DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE FOR H.R. 1528, THE "TAXPAYER PROTECTION AND IRS ACCOUNTABILITY ACT OF 2003"

Scheduled for Markup
By the
COMMITTEE ON WAYS AND MEANS
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the Staff of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's Amendment in the Nature of a Substitute for H.R. 1528, The "Taxpayer Protection and IRS Accountability Act of 2003." The House Committee on Ways and Means has scheduled a markup of this proposal for April 3, 2003.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of a Substitute for H.R. 1528, The "Taxpayer Protection and IRS Accountability Act of 2003."* (JCX-32-03), April 2, 2003.

TITLE I - PENALTY AND INTEREST REFORMS

A. Failure to Pay Estimated Tax

1. Convert estimated tax penalty into an interest provision for individuals, estates, and trusts

Present Law

The Federal income tax system is designed to ensure that taxpayers pay taxes throughout the year based on their income earned and expenses. To the extent that tax is not collected through withholding, taxpayers are required to make quarterly estimated payments of tax. If an individual fails to make the required estimated tax payments under the rules, a penalty is imposed under section 6654. The amount of the penalty is determined by applying the underpayment interest rate to the amount of the underpayment for the period of the underpayment. The amount of the underpayment is the excess of the required payment over the amount (if any) of the installment paid on or before the due date of the installment. The period of the underpayment runs from the due date of the installment to the earlier of (1) the 15th day of the fourth month following the close of the taxable year or (2) the date on which each portion of the underpayment is made. The penalty for failure to pay estimated tax is the equivalent of interest, which is based on the time value of money.

Description of Proposal

The penalty for failure to pay estimated tax is converted into an interest provision for individuals, estates, and trusts.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2003.

2. Increase and revise estimated tax threshold

Present Law

Taxpayers are not liable for a penalty for the failure to pay estimated tax when the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by withholding, is less than $1,000. This safe harbor does not apply, however, when a taxpayer has paid tax throughout the year solely through estimated tax payments. For such taxpayers, any tax shown on the return for the taxable year, net of estimated tax paid, could subject the taxpayer to the penalty for failure to pay estimated tax (unless another safe harbor applies).

Description of Proposal

Under the proposal, no interest will be charged for underpayments of estimated tax if the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by both withholding and/or equally-paid estimated tax is less than $1,600.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2003.

3. Apply one interest rate per estimated tax underpayment period for individuals, estates, and trusts

Present Law

The present-law penalty for failure to pay estimated tax is equal to the underpayment interest rate multiplied by the number of days the underpayment is outstanding, which is the number of days between when the taxpayer should have made the estimated payment and the earlier of (1) the 15th day of the fourth month following the close of the taxable year or (2) the date on which each portion of the underpayment is made. The interest rate, which equals the Federal short-term rate plus three percentage points, is subject to change on the first day of each quarter, which is January 1, April 1, July 1, and October 1.

If interest rates change while an underpayment of estimated tax is outstanding, then taxpayers are required to make separate calculations for the periods before and after the interest rate change. Such calculations generally are needed to cover 15-day periods. For example, the July 1 interest rate occurs 15 days after the June 15 payment date (for calendar-year taxpayers). A change in interest rates, which occurs on the first day of each calendar quarter, would require the use of different interest rates during one estimated tax underpayment period and would increase the number of calculations that a taxpayer must make in calculating a penalty for failure to pay estimated tax.

Description of Proposal

The interest rates are aligned so that, for any given estimated tax underpayment period, only one interest rate will apply. The underpayment interest rate in effect on the first day of the quarter in which the pertinent estimated payment due date arises is the interest rate that will apply during an entire underpayment period.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2003.

4. Provide that underpayment balances are cumulative

Present Law

Section 6654(b)(1) defines "underpayment" as the amount of an installment due over the amount of any installment paid (including withholding) on or before the due date of the installment. In determining an underpayment penalty for a calendar year taxpayer, the period of underpayment runs for each underpayment from the payment's due date through the earlier of the date on which any portion of the payment is made or the 15th day of the fourth month following the close of the taxable year. Underpayment balances are not cumulative and must be tracked separately for each estimated tax underpayment period.

Description of Proposal

The definition of "underpayment" is changed to allow existing underpayment balances to be used in underpayment calculations for succeeding estimated payment periods. Taxpayers will now calculate a cumulative underpayment at the end of each underpayment period.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2003.

B. Exclusion from Gross Income for Interest on Overpayments of Income Tax by Individuals

Present Law

Overpayment interest

Interest is included in the list of items that are required to be included in gross income (sec. 61(a)(4)). Interest on overpayments of Federal income tax is required to be included in taxable income in the same manner as any other interest that is received by the taxpayer.

Cash basis taxpayers are required to report overpayment interest as income in the period the interest is received. Accrual basis taxpayers are required to report overpayment interest as income when all events fixing the right to the receipt of the overpayment interest have occurred and the amount can be estimated with reasonable accuracy. Generally, this occurs on the date the appropriate IRS official signs the pertinent schedule of overassessments.

Underpayment interest

A corporate taxpayer is allowed to currently take into account interest paid on underpayments of Federal income tax as an ordinary and necessary business expense. Typically, this results in a current deduction. However, the deduction may be deferred if the interest is required to be capitalized or may be disallowed if and to the extent it is determined to be a cost of earning tax exempt income under section 265.

Section 163(h) of the Code prohibits the deduction of personal interest by taxpayers other than corporations. Noncorporate taxpayers, including individuals, generally are not allowed to deduct interest on the underpayment of Federal income taxes.

