at I.R.C. § 6320(a)).

92. *Id.* (codified at I.R.C. § 6320(a)(3)).

93. *Id.* § 3501(b), 112 Stat. at 747 (codified at I.R.C. § 6330).

94. *Id.* § 3401(b), (codified at I.R.C. § 6330(a)(1)).

95. *Id.* (codified at I.R.C. § 6330(a)(3)).

96. *Id.* § 3401(d), 112 Stat. at 750.

Code or Treasury Regulations.[97] The recovery of damages is limited to $100,000 in the case of negligence and up to $1 million for reckless or intentional acts.[98] Previously, there was no "requirement that administrative remedies be exhausted" before a civil action could be initiated. The 1998 Act requires that no judgment for damages can be awarded unless the "plaintiff has exhausted the administrative remedies available" within the IRS.[99]

In addition, the 1998 Act provides for "civil damages for IRS violations of bankruptcy procedures."[100] If the IRS attempts to collect federal taxes in violation of bankruptcy provisions "relating to automatic stays" or "relating to effect of discharge," the taxpayer can petition the bankruptcy court "to recover damages against the United States."[101]

IRS Procedures Relating to Appeals of Examinations and Collections

The 1998 Act strengthens procedures to resolve examination and collection issues as early as possible and fully use dispute resolution through mediation and arbitration.[102] Before the 1998 Act, the IRS had various mediation and arbitration programs in place, but the new legislation codified these programs. Similar to prior practice, the 1998 Act requires the establishment of procedures so that taxpayers can request an early referral of unresolved issues from the "examination or collection division to the IRS Office of Appeals."[103] The act does not require a minimum dollar threshold before a taxpayer can use these alternative dispute resolution procedures. Taxpayers or the IRS Office of Appeals can now request non-binding mediation on any unresolved issue after the completion of the appeals process or after the failure to reach a closing agreement or compromise.[104] Binding arbitration is now available pursuant to a pilot program where the taxpayer and the IRS Office of Appeals can jointly ask for it on any unresolved issue after the completion of the appeals process or failure to reach a closing agreement or compromise.[105] The alternative dispute resolution procedures require that "appeals officer(s)" be regularly accessible within each state[106] and directs the IRS to "consider" using "videoconferencing of appeals conferences between appeals officers and taxpayers" in "rural and remote areas."[107] The result of this new emphasis on alternative dispute resolution should be more cases resolved through these procedures and fewer cases that reach litigation.

Approval Process for Liens, Levies, and Seizures

Section 3421 of the 1998 Act does not implement or amend a section of the Code, but requires the Commissioner of the IRS to "develop and implement procedures" that relate to the "approval process for liens, levies, and seizures."[108] The IRS complied with the 1998 Act pursuant to a memorandum from the Assistant Commissioner (Collection) to all "Regional Chief Compliance Officers and Assistant Commissioners (International)" dated 30 July 1998.[109] The determination to file a "notice of lien or levy, or to levy or seize, any property, where appropriate, must be reviewed by a supervisor of the employee before the action is taken."[110] Failure to comply can result in

97. *Id.* § 3102, 112 Stat. at 730 (codified at I.R.C. §§ 7433, 7426).

98. *Id.* (codified at I.R.C. § 7426(h)). The amount of damages is limited to the lesser of the statutory limit or the "actual, direct, and economic damages sustained as a proximate result" of the disregard of tax provisions by the employee in addition to the costs of the action. *Id.*

99. *Id.* § 3102(a)(2) (codified at I.R.C. § 7433(d)(1)).

100. *Id.* § 3102(c) (codified at I.R.C. § 7433(e)).

101. *Id.* (codified at I.R.C. § 7433(e)(1)).

102. *Id.* § 3465, 112 Stat. at 767 (codified at I.R.C. § 7123).

103. *Id.* § 3465(a) (codified at I.R.C. § 7123(a)).

104. *Id.* (codified at I.R.C. § 7123(b)).

105. *Id.* (codified at I.R.C. § 7123(b)(2)).

106. *Id.* § 3465(b), 112 Stat. at 768.

107. *Id.* § 3465(c).

108. *Id.* § 3421(a), 112 Stat. at 758.

109. Memorandum, Assistant Commissioner (Collection), Internal Revenue Service, to Regional Chief Compliance Officers, Assistant Commissioner (International), subject: Approval Process for Notices of Levy, Liens, and Seizures, sec. 3421 of the Restructuring and Reform Act (30 July 1998), *available at* <http://www.irs.ustreas.gov/prod/tax_regs/rra2-3421.html> (visited 1 Oct. 1998) [hereinafter Assistant Commissioner Memorandum].

110. Internal Revenue Service Restructuring and Reform Act § 3421(a)(1), 112 Stat. at 758.

disciplinary action against the employee or supervisor.[111] The supervisory "review process" requires the examination of the taxpayer's data, confirmation of an unpaid balance, and an endorsement whether a levy or seizure "is appropriate given the taxpayer's circumstances."[112] The implementing memorandum requires supervisory approval of determinations to file tax liens by employees below the grade of GS-9, and institutes new instructions for IRS management regarding approval of levies and seizures.[113] These changes became effective on the date of enactment of the 1998 Act.[114]

Procedures for Seizure of Residences and Businesses

Before the 1998 Act, principal residences were "exempt" from levy, but levy was allowed if approval was obtained from a "district director or assistant district director of the IRS, or if the Secretary of the IRS found the collection of a tax was in jeopardy."[115] The new legislation changes the exemption rules and approval requirement. Principal residences are now exempt from levy if the amount of the deficiency does not exceed $5000.[116] Any approval of a levy of a principal residence now rests with a judge or magistrate of a United States District Court, and they have "exclusive jurisdiction" to approve these types of levies.[117] The practical effect of this change is the requirement for judicial approval or intervention before a principal residence is seized. The legislative history indicates that Congress intended this requirement to extend to the taxpayer's spouse, former spouse, and minor children.[118] These changes became effective upon enactment.[119]

Offers-in-Compromise

In some cases taxpayers agree to accept an IRS determination of a tax liability, but cannot fulfill the tax obligation in full or all at one time. In these situations, the IRS routinely enters "offers-in-compromise"[120] usually coupled with a payment plan pursuant to an installment agreement.[121] The 1998 Act expands and liberalizes the IRS's authority for granting offers-in-compromise. In addition, the IRS must develop "standards for evaluation of offers-in-compromise" for use by IRS employees in deciding whether an offer is satisfactory.[122] The "standards" are to ensure that taxpayers who enter payment plans with the IRS maintain "adequate means to provide for basic living expenses"[123] by the development and use of schedules.[124] Of particular concern is the fair treatment of "low-income taxpayers."[125] The IRS is not allowed to refuse an offer-in-compromise from a low-income taxpayer simply based upon the amount of the offer.[126] This is good news for many military taxpayers due to limited income restrictions.

Not only does the 1998 Act expand the rules that relate to offers-in-compromise, but part of its focus is to ensure that taxpayers are made aware of the availability of offers-in-compromise and installment agreements.[127] The legislation requires

111. *Id.* § 3421(a)(2), 112 Stat. at 758.

112. *Id.* § 3421(b).

113. Assistant Commissioner Memorandum, *supra* note 109.

114. Internal Revenue Service Restructuring and Reform Act § 3421(c), 112 Stat. at 758.

115. *Id.* § 3445(a), 112 Stat. at 758 (codified at I.R.C. (6334(a)(13)).

116. *Id.* § 3445(a), 112 Stat. at 762.

117. *Id.* § 3445(b), 112 Stat. at 763 (codified at I.R.C. § 6334(e)(1)).

118. H.R. Conf. Rep. No. 105-599, at 133 (1998) (requiring that notice of the judicial hearing be provided to residents of the property).