Temporary regulations provide that personal interest includes interest paid on underpayments of individual Federal, State or local income taxes, regardless of the source of the income generating the tax liability. This is consistent with the statement in the General Explanation of the Tax Reform Act of 1986 that "(p)ersonal interest also includes interest on underpayments of individual Federal, State, or local income taxes notwithstanding that all or a portion of the income may have arisen in a trade or business, because such taxes are not considered derived from conduct of a trade or business." The validity of the temporary regulation has been upheld in those Circuits that have considered the issue, including the Fourth, Sixth, Eighth, and Ninth Circuits.

Personal interest also includes interest that is paid by a trust, S corporation, or other pass-through entity on underpayments of State or local income taxes. Personal interest does not include interest that is paid with respect to sales, excise or similar taxes that are incurred in connection with a trade or business or an investment activity.

Description of Proposal

The proposal excludes overpayment interest that is paid to individual taxpayers on overpayments of Federal income tax from gross income. Interest excluded under the provision is not considered disqualified income that could limit the earned income credit. Interest excluded under the provision also is not considered in determining what portion of a taxpayer's social security or tier 1 railroad retirement benefits are subject to tax (sec. 86), whether a taxpayer has sufficient taxable income to be required to file a return (sec. 6012(d)), or for any other computation in which interest exempt from tax is otherwise required to be added to adjusted gross income.

The exclusion from income of overpayment interest does not apply if the Secretary determines that the taxpayer's principal purpose for overpaying his or her tax is to take advantage of the exclusion.

For example, a taxpayer prepares his return without taking into account significant itemized deductions of which he is, or should be, aware. Before the expiration of the statute of limitations, the taxpayer files an amended return claiming these itemized deductions and requesting a refund with interest. Unless the taxpayer can establish a principal purpose for originally overpaying the tax other than collecting excludible interest, the Secretary may determine that the principal purpose of waiting to claim the deductions on an amended return was to earn interest that would be excluded from income. In that case, the interest on the overpayment could not be excluded from income.

It is expected that the Secretary will indicate whether the interest is eligible to be excluded from income on the Form 1099 it provides that taxpayer for taxable year in which the underpayment interest is paid.

Effective Date

The proposal is effective for interest received in calendar years beginning after the date of enactment.

C. Abatement of Interest

Present Law

In general

The Secretary of the Treasury can abate or suspend the accrual of interest in a number of situations. In general, the Secretary is authorized to abate interest that is not owed by the taxpayer, either because the interest was erroneously or illegally assessed, or because the interest was assessed after the expiration of the period of limitations. The Secretary also may abate interest that is attributable to certain unreasonable errors and delays by the Internal Revenue Service. The Secretary may abate interest where, in his judgment, the administration and collection costs involved do not warrant the collection of the amount due.

The Secretary is required to abate interest in the case of a declared disaster or certain erroneous refunds attributable solely to errors made by the IRS. The Secretary is required to suspend the accrual of interest if the IRS fails to contact the taxpayer in a timely manner and in the case of taxpayers serving in a combat zone.

Interest that is abated is not owed by the taxpayer and does not accrue additional interest through compounding or result in any additional penalties. If the accrual of interest is suspended for a period, then that period is not taken into account in determining the interest owed on an underpayment.

Abatement of interest that is erroneously or illegally assessed

Most abatements of interest are a result of adjustments to the underlying tax liability. Underpayment interest is assessed any time an underpayment is assessed. If the underlying tax liability is later adjusted, resulting in a reduction in the amount of the underpayment, the portion of the interest attributable to such adjustment must be abated.

Abatement of interest on erroneous refunds

The Secretary is required to abate interest on an erroneous refund for the period from the issuance of the refund until its return is demanded. Since the taxpayer has 21 days from the date of demand to pay without interest, no interest must be paid as the result of an erroneous refund if the taxpayer repays the refund within 21 days of the IRS asking for its return. If the taxpayer does not repay the refund within the 21 day grace period, interest must be paid from the date the return of the refund is demanded. The rule abating interest in the case of erroneous refunds does not apply if the taxpayer (or a related party) has in any way caused the erroneous refund or if the amount of the erroneous refund exceeds $50,000.

Abatement of penalties and additions to tax attributable to erroneous written advice given by the IRS

The Secretary is required to abate any portion of any penalty or addition to tax attributable to erroneous advice furnished to the taxpayer in writing by an officer or employee of

the IRS acting in his or her official capacity. The abatement applies only if (1) the advice is given in response to a specific written request made by the taxpayer, (2) the taxpayer reasonably relied on the advice, and (3) the taxpayer provided adequate and accurate information.

Only penalties and additions to tax that are attributable to erroneous written advice given by the IRS are abated under this rule. Interest is abated only to the extent that it is attributable to abated penalties and additions to tax. Interest attributable to an underpayment of tax, where such underpayment is the result of the taxpayer's proper reliance on written advice of the IRS, is not eligible for abatement.

Procedures for the abatement of interest

Taxpayers may apply for the abatement of interest by filing a claim on Form 843 with the Internal Revenue Service Center that has assessed the interest the taxpayer seeks to have abated.

Typically, interest is abated when the amount of tax assessed is reduced. Thus, any procedure that may result in the reduction of assessed tax may also result in an abatement of interest.

Description of Proposal

Allow for the abatement of interest in situations where the taxpayer is repaying an excessive refund based on IRS calculations without regard to the size of the refund

The proposal eliminates the $50,000 threshold for abatement of interest on erroneous refunds. Under the proposal, the Secretary is required to abate interest on any erroneous refund, provided the taxpayer has not in any way caused the erroneous refund to occur.

Allow the abatement of interest to the extent the interest is attributable to taxpayer reliance on written statements of the IRS

The proposal requires the Secretary to abate interest on an underpayment where the underpayment is attributable to erroneous advice furnished to the taxpayer in writing by an officer or employee of the IRS acting in his or her official capacity. It is anticipated that the abatement would apply to interest attributable to the period of time from the issuance of the erroneous advice through the day that is 21 days (10 days in the case of an underpayment in excess of $100,000) after the day the IRS gives written notice that its advice was erroneous. The proposal does not eliminate the taxpayer's obligation to satisfy any underpayment of tax attributable to such erroneous advice.

Effective Date

The changes made by these provisions are effective with respect to interest accruing on or after the date of enactment.

D. Deposits Made to Suspend the Running of Interest on Potential Underpayments

Present Law

Generally, interest on underpayments and overpayments continues to accrue during the period that a taxpayer and the IRS dispute a liability. The accrual of interest on an underpayment is suspended if the IRS fails to notify an individual taxpayer in a timely manner, but interest will begin to accrue once the taxpayer is properly notified. No similar suspension is available for other taxpayers.

A taxpayer that wants to limit its exposure to underpayment interest has a limited number of options. The taxpayer can continue to dispute the amount owed and risk paying a significant amount of interest. If the taxpayer continues to dispute the amount and ultimately loses, the taxpayer will be required to pay interest on the underpayment from the original due date of the return until the date of payment.

In order to avoid the accrual of underpayment interest, the taxpayer may choose to pay the disputed amount and immediately file a claim for refund. Payment of the disputed amount will prevent further interest from accruing if the taxpayer loses (since there is no longer any underpayment) and the taxpayer will earn interest on the resultant overpayment if the taxpayer wins. However, the taxpayer will generally lose access to the Tax Court if it follows this alternative. Amounts paid generally cannot be recovered by the taxpayer on demand, but must await final determination of the taxpayer's liability. Even if an overpayment is ultimately determined, overpaid amounts may not be refunded if they are eligible to be offset against other liabilities of the taxpayer.

The taxpayer may also make a deposit in the nature of a cash bond. The procedures for making a deposit in the nature of a cash bond are provided in Rev. Proc. 84-58.

A deposit in the nature of a cash bond will stop the running of interest on an amount of underpayment equal to the deposit, but the deposit does not itself earn interest. A deposit in the nature of a cash bond is not a payment of tax and is not subject to a claim for credit or refund. A deposit in the nature of a cash bond may be made for all or part of the disputed liability and generally may be recovered by the taxpayer prior to a final determination. However, a deposit in the nature of a cash bond need not be refunded to the extent the Secretary determines that the assessment or collection of the tax determined would be in jeopardy, or that the deposit should be applied against another liability of the taxpayer in the same manner as an overpayment of tax. If the taxpayer recovers the deposit prior to final determination and a deficiency is later determined, the taxpayer will not receive credit for the period in which the funds were held as a deposit. The taxable year to which the deposit in the nature of a cash bond relates must be designated, but the taxpayer may request that the deposit be applied to a different year under certain circumstances.

Description of Proposal

In general

The proposal allows a taxpayer to deposit cash with the IRS that the may subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes. Interest will not be charged on the portion of the underpayment that is paid by the deposited amount for the period the amount is on deposit. Generally, deposited amounts that have not been used to pay a tax may be withdrawn at any time if the taxpayer so requests in writing. The withdrawn amounts will earn interest at the applicable Federal rate to the extent they are attributable to a disputable tax.

The Secretary may issue rules relating to the making, use, and return of the deposits.

Use of a deposit to offset underpayments of tax

Any amount on deposit may be used to pay an underpayment of tax that is ultimately assessed. If an underpayment is paid in this manner, the taxpayer will not be charged underpayment interest on the portion of the underpayment that is so paid for the period the funds were on deposit.

For example, assume a calendar year individual taxpayer deposits $20,000 on May 15, 2003, with respect to a disputable item on its 2002 income tax return. On April 15, 2005, an examination of the taxpayer's year 2002 income tax return is completed, and the taxpayer and the IRS agree that the taxable year 2002 taxes were underpaid by $25,000. The $20,000 on deposit is used to pay $20,000 of the underpayment, and the taxpayer also pays the remaining $5,000. In this case, the taxpayer will owe underpayment interest from April 15, 2003 (the original due date of the return) to the date of payment (April 15, 2005) only with respect to the $5,000 of the underpayment that is not paid by the deposit. The taxpayer will owe underpayment interest on the remaining $20,000 of the underpayment only from April 15, 2003, to May 15, 2003, the date the $20,000 was deposited.

Withdrawal of amounts

A taxpayer may request the withdrawal of any amount of deposit at any time. The Secretary must comply with the withdrawal request unless the amount has already been used to pay tax or the Secretary properly determines that collection of tax is in jeopardy. Interest will be paid on deposited amounts that are withdrawn at a rate equal to the short-term applicable Federal rate for the period from the date of deposit to a date not more than 30 days preceding the date of the check paying the withdrawal. Interest is not payable to the extent the deposit was not attributable to a disputable tax.

For example, assume a calendar year individual taxpayer receives a 30-day letter showing a deficiency of $20,000 for taxable year 2002 and deposits $20,000 on May 15, 2004. On April 15, 2005, an administrative appeal is completed, and the taxpayer and the IRS agree that the 2002 taxes were underpaid by $15,000. $15,000 of the deposit is used to pay the underpayment. In this case, the taxpayer will owe underpayment interest from April 15, 2003 (the original due date of the return) to May 15, 2004, the date the $20,000 was deposited. Simultaneously with

the use of the $15,000 to offset the underpayment, the taxpayer requests the return of the remaining amount of the deposit (after reduction for the underpayment interest owed by the taxpayer from April 15, 2001, to May 15, 2002). This amount must be returned to the taxpayer with interest determined at the short-term applicable Federal rate from the May 15, 2004, to a date not more than 30 days preceding the date of the check repaying the deposit to the taxpayer.