119. Internal Revenue Service Restructuring and Reform Act § 3445(d), 112 Stat. at 763.

120. I.R.C. § 7122 (West 1998).

121. *Id.* § 6159.

122. Internal Revenue Service Restructuring and Reform Act § 3462(a), 112 Stat. at 764 (codified at I.R.C. § 7122(c)).

123. *Id.* (codified at I.R.C. § 7122(c)(2)).

124. *Id.* (codified at I.R.C. § 7122(c)(2)(B)).

125. The legislation did not define the term "low income taxpayer." The IRS will most likely issue guidance that defines "low income taxpayer," along with procedures that are based upon that designation.

126. Internal Revenue Service Restructuring and Reform Act § 3462(a), 112 Stat. at 764 (codified at I.R.C. § 7122(c)(3)(A)).

127. *Id.* § 3462(d), 112 Stat. at 766.

the IRS to provide taxpayers with statements in "nontechnical terms" about offers-in-compromise and the right of a taxpayer to appeal a rejection of an offer by the IRS.[128] The rejection of offers-in-compromise or installment agreements must now undergo "independent" administrative review before a taxpayer is notified of the rejection.[129] In addition, taxpayers can now appeal a rejection of an offer or agreement to the IRS Office of Appeals.[130]

These provisions will require the development of new regulations and guidance to implement the procedures. Although schedules and procedures have not yet been issued, the legislation was effective upon enactment.[131] Even without detailed guidance or regulations, the IRS will have to be more "thoughtful" in considering allowances for living expenses, offers-in-compromise, and installment agreements. In addition, it is likely that the number of offers and agreements will greatly increase as taxpayers are properly notified of the new rules.

Guaranteed Availability of Installment Agreements

Previously, the Code "authorized" the IRS to enter installment agreements for the payment of taxes if it was determined that the agreement would "facilitate collection of such liability."[132] The IRS was not required to enter into installment agreements in any particular type of cases. The 1998 Act does require the IRS to enter installment agreements in certain cases.[133] By contrast, the IRS is required to enter an installment agreement with a taxpayer if the taxpayer's total liability does not exceed $10,000, and in the prior five taxable years the taxpayer has not failed to file a tax return, failed to pay any tax, or entered into a prior installment agreement.[134] Finally, if a taxpayer requests an installment agreement, the IRS must determine whether he is financially unable to pay the tax liability in full. If these criteria are met and the taxpayer agrees to complete an installment payment within three years,[135] he has a "right" to an installment agreement.[136]

Confidentiality Privileges Relating to Taxpayer Communications: The "Accountant-Client Privilege"

One of the more controversial sections of the 1998 Act relates to the "accountant-client privilege."[137] The new code section establishes and applies the "same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney" to "communications between a taxpayer and any federally authorized tax practitioner[138] to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney"[139] concerning "tax advice."[140] This privilege applies to "any noncriminal tax matter before the IRS" and in "any noncriminal tax proceeding in federal court."[141] The legislative history indicates that the "accountant-client privilege" does not apply to disclosure of information "for the purpose of preparing a tax return."[142]

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128. *Id.*

129. *Id.* § 3462(c) (codified at I.R.C. § 7122(d)).

130. *Id.*

131. *Id.* § 3462(e).

132. I.R.C. § 6159 (West 1998).

133. Internal Revenue Service Restructuring and Reform Act § 3467, 112 Stat. at 769 (codified at I.R.C. § 6159(c)).

134. *Id.* § 3467(a) (codified at I.R.C. § 6159(c)(2)).

135. *Id.* (codified at I.R.C. § 6159(c)(3)).

136. *Id.* § 3467(b), 112 Stat. at 770.

137. *Id.* § 3411, 112 Stat. at 750 (codified at I.R.C. § 7525).

138. *Id.* § 3411(a) (codified at I.R.C. § 7525(a)(3)(A)). "Federally authorized tax practitioner" is defined as any "individual who is authorized under federal law to practice before the IRS if such practice is subject to federal regulation under section 330 of title 31, United States Code." *Id.*

139. *Id.* (codified at I.R.C. § 7525(a)(1)).

140. *Id.* (codified at I.R.C. § 7525(a)(3)(B)). "Tax advice means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice" as a "federally authorized tax practitioner." *Id.*

141. *Id.* (codified at I.R.C. § 7525(a)(2)).

142. H.R. CONF. REP. NO. 105-599, at 135 (1998).

Burden of Proof

Before the 1998 Act, a rebuttable presumption existed that an IRS determination of tax liability was correct. The taxpayer not only had the burden to prove that the IRS determination was incorrect, but also had to prove the merit of his claim by a preponderance of the evidence if a case was litigated.[143] Placing the burden of proof on the taxpayer created a perception that he was "guilty until proven innocent." The 1998 Act shifts the burden of proof in judicial proceedings.[144] When a taxpayer introduces "credible evidence regarding any factual point relating to determining their tax liability, the IRS will have the burden of proof on the issue."[145] In order for the burden shift to occur, the taxpayer must have complied with substantiation requirements for an item, maintained all required records, and cooperated with any IRS request for information.[146] If a taxpayer has complied with the substantiation and recordkeeping requirements of the Code, the government must then prove that the taxpayer's determination of accountability was incorrect. This change in the burden of proof only applies to judicial proceedings. It does not apply to audits and investigations. Consequently, the IRS will place more emphasis on meticulous investigations and audits of a tax issue before it initiates litigation. Because of the threshold requirements of substantiation and cooperation that are placed upon the taxpayers, audited taxpayers should expect an increase in requests for detailed information and documentation by the IRS.

During some judicial proceedings relating to an item of income (usually relating to unreported income), the IRS uses "statistical information on unrelated taxpayers." The 1998 Act requires the IRS to have the burden of proof in court proceedings regarding any component of income that the IRS reconstructs "entirely by using statistical data on different taxpayers."[147] There is no prerequisite that taxpayers provide records or cooperate with the IRS in its use of this type of statistical data.

Offset of Past-Due, Legally Enforceable State Income Tax Obligations against Overpayments

Currently, under the Tax Refund Offset Program, the IRS may offset over payments for support and collection of debts owed to federal agencies.[148] However, "past-due, legally enforceable state income tax obligations"[149] have not been a part of the Tax Refund Offset Program. The 1998 Act allows states to participate in the "Tax Refund Offset Program" starting after 31 December 1999.[150] When the IRS receives notice from any state that a taxpayer owes a "past-due, legally enforceable state income tax obligation," the IRS can decrease the amount of any overpayment (refund) payable by the amount of the state income tax debt.[151] This new offset program could have a potential impact on military taxpayers because of their mobility from state to state. However, military practitioners should be aware of various procedural requirements of the new provision that provide adequate safeguards and protections to military taxpayers. In order for the IRS to apply an offset for a tax year, the address as listed on the taxpayer's federal tax return for the year of overpayment must be the same as the state that is requesting the offset.[152] Additionally, the state must comply with strict notice and "consideration of evidence"

143. Danville Plywood Corp. v. United States, 16 Ct. Cl. 584 (1989).

144. *Id.* § 3001(a), 112 Stat. at 726 (codified at I.R.C. § 7491).

145. *Id.* (codified at I.R.C. § 7491(a)(1)).

146. *Id.* (codified at I.R.C. § 7491(a)(2)).

147. *Id.* (codified at I.R.C. § 7491(b)).

148. I.R.C. § 6402 (West 1998).

149. Internal Revenue Service Restructuring and Reform Act § 3711(a), 112 Stat. at 779 (codified at I.R.C. § 6402(e)(5)). "Past-due, legally enforceable state income tax obligation means a debt which resulted from a judgment rendered by a court of competent jurisdiction which has determined an amount of state income tax to be due; or a determination after an administrative hearing which has determined an amount of state income tax to be due; and which is no longer subject to judicial review; or which has been assessed but not collected, the time for redetermination of which has expired, and which has not been delinquent for more than ten years." In addition, "state income tax" includes any local income tax administered by the tax agency of the state. *Id.*

150. *Id.* § 3711(d), 112 Stat. at 781 (1998).

151. *Id.* § 3711(a), 112 Stat. at 779 (codified at I.R.C. § 6402(e)(1)).

152. *Id.* (codified at I.R.C. § 6402(e)(2)).

requirements before the IRS will consider an offset.[153] Legal assistance attorneys who encounter offsets for state income tax obligations should make sure that the state met these notice and evidentiary requirements.

Elimination of the Eighteen-Month Holding Period for Capital Gains

Last year, the 1997 Act[154] lowered capital gains rates for individuals,[155] but required property to be held more than eighteen months to receive a more favorable rate.[156] The 1998 Act reduces the period of time required for holding "long-term capital gains" from eighteen months to twelve months.[157] The practical effect of the 1998 Act, when coupled with the 1997 Act, is to reduce the long-term capital gains rate from twenty-eight percent to twenty percent. For those taxpayers in the fifteen percent tax bracket, the rate will be reduced to ten percent.[158] The change in the long-term holding period from eighteen months to twelve months is retroactive to 1 January 1998.[159] A result of the change in the holding period for long-term capital gains is the elimination of the very complex computations that were required on Form 1040,[160] Schedule D last year. The change in the holding period is a clear benefit that allows taxpayers to receive a favorable tax rate on capital gains for what in reality is a fairly short holding period. Taxpayers should carefully examine their assets to take advantage of the preferred capital gains rates over ordinary income tax rates.

Tax Technical Corrections Act of 1998

The Tax Technical Corrections Act of 1998[161] was originally a separate bill introduced in 1997 to make various corrections and amendments primarily to code provisions from the 1997 Act. Although it is totally unrelated to restructuring and reforming the IRS, it was included as a part of the 1998 Act.

Amendments to the Child Credit

For tax year 1998, there is a tax credit of $400 ($500 in 1999) for each qualifying child[162] of a taxpayer under the age of seventeen.[163] The child tax credit is limited or phased out subject to adjusted gross income.[164] The maximum amount of the child tax credit for a taxable year is restricted to the excess of a taxpayer's regular tax liability over his tentative minimum tax

153. *Id.* (codified at I.R.C. § 6402(e)(4)).

> a. Notice; Consideration of Evidence – No state may take action under this subsection until such state-
> b. notifies by certified mail with return certified mail with receipt the person owing the past-due state income tax liability that the state proposes to take action pursuant to this section;
> c. gives such person at least sixty days to present evidence that all or part of such liability is not past-due or not legally enforceable;
> d. considers any evidence presented by such person and determines that an amount of such debt is past-due and legally enforceable; and
> e. satisfies such other conditions as the secretary may prescribe to ensure that the determination made under subparagraph (c) is valid and that the state has made reasonable efforts to obtain payment of such state income tax obligation.

Id.

154. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 26 U.S.C.A.).

155. *Id.* § 311(a), 111 Stat. at 831 (codified at I.R.C. § 1(h)(1)(E)) (West 1997)).

156. *Id.* at 832 (codified at I.R.C. § 1(h)(8)(A) (West 1997)).

157. Internal Revenue Service Restructuring and Reform Act § 5001(a), 112 Stat. at 787 (codified at I.R.C. §§ 1(h), 1223(11), (12)).

158. I.R.C. § 1(h) (West 1998).

159. Internal Revenue Service Restructuring and Reform Act § 5001(b), 112 Stat. at 788.

160. U.S. Internal Revenue Serv., Form 1040, Income Tax Return for Single and Joint Filers (1998).

161. Internal Revenue Service Restructuring and Reform Act § 6001, 112 Stat. at 790.

162. *Id.* § 24(c). A qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer, a stepchild, or an eligible foster child of the taxpayer. *Id.*

163. *Id.* § 24(a).

164. *Id.* § 24(b). The child tax credit is reduced by $50 for each $1000 by which the taxpayer's "modified adjusted gross income exceeds the threshold amounts." The "threshold" amount is $110,000 in for joint returns, $75,000 for single filers, $55,000 for filers of a married filing separate return. *Id.*

liability.[165] Additional rules and credits apply for families with three or more qualifying children.[166]

The 1998 Act clarifies the rules for the child tax credit by treating the refundable portion of the child credit in the same manner as other refundable credits.[167] After the application of all other credits according to the "stacking rules" of the income tax limitation, the refundable credits are applied to first decrease the tax liability, and then to provide a credit in excess of the income tax liability for the year.[168] A portion of the child credit[169] is treated as a "supplemental child credit" under the "earned income credit"[170] and an offsetting reduction of the child credit.[171] The offset does not affect the total tax credits allowable or available to the taxpayer.[172] However, it does decrease the normally allowable "nonrefundable child credit" by the amount of the "supplemental child credit" which is a "refundable credit."[173] The 1998 Act also details how the "supplemental child credit" is computed.[174]

Amendments to Educational Incentives

Under the 1997 Act,[175] an individual could make a nondeductible contribution of up to $500 per year to an education IRA.[176] The education IRAs was established to pay for qualified higher education expenses for a specified person.[177] Generally, the earnings on an education IRA are not subject to taxation at distribution if they are used to pay for qualified educational expenses.[178] However, distributed earnings that are not used to pay higher educational expenses are included in income, and result in a ten-percent penalty.[179] The 1997 Act was not clear regarding the distribution and taxation of the balance of education IRAs upon the death of a named beneficiary. The 1998 Act treats all the residue of an education IRA as distributed within thirty days after the date the beneficiary attains the age of thirty or dies.[180] Taxpayers can avoid the ten percent penalty and income tax by rolling over the remaining balance of an education IRA to another family member's (who is under the age of thirty) education IRA. Taxpayers can also avoid the penalty and income tax by changing the beneficiary designation on the existing IRA to another family member within thirty days after the original beneficiary turns thirty or dies.[181]

The 1998 Act also addresses how a taxpayer can treat distributions from an educational IRA when the taxpayer elects to claim a Hope Scholarship Credit or Lifetime Learning Credit with respect to a beneficiary. In these situations, the new law allows for a waiver of the ten percent penalty tax for distributions from an education IRA if the following criteria are met: (1) the distributions were used to pay qualified higher education expenses; (2) the beneficiary waives the tax-free handling of distributions from an education IRA; and (4) the dispersal is

165. *Id.* § 26.

166. *Id.* § 24(d). Taxpayers with three or more qualifying children are limited to a child tax credit to the greater of the normal amount computed, or an amount equal to the excess sum of the taxpayer's regular income tax liability and the social security taxes for the taxable year.

167. Internal Revenue Service Restructuring and Reform Act § 6003(a), 112 Stat. at 790 (codified at I.R.C. § 24(d)).

168. *Id.*

169. I.R.C. § 24 (West 1998).

170. *See generally id.* § 32.

171. Internal Revenue Service Restructuring and Reform Act § 6003(b), 112 Stat. at 791 (codified at I.R.C. § 32(n)).

172. *Id.* (codified at I.R.C. § 32(n)(2)).

173. *Id.* (codified at I.R.C. § 32(n)(1)).

174. *Id.* (codified at I.R.C. § 32(n)). The sum of the "supplemental child credit" is the lesser of the amount of the taxpayer's total nonrefundable personal tax credits that are increased by reason of the child credit, or the taxpayer's total tax credits, including the earned income credit over the sum of the taxpayer's regular income taxes and social security taxes. The earned income credit "phase-out rules" do not apply to the "supplemental child credit." *Id.*

175. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788.

176. *Id.* § 213(a), 111 Stat. at 812 (codified at I.R.C. § 530 (West 1997)).