Limitation on amounts for which interest may be allowed

Interest on a deposit that is returned to a taxpayer shall be allowed for any period only to the extent attributable to a disputable item for that period. A disputable item is any item for which the taxpayer 1) has a reasonable basis for the treatment used on its return and 2) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer's treatment of such item.

All items included in a 30-day letter to a taxpayer are deemed disputable for this purpose. Thus, once a 30-day letter has been issued, the disputable amount cannot be less than the amount of the deficiency shown in the 30-day letter. A 30-day letter is the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

Deposits are not payments of tax

A deposit is not a payment of tax prior to the time the deposited amount is used to pay a tax. Thus, the interest received on withdrawn deposits will not be eligible for the proposed exclusion from income of an individual. Similarly, withdrawal of a deposit will not establish a period for which interest was allowable at the short-term applicable Federal rate for the purpose of establishing a net zero interest rate on a similar amount of underpayment for the same period.

Effective Date

The proposal applies to deposits made after the date of enactment. Amounts already on deposit as of the date of enactment are treated as deposited (for purposes of applying this provision) on the date the taxpayer identifies the amount as a deposit made pursuant to this provision.

E. Expansion of Interest Netting for Individuals

Present Law

A special net interest rate of zero applies to the extent that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer. If both the underpayment and overpayment are unsatisfied, the interest rate applied to both will be zero. If either the underpayment or overpayment has previously been satisfied, the interest rate applicable to the unsatisfied amount will be equal to the interest rate applicable to the satisfied amount to the extent that interest was allowable or payable on both the underpayment and the overpayment for the same period.

Interest must be both payable and allowable for interest netting to apply. If interest is not payable by the taxpayer with respect to an underpayment of tax, or interest is not allowable to the taxpayer on an overpayment of tax, the interest netting rules will not apply.

For example, on July 1, 2005, a deficiency of $1,500 is determined with respect to an individual taxpayer's 2002 Federal income tax return, which the taxpayer pays within 21 days. In the meantime, the taxpayer has filed returns for 2003 and 2004, showing a refund due to overwithholding each year of $1,000. The IRS issues the appropriate refund checks on May 15 of each year, within 45 days of the due date of the return. Thus, interest is not allowable to the taxpayer with respect to either 2003 or 2004. In this case, the taxpayer owes interest on the $1500 year 2002 underpayment from the original due date of the return (April 15, 2003) until the underpayment is satisfied. Although, there are offsetting periods of overpayment (April 15, 2004 to May 15, 2004 and April 15, 2005 to May 15, 2005), there is no offsetting period for which interest is allowable on an overpayment.

Description of Proposal

In the case of an individual taxpayer, the interest netting rules are applied without regard to the 45-day period in which the Secretary may refund an overpayment of tax without the payment of interest under section 6611(e). Solely for the purpose of the interest netting computation, the portion of the 45-day period before repayment of the overpayment is considered as a period for which overpayment interest was allowable at a zero rate. The proposal does not modify the period for which interest is payable or allowable for any other purpose.

In the example discussed as part of present law, above, a net interest rate of zero would be applied to $1,000 of the taxpayer's year 2002 underpayment for the periods between the due date of the 2003 and 2004 returns and the dates on which the refunds are made. The taxpayer in the example would owe interest at the underpayment rate for the periods from April 16, 2003 to April 16, 2004; May 16, 2004 to April 16, 2005; and from May 16, 2005 to July 1, 2005. For the periods April 16, 2004 to May 15, 2004 and April 16, 2005 to May 15, 2005, a zero net interest rate will apply.

Effective Date

The proposal is effective for interest accrued after December 31, 2003.

F. Waiver of Certain Penalties for First-Time Unintentional Minor Errors

Present Law

Taxpayers who fail to file tax returns or pay taxes as required by the Code are subject to penalty (sec. 6651). The Code authorizes the IRS to waive these penalties for reasonable cause. There is no explicit statutory provision providing a waiver for first-time unintentional minor errors.

Description of Proposal

The proposal explicitly permits the IRS to waive these penalties for unintentional minor errors that are committed by an individual taxpayer with a good history of tax compliance and the penalty for which would be grossly disproportionate to the action or expense that would have been needed to avoid the error. Waiving these penalties under these circumstances must also promote tax compliance and effective tax administration. This waiver is applicable once to a taxpayer.

Effective Date

The proposal is effective after December 31, 2003.

G. Frivolous Tax Returns and Submissions

Present Law

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of $500 imposed by the IRS (sec. 6702). The Code also permits the Tax Court to impose a penalty of up to $25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in the proceeding is frivolous or groundless (sec. 6673(a)).

Description of Proposal

The proposal modifies this IRS-imposed penalty by increasing the amount of the penalty to up to $5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The proposal also modifies present law with respect to certain submissions that raise frivolous arguments. The submissions to which this provision applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. The proposal permits the IRS to impose a penalty of up to $5,000 for such frivolous submissions, unless the taxpayer withdraws the request within 30 days after being given an opportunity to do so.

The proposal requires the IRS to publish a list of positions, arguments, requests, and proposals determined to be frivolous for purposes of these provisions.

Effective Date

The proposal is effective for submissions made and issues raised after the date on which the Secretary first prescribes the required list.

H. Clarification of Application of Federal Tax Deposit Penalty

Present Law

In many instances, taxpayers are required to make deposits of Federal taxes (sec. 6302). Failure to do so is subject to a penalty (sec. 6656). The amount of that penalty depends on the length of time that the deposit was not made. The penalty is 2 percent of the underpayment if the failure to deposit is for not more than 5 days, 5 percent for 6 through 15 days, and 10 percent for more than 15 days. The IRS has stated its position that the 10 percent penalty rate automatically applies if a deposit is not made in the manner required.

Description of Proposal

The application of the Federal tax deposit penalty is clarified so that the 10 percent penalty rate only applies in cases where the failure to deposit extends for more than 15 days. Thus, a taxpayer who makes a deposit on time but not in the manner required will be subject to a penalty of 2 percent.

Effective Date

The proposal is effective on the date of enactment.

TITLE II - FAIRNESS OF COLLECTION PROCEDURES

A. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment

Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed (sec. 6159). An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

Prior to 1998, the IRS administratively entered into installment agreements that provided for partial payment (rather than full payment) of the total amount owed over the period of the agreement. In that year, the IRS Chief Counsel issued a memorandum concluding that partial payment installment agreements were not permitted.

Description of Proposal

The proposal clarifies that the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. The proposal also requires the IRS to review partial payment installment agreements at least every two years. The primary purpose of this review is to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

Effective Date

The proposal is effective for installment agreements entered into on or after the date of enactment.

B. Extend Time Limit for Contesting IRS Levy

Present Law

The IRS is authorized to return property that has been wrongfully or mistakenly levied upon (sec. 6343). In general, monetary proceeds may be returned within 9 months of the date of the levy.

Description of Proposal

The proposal extends this 9-month period to 2 years.

Effective Date

The proposal is effective on the date of enactment.

C. Individuals Held Harmless on Improper Levy on Individual Retirement Plan

Present Law

Distributions from an individual retirement arrangement ("IRA") made on account of an IRS levy are includible in the gross income of the individual under the rules applicable to the IRA subject to the levy. Thus, in the case of a traditional IRA, the amount withdrawn as a result of a levy is includible in gross income except to the extent such amount represents a return of nondeductible contributions (i.e., basis). In the case of a Roth IRA, earnings on a distribution are excludable from gross income if the distribution is made (1) after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA and (2) after attainment of age 59-1/2 or on account of certain other circumstances. Amounts withdrawn from an IRA due to a levy are not subject to the 10-percent early withdrawal tax, regardless of whether the amount is includible in income.

Present law provides rules under which the IRS returns amounts subject to a levy. For example, amounts withdrawn from an IRA pursuant to a levy are returned to the individual owning the IRA in the case of a wrongful levy or if the levy was not in accordance with IRS administrative procedures. In the case of a wrongful levy, the IRS is required to pay interest on the amount returned to the individual at the overpayment rate.

Present law does not provide special rules to allow an individual to recontribute to an IRA amounts withdrawn from an IRA pursuant to a levy and later returned to the individual by the IRS (or interest thereon). Thus, if an individual wishes to contribute such returned amounts to an IRA, the contribution would be subject to the normally applicable rules for IRA contributions.

Description of Proposal

Under the proposal, an individual is able to recontribute to an IRA amounts withdrawn pursuant to a levy and returned by the IRS (and any interest thereon) within 60 days of receipt by the individual, without regard to the normally applicable limits on IRA contributions and rollovers. The proposal applies to levied amounts returned to the individual because the levy (1) was wrongful or (2) is determined to be premature or otherwise not in accordance with administrative procedures. The contribution has to be made to the same type of IRA from which the amounts were withdrawn.

Under the proposal, the IRS is required to pay interest on amounts returned to the individual at the overpayment rate in the case of a levy that is determined to be premature or otherwise not in accordance with administrative procedures (as well as in the case of a wrongful levy under present law). Interest paid by the IRS on the amount returned to the individual and contributed to the IRA is treated as part of the distribution made from the IRA on account of the levy and is not includible in gross income. In addition, any tax attributable to an amount distributed from an IRA by reason of a levy is abated if the amount is recontributed to an IRA pursuant to the proposal.

Effective Date

The proposal is effective for levied amounts (and interest thereon) returned to individuals after December 31, 2003.

D. Place Threshold on Tolling of Statute of Limitations During Review by Taxpayer Advocate Service

Present Law

Taxpayers suffering significant hardship may request that the Office of the Taxpayer Advocate issue a Taxpayer Assistance Order, which requires the IRS to take (or refrain from taking) specified actions (sec. 7811). The statute of limitations is suspended for the period beginning on the date of the taxpayer's application and ending on the date of the decision by the National Taxpayer Advocate.

Description of Proposal

The proposal modifies this suspension of statute of limitations by applying it only if the date of the decision by the National Taxpayer Advocate is at least 7 days after the date of the taxpayer's application.

Effective Date

The proposal is effective for applications filed after the date of enactment.

E. Study of Liens and Levies

Present Law

To aid in the collection of tax liabilities, the IRS may impose liens and levies against property of the taxpayer.

Description of Proposal

The proposal requires the Treasury to conduct a study of the practices of the IRS concerning liens and levies. The study will examine the declining use of liens and levies by the IRS and the practicality of recording liens and levies against property in cases where the cost of such actions exceeds the amount to be realized from the property.

Effective Date

The study is required to be submitted to the Congress not later than one year after the date of enactment.