177. I.R.C. § 530(b)(2) (West 1998).

178. *Id.* § 530(d).

179. *Id.* § 530(d).

180. Internal Revenue Service Restructuring and Reform Act § 6004(d), 112 Stat. at 793 (codified at I.R.C. § 530(b)(1)(E)).

181. *Id.* (codified at I.R.C. § 530(d)(5) - (8)).

made on or before the beneficiary's income tax return due date for the year.[182] This change is important because taxpayers who elect a tax-free distribution from an education IRA cannot claim the Hope Scholarship Credit or Lifetime Learning Credit.[183] Generally, most taxpayers will benefit more from using the Hope Scholarship Credit or Lifetime Learning Credit than from having a tax-free distribution from the education IRA. The 1998 Act allows the taxpayer to make this election and in effect, elect to waive what would otherwise be a ten-percent penalty tax.[184] Finally, the 1997 Act did not answer whether an education IRA could be created for an unborn child or grandchild. The 1998 Act makes it clear that the education IRA contribution must be for a "life in being" or a living person.[185]

The 1997 Act introduced a new code provision that allows taxpayers who have paid interest on qualified education loans (student loans) after 31 December 1997, to claim an above-the-line deduction for the interest expense up to a maximum amount ($1000 annually in 1998).[186] The 1998 Act clarifies the Code to specify that the deduction of interest on qualified education loans is only available to the taxpayer who is legally obligated to make interest payments on the loan.[187] Therefore, taxpayers should decide or plan who will be legally obligated on the loan (usually parent or student), and therefore able to deduct the student loan interest. The 1998 Act also specifies that no deduction is allowed unless the loan is used solely to pay higher education expenses.[188] The practical effect of this provision is to exclude interest of various forms of credit (for example, revolving credit) unless the taxpayer had agreed to use the line of credit exclusively to pay for qualified education expenses.

Roth IRA Changes

The 1997 Act introduced a new type of retirement plan called a "Roth IRA."[189] The Roth IRA is popular with taxpayers because distributions of earnings from the Roth IRAs are excludable from income taxation if the taxpayer maintains the account for at least five years and fulfills various other qualifying factors.[190] One of the attractive features of the 1997 Act relating to Roth IRAs was the ability of taxpayers with up to $100,000 of "modified adjusted gross income"[191] to rollover or to convert their savings from traditional IRAs into Roth IRAs.[192] Despite the ability to rollover or to convert a traditional IRA into a Roth IRA, the rollover is treated as a taxable liquidation of the traditional IRA.[193] Pursuant to the 1997 Act, rollover from a traditional IRA before 1 January 1999, requires the taxpayer to include the distribution in their gross income "ratably over the four-taxable year period beginning with the taxable year in which the payment or distribution is made."[194] The 1998 Act now makes the four-year spread of income taxes relating to the distribution of a traditional IRA optional rather than mandatory.[195] Based upon the individual situation, some taxpayers may find it more beneficial to include the distribution in their income in the one-year versus including it ratably over four years.

The 1998 Act provides relief for the taxpayer who makes a contribution or rollover conversion and subsequently determines that he was not eligible to make some or all of the contribution because he exceeded the adjusted gross income limitations.[196] The taxpayer is now allowed to shift the excess contribution to a regular IRA without a penalty being assessed.

182. *Id.* (codified at I.R.C. § 530(d)(4)(C)).

183. I.R.C. § 25A(e) (West 1998).

184. Internal Revenue Service Restructuring and Reform Act § 6004(d), 112 Stat. at 793 (codified at I.R.C. § 530(d)(4)).

185. *Id.* (codified at I.R.C. § 530(b)(1)).

186. I.R.C. § 221 (West 1998).

187. Internal Revenue Service Restructuring and Reform Act § 6004(b), 112 Stat. at 792 (codified at I.R.C. § 221(e)).

188. *Id.*

189. Taxpayer Relief Act of 1997 § 302(a), Pub. L. No. 105-34, 111 Stat. at 825 (codified at I.R.C. § 408A (West 1997)).

190. I.R.C. § 408A(d) (West 1998).

191. *Id.* § 408(c)(3).

192. *Id.* § 408A(d)(3).

193. *Id.*

194. *Id.* § 408A(d)(3)(A)(iii).

195. Internal Revenue Service Restructuring and Reform Act § 6005(b)(4), 112 Stat. at 797 (codified at I.R.C. § 408A(d)(3)(A)(iii)).

196. *Id.* § 6005(b)(6), 112 Stat. at 799 (codified at I.R.C. § 408A(d)(6)).

The transfer, however, must be made before the filing due date for the income tax return for the year of contribution.[197]

The 1997 Act created a situation under which a five-year holding period began for purposes of deciding whether a distribution of an amount attributable to a conversion is a qualified dispersion for each separate individual rollover.[198] Under the old provision it was important to separate Roth IRA rollover accounts due to the separate five year holding period for each rollover. Now the five-year holding period begins with the tax year in which the first contribution was made to a Roth IRA.[199] A more recent conversion of amounts from traditional IRAs will not begin the running of a new five-year term.

Because the 1998 Act eliminated the requirement for separate or segregated accounts for annual contributions and rollovers of contributions to a Roth IRA, some type of "ordering rules" were required to account for the Roth IRA. One Roth IRA can include amounts from annual contributions, one or more rollover contributions from traditional IRAs, and the earnings generated from the IRA.[200] Under the "ordering rules," withdrawals are deemed to have been withdrawn first from annual after tax contributions or regular Roth IRA contributions. This first order is always determined to be tax and penalty-free. The second order is considered to have come from rollover contributions to a Roth IRA.[201] Finally, after all contributions have been "withdrawn" from the Roth IRA, ensuing withdrawals contain the earnings accumulated. These withdrawals are generally tax and penalty-free if certain criteria are met.[202]

One concern following the 1997 Act was the apparent disqualification of many taxpayers to make Roth IRA conversions because the definition of adjusted gross income appeared to include the amount of the rollover and prevented taxpayers from qualifying because their adjusted gross income exceeded $100,000.[203] The 1998 Act clarifies the calculation of adjusted gross income for purposes of the Roth IRA to exclude or subtract the conversion amounts.[204] Changes are also included which address premature distributions from Roth IRAs that were converted from a traditional IRA and are still within the four-year income-averaging period.[205] Withdrawn amounts during the four-year income-averaging period are subject to a disadvantageous income-acceleration rule.[206]

A perplexing question ensued following the enactment of the 1997 Act relating to how to handle the death of a taxpayer during the four-year income-averaging period. Generally, the leftover rollover income must be included in the final return of the deceased taxpayer.[207] Nevertheless, a surviving spouse who is a beneficiary of a 1998 Roth IRA conversion can elect to continue to spread income over the remainder of the four-year income-averaging period.[208]

Amendments to the Earned Income Credit (EIC)

The EIC[209] is subject to "phase-out" rules for taxpayers who are above a certain level of income.[210] Individuals that qualify for the EIC who have earned income within the phase-out range have the applicable credit ratably reduced. If earned income exceeds the phase-out, the taxpayer is not entitled to the credit. The Code specifies what is excludable or "disregarded" in computing a "modified adjusted gross income" for purposes of the

197. *Id.*

198. Taxpayer Relief Act of 1997, § 302(a), Pub. L. No. 105-34, 111 Stat. at 827 (codified at I.R.C. § 408A(d)(2)(B)(ii) (West 1997)).

199. Internal Revenue Service Restructuring and Reform Act § 6005(b)(3), 112 Stat. at 797 (codified at I.R.C. § 408A(d)(2)(B)).

200. *Id.* § 6005(b)(5)(A), 112 Stat. at 798 (codified at I.R.C. § 408A(d)(4)).