TITLE III - TAX ADMINISTRATION REFORMS

A. Revisions relating to Termination of Employment of IRS Employees for Misconduct

Present Law

Section 1203 of the IRS Restructuring and Reform Act of 1998 requires the IRS to terminate an employee for certain proven violations committed by the employee in connection with the performance of official duties. The violations include: (1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets; (2) providing a false statement under oath material to a matter involving a taxpayer; (3) with respect to a taxpayer, taxpayer representative, or other IRS employee, the violation of any right under the U.S. Constitution, or any civil right established under titles VI or VII of the Civil Rights Act of 1964, title IX of the Educational Amendments of 1972, the Age Discrimination in Employment Act of 1967, the Age Discrimination Act of 1975, sections 501 or 504 of the Rehabilitation Act of 1973 and title I of the Americans with Disabilities Act of 1990; (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or a taxpayer representative; (5) assault or battery on a taxpayer or other IRS employee, but only if there is a criminal conviction or a final judgment by a court in a civil case, with respect to the assault or battery; (6) violations of the Internal Revenue Code, Treasury Regulations, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating or harassing a taxpayer or other IRS employee; (7) willful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry; (8) willful failure to file any tax return required under the Code on or before the due date (including extensions) unless failure is due to reasonable cause; (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause; and (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

Section 1203 also provides non-delegable authority to the Commissioner to determine that mitigating factors exist, that, in the Commissioner's sole discretion, mitigate against terminating the employee. The Commissioner, in his sole discretion, may establish a procedure to determine whether an individual should be referred for such a determination by the Commissioner.

Description of Proposal

The proposal requires that the Commissioner issue guidelines for determining the appropriate level of discipline, up to and including termination of employment, for the commission or omission of a specified act. The proposal also removes from the list of violations: (1) the late filing of refund returns; and (2) employee versus employees acts. The proposal adds to the list of violations: (1) willful unauthorized inspection of returns and return information; and (2) the requirement that other violations in general be willful. The proposal also provides that, notwithstanding any other provision of law, any determination by the Commissioner may not be reviewed. Finally, the proposal places the entire provision in the Internal Revenue Code.

Effective Date

The proposal is effective on the date of enactment.

B. Confirmation of Authority of Tax Court to Apply Doctrine of Equitable Recoupment

Present Law

Equitable recoupment is a common-law equitable principle that permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[2] In *Estate of Mueller v. Commissioner*,[3] the Court of Appeals for the Sixth Circuit held that the Tax Court may not apply the doctrine of equitable recoupment. More recently, the Court of Appeals for the Ninth Circuit, in *Branson v. Commissioner*,[4] held that the Tax Court may apply the doctrine of equitable recoupment.

Description of Proposal

The proposal confirms that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the U.S. District Courts or the U.S. Court of Claims. No implication is intended as to whether the Tax Court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

Effective Date

The proposal is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

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[2] *See Stone v. White*, 301 U.S. 532 (1937); *Bull v. United States*, 295 U.S. 247 (1935).

[3] 153 F.3d 302 (6th Cir.), *cert. den*., 525 U.S. 1140 (1999).

[4] 264 F.3d 904 (9th Cir.), *cert. den*., 2002 U.S. LEXIS 1545 (U.S. Mar. 18, 2002).

C. Jurisdiction of Tax Court Over Collection Due Process Cases

Present Law

In general, the Internal Revenue Service ("IRS") is required to notify taxpayers that they have a right to a fair and impartial hearing before levy may be made on any property or right to property.[5] Similar rules apply with respect to liens.[6] The hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. The appeal must be brought to the United States Tax Court, unless the Tax Court does not have jurisdiction over the underlying tax liability. If that is the case, then the appeal must be brought in the district court of the United States.[7] Special rules apply if the taxpayer files the appeal in the incorrect court.

The United States Tax Court is established under Article I of the United States Constitution[8] and is a court of limited jurisdiction.[9]

Description of Proposal

The proposal provides that all appeals of collection due process determinations are to be made to the United States Tax Court.

Effective Date

The proposal applies to determinations made after the date of enactment.

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[5] Sec. 6330(a).

[6] Sec. 6320.

[7] Sec. 6330(d).

[8] Sec. 7441.

[9] Sec. 7442.

D. Office of Chief Counsel Review of Offers-in-Compromise

Present Law

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. IRS regulations provide that such offers can be accepted if the taxpayer is unable to pay the full amount of the tax liability and it is doubtful that the tax, interest, and penalties can be collected or there is doubt as to the validity of the actual tax liability. Amounts of $50,000 or more can only be accepted if the reasons for the acceptance are documented in detail and supported by a written opinion from the IRS Chief Counsel (sec. 7122).

Description of Proposal

The proposal repeals the requirement that an offer-in-compromise of $50,000 or more must be supported by a written opinion from the Office of Chief Counsel. Written opinions must only be provided if the Secretary determines that an opinion is required with respect to a compromise.

Effective Date

The proposal applies to offers-in-compromise submitted or pending on or after the date of enactment.

E. Extend the Due Date for Electronically Filed Tax Returns by 15 Days

Present Law

In general, individuals must file their income tax returns and pay the full amount owed by April 15 (sec. 6072(a)). This deadline applies regardless of the method the taxpayer may choose to submit the tax return to the IRS. The Secretary may grant reasonable extensions of time for filing returns, but in general the time for paying tax cannot be extended (sec. 6081(a)). Failure to file or pay on a timely basis may subject the taxpayer to interest and penalties.

Description of Proposal

The proposal extends the due date for filing and paying individual income taxes to April 30 provided that the taxpayer files the return electronically and pays the entire balance due electronically by that date. The due date for filing by any other method or for filing electronically but paying the balance due by non-electronic means is not changed.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002; the proposal sunsets in five years.

F. Access of National Taxpayer Advocate to Independent Legal Counsel

Present Law

The National Taxpayer Advocate receives legal advice from the Special Counsel to the National Taxpayer Advocate. This Special Counsel reports directly to, and is evaluated by, the Chief Counsel of the IRS.

Description of Proposal

The proposal permits the National Taxpayer Advocate to appoint a counsel in the Office of the Taxpayer Advocate to report solely to the National Taxpayer Advocate.

Effective Date

The proposal is effective on the date of enactment.

G. Payment of Motor Fuel Excise Tax Refunds by Direct Deposit

Present Law

Refunds or income tax credits may be claimed (generally by consumers) for fuels on which tax is paid and which ultimately are used for a non-taxable purpose. The rules governing how and by whom a refund is claimed differ by type of fuel, by end use, and by dollar amount of the claim. Except in the case of "gasohol" (gasoline blended with ethanol) and kerosene sold from certain "blocked pumps" for which weekly claims are allowed, no more than one claim per quarter may be filed. Refund claims may be filed only if prescribed dollar thresholds are satisfied. If the dollar amounts are not satisfied in a calendar year, refunds must be claimed as credits on income tax returns. Unlike income tax refunds, excise tax refunds generally do not bear interest if they are not paid within set periods. However, interest does accrue on gasohol and kerosene "blocked pump" refunds if not paid within 20 days.

Finally, as stated above, most refunds must be claimed by consumers (who are deemed to bear the burden of the tax). Exceptions are provided for fuels sold to States and local governments and farmers, and for kerosene sold from blocked pumps for heating purposes. Those refunds must be claimed by actual taxpayers, wholesale distributors, or ultimate vendors.

There is no requirement that the Secretary make payment of these refunds available by electronic funds transfer ("direct deposit").[10]

Description of Proposal

The proposal requires the Secretary to make payments of fuel tax refunds pursuant to sections 6420 (relating to gasoline used on farms), 6421 (relating to gasoline used for certain nonhighway purposes, used by local transit systems or sold for certain exempt purposes) and 6427 (relating to fuels used for nontaxable purposes) by electronic funds transfer if the person who is entitled to the payment elects to receive the payment by electronic funds transfer and satisfies certain other requirements. Specifically, the person entitled to the payment must, at such time and manner as the Secretary may require: (1) designate 1 or more financial institutions or other authorized agents to which such payment is to be made and (2) provide information necessary for the person entitled to payment to receive electronic funds transfer payments through each institution or agent designated in (1).

An electronic funds transfer is defined as any transfer of funds, other than a transaction originated by cash, check, or similar paper instrument, that is initiated through an electronic terminal, telephone, computer, or magnetic tape, for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account. The term includes Automated

[10] Notwithstanding any other provision of law, all Federal wage, salary, and retirement payments are required to be paid to recipients of such payments by electronic funds transfer, unless another method has been determined by the Secretary of the Treasury to be appropriate. 31 U.S.C. sec. 3332(a).

Clearing House transfers, Fed Wire transfers, transfers made at automatic teller machines, and point-of-sale terminals.[11]

Effective Date

The proposal is effective upon date of enactment.

[11] *See* 31 U.S.C. sec. 3332(j)(1).

H. Family Business Tax Simplification

Present Law

Under present law, a partnership is defined to include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation or ventured is carried on, and which is not a trust or estate or a corporation (sec. 7701(a)(2)). A partnership is treated as a pass-through entity, and income earned by the partnership, whether distributed or not, is taxed to the partners. The income of a partnership and its partners is determined under subchapter K of the Code. An election not to be subject to the rules of subchapter K is provided for certain partnerships that meet specified criteria (i.e., the partnership is for investment purposes only, is for the joint production, extraction or use of property but not for selling services or property produced or extracted, or is used by securities dealers for short periods to underwrite, sell or distribute securities) (sec. 761)(a)). Otherwise, the rules of subchapter K apply to a venture that is treated as a partnership for Federal tax purposes.

In the case of an individual with self-employment income, the income subject to self-employment tax is the net earnings from self-employment (sec. 1402(a)). Net earnings from self-employment is the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules. If the individual is a partner in a partnership, the net earnings from self-employment generally include his or her distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership.

Description of Proposal

The proposal generally permits a joint venture whose only members are a husband and wife filing a joint return to elect not to be treated as a partnership. A joint venture qualifying for this treatment is one involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect under the proposal.

Under the proposal, a qualified joint venture conducted by a husband and wife who file a joint return is not treated as a partnership for Federal income tax purposes. All items of income, gain, loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Thus, it is anticipated that each spouse would account for his or her respective share on the appropriate form, such as Schedule C.

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for Federal income tax purposes (i.e., in accordance with their respective interests in the venture). A corresponding change is made to the definition of net earnings from self-employment under the Social Security Act.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

I. Consumer Options under the Refundable Credit for Health Insurance Costs of Eligible Individuals

Present Law

Refundable health insurance credit: in general

In the case of taxpayers who are eligible individuals, a refundable tax credit is provided for 65 percent of the taxpayer's expenses for qualified health insurance of the taxpayer and qualifying family members for each eligible coverage month beginning in the taxable year. The credit is available only with respect to amounts paid by the taxpayer. The credit is available in taxable years beginning after December 31, 2002.

Qualifying family members are the taxpayer's spouse and any dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency exemption.[12] Any individual who has other specified coverage is not a qualifying family member.

Persons eligible for the credit

Eligibility for the credit is determined on a monthly basis. In general, an eligible coverage month is any month if, as of the first day of the month, the taxpayer (1) is an eligible individual, (2) is covered by qualified health insurance, (3) does not have other specified coverage, and (4) is not imprisoned under Federal, State, or local authority. In the case of a joint return, the eligibility requirements are met if at least one spouse satisfies the requirements. An eligible month must begin more than 90 days after the date of enactment of the Trade Act of 2002.[13]

An eligible individual is (1) an eligible TAA recipient, (2) an eligible alternative TAA recipient, and (3) an eligible PBGC pension recipient.