201. *Id.* § 6005(b)(5)(A) (codified at I.R.C. § 408A(d)(4)(B)(ii)(II)). If the Roth IRA is composed of several rollover contributions, withdrawals will be considered to be apportioned on a "first in, first out" basis. *Id.*

202. *Id.* § 6005(b)(3), 112 Stat. at 797 (codified at I.R.C. § 408A(d)(2)). Withdrawal of earnings is considered tax and penalty free if the withdrawal occurs more than five years after the initiation of the year commencement of the Roth IRA and after age 59.5, death, or disability. *Id.*

203. Taxpayer Relief Act of 1997 § 302(a), 111 Stat. at 825 (codified at I.R.C. § 408A(c) (West 1997)).

204. Internal Revenue Service Restructuring and Reform Act § 6005(b)(2), 112 Stat. at 797 (codified at I.R.C. § 408A(c)(3) (West 1998)).

205. *Id.* § 6005(b)(4)(B) (codified at I.R.C. § 408A(d)(3)(E)).

206. *Id.*

207. *Id.* (codified at I.R.C. § 408A(d)(3)(E)(ii)).

208. *Id.*

209. *See generally* I.R.C. § 32 (West 1998).

210. *Id.* § 32(b), (f).

EIC.[211] The 1998 Act specifies that two nontaxable amounts are now added or included in the "modified adjusted gross income" for purposes of the EIC.[212] Tax exempt interest and amounts received from pensions, annuities, or retirement plans, to the extent they are not normally included in gross income, are included in the EIC computation of "modified adjusted gross income."[213]

Amendments to Exclusion of Gain from the Sale of Principal Residence

Following the 1998 Act, taxpayers who comply with a two-year ownership and use test[214] are allowed to exclude a maximum of $500,000 of principal residence gain on a joint return or $250,000 on a single return.[215] In the event a taxpayer fails to meet the two-year ownership and use test because of a change in employment, health problems, or other unexpected circumstances, he is still able to obtain some benefit from the gain exclusion rules. The 1998 Act amends the Code to make it clear that the reduced exclusion available to the taxpayer is a pro rata share of the full exclusion limitation ($500,000 for married) as opposed to a pro rata portion of the taxpayer's gain on the sale.[216]

Conclusion

The 1998 Act significantly changes the manner in which the IRS operates on a daily basis. The changes were designed to strengthen taxpayer rights and curb perceived abuses by the IRS. In addition, procedural due process protections were codified in order to eliminate arbitrary actions on the part of the IRS. The gains and protections to taxpayers instituted by the 1998 Act are negated if taxpayers are not informed of the recent changes. Legal assistance attorneys should inform the military community of the significant changes pursuant to preventive law programs and be prepared to provide services to military tax clients. Major Rousseau.

Update for 1998 Federal Income Tax Returns

It is that time of year when legal assistance attorneys begin preparing for the 1998 federal income tax filing season. The following article is a brief update of important changes for taxpayers in the military community. This note is not intended to serve as an in-depth review or explanation of each topic discussed, but to inform legal assistance attorneys of updates in taxation and numerology for the upcoming tax season.

Key Changes for 1998

Child Tax Credit

Beginning in 1998, taxpayers can claim a child tax credit of $400 for each "qualifying child"[217] under the age of seventeen.[218] The amount of the child tax credit is subject to limitations based upon the taxpayer's modified adjusted gross income (MAGI).[219] For most taxpayers, the credit is nonrefundable and subject to other limitations based upon tax liabilities.[220] However, special rules apply for families with three or more qualifying children.[221] Families with three or more qualifying children may be able to take the credit as a refundable amount.[222]

211. *Id.* § 32(c)(5).

212. Internal Revenue Service Restructuring and Reform Act § 6010(p), 112 Stat. at 816 (codified at I.R.C. § 32(c)(5)(C)).

213. *Id.*

214. I.R.C. § 121(a) (West 1998).

215. Internal Revenue Service Restructuring and Reform Act § 6005(e), 112 Stat. at 805 (codified at I.R.C. § 121(b)).

216. *Id.* (codified at I.R.C. § 121(c)(1)).

217. I.R.C. § 24(c) (West 1998). A "qualifying child" is a son, daughter, stepchild, eligible foster child, or other descendant for whom the taxpayer can claim a dependency deduction for the tax year. The "qualifying child" must also be a citizen or resident of the United States. *Id.*

218. *Id.* § 24.

219. *Id.* § 24(b). For joint taxpayers, the amount of the credit will be reduced by $50 for every $1000 of MAGI above $110,000. Likewise, it will be reduced in a similar manner for unmarried individuals with MAGI above $75,000 and those taxpayers that are married filing separately with a MAGI in excess of $55,000. *Id.*

220. *Id.* § 26.

221. *Id.* § 24(d). The additional credit is computed by adding the taxpayer's social security taxes paid for the tax year to the tax liability limitations of I.R.C. § 26, and subtracting that amount by all nonrefundable credits, and the earned income credit (not including the supplemental child credit as specified in I.R.C. §32(n)). *Id.*

222. *Id.*

Of all the tax changes for 1998, the Child Tax Credit should have the broadest impact on military taxpayers for the upcoming tax season. The credit directly reduces tax liability on a dollar-for-dollar basis. Military taxpayers with children who did not adjust their federal income tax withholding in 1998 may see their overall tax liability decrease or the size of refunds increase. Military taxpayers who receive a large refund because of the child tax credit should consider a corresponding reduction in wage withholding. The reality of a large tax refund is that the taxpayer most likely inaccurately computed the withholding of taxes. A taxpayer can have more money in his paycheck each month by carefully reviewing his withholding allowances on an IRS form W-4.

Education Incentives

The Hope Scholarship Credit allows taxpayers to elect to take a nonrefundable tax credit against federal income taxes up to $1500 per student for "qualified tuition and related expenses"[223] paid during the tax year on behalf of a student.[224] The maximum Hope Scholarship Credit in 1998 is $1500 for each eligible student. The credit is subject to phase-out rules for joint taxpayers with MAGI between $80,000 to $100,000 (single taxpayers with MAGI of $40,000 to $50,000).[225] Married taxpayers must file jointly in order to claim the credit.[226] The ability to claim the Hope Scholarship Credit is only available to those taxpayers who can claim a dependency exemption for the student.[227] The Hope Scholarship credit is allowable for the expenses of students who have not completed the first two years of post-secondary education.[228] In addition, the election of the credit is allowable for only two tax years.[229] To be eligible, the student must carry at least one-half the "normal full-time workload for the course of study the student is pursuing."[230] Taxpayers should be careful to reduce the qualified tuition and related expenses by any scholarship amounts that are excludable to income[231] that the taxpayer received during the tax year.[232] Nevertheless, a reduction in qualified tuition and expenses does not have to be made for amounts paid or received by gift, bequest, devise, or inheritance.[233]

While the Hope Scholarship Credit only applies to the first two years of post-secondary education, the Lifetime Learning Credit is available for students who are enrolled in undergraduate or graduate education to acquire or improve job skills.[234] Special rules disqualify students for the Lifetime Learning Credit if they are eligible for the Hope Scholarship Credit.[235] For qualified expenses that are paid after 30 June 1998, taxpayers can claim a Lifetime Learning Credit up to twenty percent of $5000 of qualified tuition and related expenses paid during the tax year.[236] It is important to note that the Hope Scholarship Credit is available for qualifying expenses for each qualifying student,[237] but the Lifetime Learning Credit is available only per taxpayer.[238] Therefore, the maximum Lifetime Learning Credit available in 1998 is $1000 per taxpayer. The same rules previously mentioned for the Hope Scholarship Credit relating to phase-out limitations, definition of qualified tuition and expenses, reductions for scholarships, ability to claim depen-

223. *Id.* § 25A(f). "Qualified tuition and expenses means tuition and fees required for enrollment or attendance of the taxpayer, spouse or any tax dependent of the taxpayer" at a post-secondary educational institution. They do not include books, room and board, student activities, insurance, equipment, transportation, or similar personal or living expenses. *Id.*

224. *Id.* § 25A.

225. *Id.* § 25A(d).

226. *Id.* § 25A(g)(6).

227. *Id.* § 25A(g)(3).

228. *Id.* § 25A(b)(2).

229. *Id.*

230. *Id.* § 25A(b)(3).

231. *Id.* § 117.

232. *Id.* § 25A(g)(2).

233. *Id.*

234. *Id.* § 25A(c)(2).

235. *Id.*

236. *Id.* § 25A(c)(1).

237. *Id.* § 25A(b)(1).

238. *Id.* § 25A(c)(1).

dency exemption, and requirement for married couples to file jointly all pertain to the Lifetime Learning Credit. However, the Lifetime Learning Credit is distinguishable from the Hope Scholarship Credit because it expands the timing and types of educational courses that are allowable for the credit. There is no requirement that taxpayers attend an educational course on a half-time basis. Rather, taxpayers merely have to attend any course of instruction to "acquire or improve job skills."[239] The Lifetime Learning Credit can be used for credit and non-credit courses, professional seminars, and similar classes by educational institutions. Although the rules for the Hope Scholarship Credit restrict the ability to claim the credit for two-years,[240] there are no such restrictions for the Lifetime Learning Credit.

Taxpayers should be aware that educational payments that are made during one tax year for an academic period that begins within three months of the next tax year, can still be claimed as a qualified expense in the year paid.[241] This provision allows parents to consider paying spring term tuition in December in order to maximize the amount of the credit for the current year.

Beginning in 1998, taxpayers who are legally obligated to pay student or educational loans can take an above-the-line deduction or adjustment to income for the interest paid on qualified loans up to a maximum of $1000 per year.[242] Similar to the tax credits already mentioned, this adjustment to income is extremely valuable because taxpayers can claim the adjustment even if they do not itemize. In order to claim the adjustment, taxpayers must claim the student as a dependent on their federal tax returns.[243] The deduction is subject to phase-out rules for married taxpayers who file a joint return with MAGI between $60,000 to $75,000 (single taxpayers with MAGI between $40,000 to $55,000).[244] The deduction is available for the first sixty months in which interest payments are due.[245] If a student loan is deferred, the months when payments do not have to be made will not count against the sixty-month period. Unlike the Hope Scholarship Credit and the Lifetime Learning Credit, the deduction for student loan interest is not only for tuition and fees, but also room, board, books, and other necessary expenses.[246] To be eligible, the student must carry at least one-half the "normal full-time workload for the course of study the student is pursuing."[247]

Taxpayers are allowed to prepay college tuition, fees, books, and equipment pursuant to "qualified state tuition" programs. Any distribution or earnings under the programs are not included in the taxpayers gross income.[248] Beginning in 1998, individuals can prepay room and board expenses on the same tax-exempt and deferred basis.[249]

Another new education incentive in 1998 is the creation of education IRAs.[250] These new IRAs are for paying the beneficiary's qualified education expenses.[251] Taxpayers can make an annual contribution of up to $500 per beneficiary, but a corresponding tax deduction or adjustment to income is not allowed.[252] Nevertheless, education IRAs are exempt from taxation, and distributions for qualified higher education expenses are tax-free.[253] Taxpayers cannot contribute to an education IRA after the beneficiary turns eighteen years of age.[254] The contribution limit does phase out for joint filers with MAGI

239. *Id.* § 25A(c)(2)(B).

240. *Id.* § 25A(b)(2).

241. *Id.* § 25A(g)(4).

242. *Id.* § 221.

243. *Id.* § 221(c).

244. *Id.* § 221(b).

245. *Id.* § 221(d).

246. *Id.* § 221(e)(2).

247. *Id.* § 221(e)(3).

248. *Id.* § 529(c).

249. *Id.* § 529(e)(3)(B).

250. *Id.* § 530.

251. *Id.* § 530(b)(1).

252. *Id.* § 530(b)(1)(A).

253. *Id.* § 530(a).

254. *Id.* § 530(b)(1)(A).

between $150,000 and $160,000 ($95,000 and $110,000 for single filers).[255] It is important to note that a taxpayer is not permitted a Hope Scholarship Credit or Lifetime Learning Credit for education expenses for a tax year if there has been a tax-free education IRA distribution.[256] However, there is an election whereby a taxpayer can waive the income exclusion of the education IRA. This waiver would be beneficial in situations where a greater tax savings was produced by the education credits instead of the exclusion by the education IRA rules.[257]

Individual Retirement Arrangements

More service members will be eligible to take a deduction for IRAs in 1998 due to an increase in the phase-out limitations. Because service members are active participants who are covered by a pension or retirement plan, deductible IRA contributions are subject to limitations.[258] For 1998, taxpayers that are married and filing a joint return are subject to phase-out limitations if their MAGI exceeds $50,000 and eliminated if MAGI exceeds $60,000 (married filing separately phase-out limitations are $0 - $10,000; $30,000 - $40,000 phase-out limitations for all other filers).[259]

Before 1998, if one spouse was an active participant in a retirement plan (for example, a service member), both spouses were subject to the dollar limitations for the deductibility of IRA contributions.[260] Now, even if a spouse is an active participant in a retirement plan (for example, a service member), the non-active participant spouse may be able to deduct a contribution to an IRA with higher phase-out limitations (phase-out begins at MAGI of $150,000).[261]

A new type of IRA was initiated in 1998 called the Roth IRA.[262] Contributions to Roth IRAs are non-tax deductible, but, unlike regular IRAs, withdrawals are tax-free provided the withdrawals take place at least five years after the establishment of the Roth IRA and the taxpayer is fifty-nine and a half years of age.[263] A taxpayer can make annual nondeductible contributions that are made to a Roth IRA up to $2000, but that amount is reduced by the amount of contributions made to all other IRAs for the tax year.[264] Many taxpayers made rollovers from regular IRAs to Roth IRAs during 1998. Taxpayers with an AGI of $100,000 or less were allowed to rollover distributions from regular IRAs to Roth IRAs within sixty days of withdrawal.[265] The rollover or conversion is subject to taxation as if it was not rolled over.[266] However, the rollover will not be subject to a ten percent tax for premature distribution.[267] The taxpayer can elect whether to pay the entire tax for the rollover in 1998 or elect to spread the tax out over four tax years beginning in 1998.[268]

Two new penalty-free withdrawals from IRAs took effect in 1998. Certain first-time homebuyers can withdraw up to $10,000 from an IRA penalty-free.[269] The term "first time homebuyer" is broadly defined as one who had no ownership interest in a principal residence in the two years before buying the new home.[270] Taxpayers can also make a withdrawal from a regular IRA for qualifying education expenses without paying

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255. *Id.* § 530(c).

256. *Id.* §§ 25A(e), 530(d)(2).

257. *Id.*

258. *Id.* § 219(g).

259. *Id.* § 219(g).

260. *Id.* § 219(g)(1).

261. *Id.* § 219(g)(7).

262. *Id.* § 408A.

263. *Id.* § 408A(d).

264. *Id.* § 408A(c).

265. *Id.* § 408A(c)(3)(B).

266. *Id.* § 408A(d)(3).

267. *Id.* § 408A(d)(3).

268. *Id.* § 408A(d)(3)(A)(iii).

269. *Id.* § 72(t).

270. *Id.* § 72(t)(8).

the ten-percent penalty on early withdraw.[271] Despite the ability to withdraw from an IRA without paying the early withdrawal penalty, taxpayers should be aware that amounts withdrawn are still subject to regular income taxation.

271. *Id.* § 72(t).

1998 Numerology[a]

Tax Rates

The 1998 tax rates are: 15%, 28%, 31%, 36%, and 39.6%. The 1998 tax rates by filing status are:

Married filing jointly and Qualifying Widow(er):

Taxable Income	Marginal Tax Rate
$1 - 42,350	15%
42,350 - 102,300	28%
102,300 - 155,950	31%
155,950 - 278,450	36%
over 278,450	39.6%

Single:

$1 - 25,350	15%
25,530 - 61,400	28%
61,400 - 128,100	31%
128,100 - 278,450	36%
over 278,450	39.6%

Head of household:

$0 - 33,950	15%
33,950 - 87,700	28%
87,700 - 142,000	31%
142,000 - 278,450	36%
over 278,450	39.6%

Married filing separately:

$1 - 21,175	15%
21,175 - 51,150	28%
51,150 - 77,975	31%
77,975 - 139,225	36%
over 139,225	39.6%

Estates and trusts:

$1 - 1700	15%
1700 - 4000	28%
4000 - 6100	31%
6100 - 8350	36%
over 8350	39.6%

a. *Id.* § 1; Rev. Proc. 97-57.

Standard Deduction

Married filing jointly or qualifying widow(er)—$7100 ($6900 in 1997).
Single—$4250 ($4150 in 1997).
Head of household—$6250 ($6050 in 1997).
Married filing separately—$3550 ($3450 in 1997).

Reduction of Itemized Deductions

Otherwise allowable itemized deductions are reduced if AGI in 1998 exceeds:
Married filing separately—$52,250.
All other returns—$124,500.

Personal Exemptions

Personal exemption deduction—$2700 ($2650 in 1997).
Phase-out of Personal Exemptions:

Filing Status	**Phase-out Begins After**
Married filing jointly	$186,800
Single	$124,500
Head of household	$155,500
Married filing separately	$ 93,400

Earned Income Credit

Number of Children	Maximum Amount of the Credit	Earned Income Amount	Threshold Phase-out Amount	Completed Phase-out Amount
1	$2271	$6680	$12,260	$26,473
2 or more	$3756	$9390	$12,260	$30,095
None	$341	$4460	$5570	$10,030

International and Operational Law Note

Principle 4: Preventing Unnecessary Suffering

The following note is the fifth in a series of practice notes[272] that discuss concepts of the law of war that might fall under the category of "principle" for purposes of the Department of Defense (DOD) Law of War Program.[273]

The principle of preventing unnecessary suffering is closely related to both the principle of military necessity and the principle of minimizing harm to civilians.[274] While the other principles seek to protect civilians, this principle focuses on restraining the suffering inflicted on enemy combatants. It is, perhaps, the most obvious example of the "desire to diminish the evils of war."[275] According to *Field Manual (FM) 27-10*, this is the fundamental purpose of the law of war. *Field Manual 27-10* states that "the conduct of armed hostilities on land is regulated by the law of land warfare which is both written and unwritten. It is inspired by the desire to diminish the evils of war by [p]rotecting both combatants and noncombatants from unnecessary suffering."[276]

The preamble to the 1907 Hague Convention IV also reflects this "desire to diminish the evils of war."[277] The 1907 Hague Convention IV is one of the first multilateral law of war treaties that attempts to comprehensively regulate the methods and means of warfare. The language in the preamble, known as the "Martens Clause,"[278] has been replicated in subsequent law of war treaties.[279] The preamble states: "in cases not covered by the attached regulations, the belligerents remain under the protection and the rule of the principles of the law of nations as derived from the usages established among civilized people, the laws of humanity and the dictates of the public conscience."[280]

Describing the purpose of this clause, A.P.V. Rogers explains that it was intended to ensure that humane limits existed in warfare for all those affected, not only civilians. A.P.V. Rogers states that:

> The purpose of the clause was not only to confirm the continuance of customary law, but also to prevent arguments that because a particular activity had not been prohibited in a treaty it was lawful. Humanity is, therefore, a guiding principle which puts a brake on the undertakings which might otherwise be justified by the principle of military necessity.[281]

Regarding lawful enemy combatants, this principle must be reconciled with the concept of military necessity. Warfare obviously justifies subjecting an enemy to massive and decisive force, and the suffering that it brings. Military necessity justifies the infliction of suffering upon an enemy combatant.[282] Since 1868, however, it has been explicitly recognized that military necessity only justifies the infliction of as much suffering as is necessary to bring about the submission of an enemy.[283] Prohibiting the infliction of suffering upon enemy combatants, beyond what is necessary, is the "brake" that A.P.V. Rogers describes. The St. Petersburg Declaration of 1868 clearly articulated this prohibition:

> The only legitimate object which states should endeavor to accomplish during war is to weaken the military forces of the enemy; That for this purpose it is sufficient to disable the greatest possible number of men;

272. *See* International and Operational Law Note, *When Does the Law of War Apply: Analysis of Department of Defense Policy on Application of the Law of War,* ARMY LAW., June 1998, at 17; International and Operational Law Note, *Principle 1: Military Necessity,* ARMY LAW., July 1998, at 72 [hereinafter *Principle 1*]; International and Operational Law Note, *Principle 2: Distinction,* ARMY LAW., Aug. 1998, at 35 [hereinafter *Principle 2*]; International and Operational Law Note, *Principle 3: Endeavor to Prevent or Minimize Harm to Civilians,* ARMY LAW., Oct. 1998, at 54 [hereinafter *Principle 3*].

273. *See* U.S. DEP'T OF DEFENSE, DIR. 5100.77, DOD LAW OF WAR PROGRAM (10 July 1979). *See also* CHAIRMAN, JOINT CHIEFS OF STAFF INSTR. 5810.01, IMPLEMENTATION OF THE DOD LAW OF WAR PROGRAM (12 Aug. 1996).

274. *See Principle 1*, *supra* note 272; *Principle 2*, *supra* note 272; *Principle 3*, *supra* note 272.

275. U.S. DEP'T OF ARMY, FIELD MANUAL 27-10, THE LAW OF LAND WARFARE 3 (July 1956) [hereinafter FM 27-10].

276. *Id.*

277. Hague Convention No. IV Respecting the Laws and Customs of War on Land, Oct. 18, 1907, art. 22 [hereinafter Hague IV], *reprinted in* U.S. DEP'T OF ARMY, PAM. 27-1, TREATIES GOVERNING LAND WARFARE (Dec. 1956).

278. This was the name of the Russian representative who drafted the language. *See* A.P.V. ROGERS, LAW ON THE BATTLEFIELD 6 n.36 (1996).

279. *See id.* at 7 n.37.

280. Hague IV, *supra* note 277, at preamble.

281. ROGERS, *supra* note 278, at 7.

282. *See Principle 1*, *supra* note 272.

283. *Id.* at 72 nn.161-62 (citing the St. Petersburg Declaration of 1868).

> That this object would be exceeded by the employment of arms which uselessly aggravate the sufferings of disabled men, or render their death inevitable . . . . That the employment of such arms would, therefore, be contrary to the laws of humanity.[284]

One text summarizes the intersection between the necessity to destroy an enemy force and the dictates of humanity as follows:

> Not all means or methods of attaining even a 'legitimate' object of weakening the enemy's military forces are permissible under the laws of armed conflict. In practice, a line must be drawn between action accepted as 'necessary' in the harsh exigencies of warfare and that which violates basic principles of moderation.[285]

As this quote highlights, the law of war requires a balance between destruction and humanity. This balance applies not only where noncombatants are concerned, but also when violence is inflicted upon an enemy force. In practice within the United States armed forces, this balance arguably takes two forms, one well accepted and the other less apparent.

The well accepted form of this balance or "brake" explicitly prohibits employing arms that are calculated to cause unnecessary suffering. This prohibition is found in *FM 27-10*, and is based on the express language of Article 23 of Hague IV, which states: "It is especially forbidden . . . to employ arms, projectiles, or other materiel calculated to cause unnecessary suffering."[286] According to *FM 27-10's* interpretation of this provision:

> What weapons cause "unnecessary injury" can only be determined in light of the practice of states in refraining from the use of a given weapon because it is believed to have that effect . . . . Usage has, however, established the illegality of the use of . . . irregular-shaped bullets, and projectiles filled with glass, the use of any substance on bullets that would tend unnecessarily to inflame a wound inflicted by them, and the scoring of the surface or the filing off of the hard cases of bullets.[287]

Department of Defense Directive 5000.1 mandates the legal review of new weapon systems to ensure that they comply with this treaty obligation.[288] This review is performed at the service secretary level. Judge advocates, however, should not assume that no further responsibility exists simply because a weapon system was reviewed before it was fielded. As the quoted interpretation states, it is not only the weapon system itself that can run afoul of this prohibition, but also the projectile. Weapons and ammunition that are found to comply with this treaty obligation could later be modified in the field. Because a modification could violate the treaty, judge advocates at every level of command must ensure that soldiers understand that such modifications are prohibited.

The second aspect of this principle is found in revised paragraph 41, *FM 27-10*.[289] This paragraph is entitled "Unnecessary Killing and Devastation,"[290] a 1976 change to the original 1956 wording[291] states:

> [L]oss of life and damage to property incidental to attacks must not be excessive in relation to the concrete and direct military advantage expected to be gained. Those who plan or decide upon an attack, therefore, must take all reasonable steps to ensure not only that the objectives are identified as military objectives or defended places . . . but also that these objectives may be attacked without probable losses in lives and damage to property disproportionate to the military advantage anticipated . . . .[292]

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284. Declaration Renouncing the Use, in Time of War, of Explosive Projectiles Under 400 Grammes Weight, Dec. 11, 1868, 1 A.J.I.L. 95-96 *reprinted in* THE LAWS OF ARMED CONFLICT 102 (Dietrich Shindler & Nigel Jiri Thomas eds., 3d ed. 1988).

285. HILLAIRE MCCOUBREY & NIGEL D. WHITE, INTERNATIONAL LAW AND ARMED CONFLICT 226 (1992).

286. Hague IV, *supra* note 277, art. 23.

287. FM 27-10, *supra* note 275, at 18.

288. U.S. DEP'T OF DEFENSE, DIR. 5000.1, DEFENSE ACQUISITION (15 Mar. 1996).

289. FM 27-10, *supra* note 275, at 5.

290. *Id.*

291. *Id.* at 1. Note that this modification occurred during the negotiation of 1977 Protocol I to the Geneva Conventions of 1949.

292. *Id.*

This language is nearly identical to the "proportionality" test[293] of Articles 51 and 57 of the 1977 Protocol I.[294] It establishes a test for determining when "incidental" losses become unnecessary; thereby, violating the law of war. The inherent balancing test contained in this paragraph implicitly acknowledges that most suffering is unavoidable. The paragraph, however, categorizes unavoidable suffering as "unnecessary" when it is "excessive" in relation to the concrete and direct military advantage anticipated.

The language used in *FM 27-10*, however, contains one interesting difference from that used in Protocol I—the absence of the word "civilian." Unlike the "proportionality" test of Protocol I, which relates to "incidental" harm caused to *civilians*, the *FM 27-10* prohibition against "unnecessary killing and devastation" appears to extend the "proportionality" test to harm inflicted upon both noncombatants and combatants. The test established by the quoted language is general in nature and is not limited to situations involving noncombatants.

Applying a "proportionality" test to enemy combatants seems consistent with the principle of preventing unnecessary suffering. This principle is based on the notion that infliction of suffering upon an enemy that is not "necessary" to achieve the submission of that enemy must be prohibited. Without this prohibition, war would license the infliction of suffering for inhumane purposes, such as revenge or plunder.[295] It is also thoroughly consistent with the *FM 27-10* "purpose statement," quoted above. The "purpose statement" identifies the prevention of unnecessary suffering of noncombatants, and the restoration of peace, as key components of the purpose of the law of war.[296] Prohibiting the infliction of suffering on enemy forces, which would be "excessive" in relation to the anticipated military advantage, clearly serves both of these ends.

In spite of the appeal of this logic, determining that the use of force against a valid military objective might be excessive is an extremely controversial proposition. It seems to contradict the right of a belligerent to apply "overwhelming" or "decisive" force. There is no basis to support such a conclusion. The right of a belligerent to inflict extensive suffering on a legitimate opponent is implied within this standard. But no right in war is without limit, and at some exteme, this test might be applicable. What is certain is that if applicable, the standard must be more permissive than the standard used to protect non-combatants.

This rule, therefore, should not be read to prohibit a military force from assaulting a lawful military objective with "overwhelming" force. Rather, it suggests that there might be some limit to the methods and means of warfare that can lawfully be used against a military objective, even if the exact determination of "excessive force" is undefined. At a minimum, rule is restricts employing an otherwise lawful means of warfare in a method that is calculated to cause unnecessary suffering on the enemy.

The principle of preventing unnecessary suffering clearly applies to Operations Other Than War. It applies equally to the use of weapons that cause unnecessary suffering, and to the use of force that is excessive in relation to the anticipated military advantage. In fact, the relationship between preventing unnecessary suffering and mission legitimacy is arguably more pronounced during these types of operations than during international armed conflict. Judge advocates must ensure that the use of force during all military operations, including isolated uses of force deemed necessary during non-conflict operations, comports with this principle. Regarding weapon systems, this requires that all members of the force understand the dangers related to "home-grown" modifications of weapons and ammunition. These modifications could fundamentally alter the characteristics of a weapons system that was deemed to comport with this principle when it was fielded. When a weapons system is later modified, it could result in a conclusion that the actual use of the weapon was intended to cause unnecessary suffering.[297]

Concerning the use of weapons systems during non-conflict operations, the judge advocate must apply the same analysis that is used in armed conflict. Specifically, he must ensure that the infliction of unnecessary suffering is not the purpose of using the weapons system. This analysis is relatively straight forward—ensuring that commanders understand that infliction

293. Practitioners should ensure that they distinguish between the proportionality test discussed herein, which is related to the legality of the conduct of combatants, and the proportionality test related to when the use of force by a nation complies with the requirements of Article 51 of the United Nations Charter. *See Principle 3*, *supra* note 273.

294. 1977 Protocol I Additional to the Geneva Conventions, Dec. 12, 1977, arts. 51, 57, *reprinted in* 16 I.L.M. 1391.

295. *See* ROGERS, *supra* note 278, at 6.

296. FM 27-10, *supra* note 275, at 3.

297. Applying this test arguably requires commanders to make a good faith assessment of both the anticipated benefits of applying force, and whether any anticipated "suffering" will be excessive in relation to this benefit. As the discussion of *FM 27-10* indicates, applying the proportionality test to determine when suffering caused by a military operation becomes "unnecessary" arguably applies to suffering caused to both non-combatants and combatants. While the definition of "excessive" suffering must certainly vary between these two categories of individuals, the basic analysis remains the same.

of suffering for no other purpose than to cause suffering is not justified even by armed conflict.

Commanders must ensure that the use of military force will not result in "unnecessary" suffering. According to *FM 27-10*, suffering is unnecessary when it is "excessive" in relation to the military benefit expected to be gained from employing the force causing the suffering. The use of force has always caused some amount of suffering to both combatants and non-combatants. Prohibiting suffering that is unnecessary or excessive, however, is a fundamental "check" on the destructive power of combatants. This "check" applies across the spectrum of military operations, and should help judge advocates analyze the legality of supported military operations. Major Corn.