An individual is an eligible TAA recipient during any month if the individual (1) is receiving for any day of such month a trade adjustment allowance[14] or who would be eligible to receive such an allowance but for the requirement that the individual exhaust unemployment benefits before being eligible to receive an allowance and (2) with respect to such allowance, is covered under a certification issued under subchapter A or D of chapter 2 of title II of the Trade

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[12] Present and prior law allows the custodial parent to release the right to claim the dependency exemption for a child to the noncustodial parent. In addition, if certain requirements are met, the parents may decide by agreement that the noncustodial parent is entitled to the dependency exemption with respect to a child. In such cases, the provision treats the child as the dependent of the custodial parent for purposes of the credit.

[13] The date of enactment is August 6, 2002.

[14] Part I of subchapter B, or subchapter D, of chapter 2 of title II of the Trade Act of 1974.

Act of 1974. An individual is treated as an eligible TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

An individual is an eligible alternative TAA recipient during any month if the individual (1) is a worker described in section 246(a)(3)(B) of the Trade Act of 1974 who is participating in the program established under section 246(a)(1) of such Act, and (2) is receiving a benefit for such month under section 246(a)(2) of such Act. An individual is treated as an eligible alternative TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

An individual is a PBGC pension recipient for any month if he or she (1) is age 55 or over as of the first day of the month, and (2) is receiving a benefit any portion of which is paid by the Pension Benefit Guaranty Corporation (the "PBGC").

An otherwise eligible taxpayer is not eligible for the credit for a month if, as of the first day of the month the individual has other specified coverage. Other specified coverage is (1) coverage under any insurance which constitutes medical care (except for insurance substantially all of the coverage of which is for excepted benefits)[15] if at least 50 percent of the cost of the coverage is paid by an employer[16] (or former employer) of the individual or his or her spouse or (2) coverage under certain governmental health programs.[17] A rule aggregating plans of the same employer applies in determining whether the employer pays at least 50 percent of the cost of coverage. A person is not an eligible individual if he or she may be claimed as a

[15] Excepted benefits are: (1) coverage only for accident or disability income or any combination thereof; (2) coverage issued as a supplement to liability insurance; (3) liability insurance, including general liability insurance and automobile liability insurance; (4) worker's compensation or similar insurance; (5) automobile medical payment insurance; (6) credit-only insurance; (7) coverage for on-site medical clinics; (8) other insurance coverage similar to the coverages in (1)-(7) specified in regulations under which benefits for medical care are secondary or incidental to other insurance benefits; (9) limited scope dental or vision benefits; (10) benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof; and (11) other benefits similar to those in (9) and (10) as specified in regulations; (12) coverage only for a specified disease or illness; (13) hospital indemnity or other fixed indemnity insurance; and (14) Medicare supplemental insurance.

[16] An amount is considered paid by the employer if it is excludable from income. Thus, for example, amounts paid for health coverage on a salary reduction basis under an employer plan are considered paid by the employer.

[17] Specifically, an individual is not eligible for the credit if, as of the first day of the month, the individual is (1) entitled to benefits under Medicare Part A, enrolled in Medicare Part B, or enrolled in Medicaid or SCHIP, (2) enrolled in a health benefits plan under the Federal Employees Health Benefit Plan, or (3) entitled to receive benefits under chapter 55 of title 10 of the United States Code (relating to military personnel). An individual is not considered to be enrolled in Medicaid solely by reason of receiving immunizations.

dependent on another person's tax return. A special rule applies with respect to alternative TAA recipients.

Qualified health insurance

Qualified health insurance eligible for the credit is: (1) COBRA continuation coverage; (2) State based continuation coverage provided by the State under a State law that requires such coverage; (3) coverage offered through a qualified State high risk pool; (4) coverage under a health insurance program offered to State employees or a comparable program; (5) coverage through an arrangement entered into by a State and a group health plan, an issuer of health insurance coverage, an administrator, or an employer; (6) coverage offered through a State arrangement with a private sector health care coverage purchasing pool; (7) coverage under a State-operated health plan that does not receive any Federal financial participation; (8) coverage under a group health plan that is available through the employment of the eligible individual's spouse; and (9) coverage under individual health insurance if the eligible individual was covered under individual health insurance during the entire 30-day period that ends on the date the individual became separated from the employment which qualified the individual for the TAA allowance, the benefit for an eligible alternative TAA recipient, or a pension benefit from the PBGC, whichever applies.[18]

Qualified health insurance does not include any State-based coverage (i.e., coverage described in (2)-(8) in the preceding paragraph), unless the State has elected to have such coverage treated as qualified health insurance and such coverage meets certain requirements. Such State coverage must provide that each qualifying individual is guaranteed enrollment if the individual pays the premium for enrollment or provides a qualified health insurance costs eligibility certificate and pays the remainder of the premium. In addition, the State-based coverage cannot impose any pre-existing condition limitation with respect to qualifying individuals. State-based coverage cannot require a qualifying individual to pay a premium or contribution that is greater than the premium or contribution for a similarly situated individual who is not a qualified individual. Finally, benefits under the State-based coverage must be the same as (or substantially similar to) benefits provided to similarly situated individuals who are not qualifying individuals. A qualifying individual is an eligible individual who seeks to enroll in the State-based coverage and who has aggregate periods of creditable coverage[19] of three months or longer, does not have other specified coverage, and who is not imprisoned. A qualifying individual also includes qualified family members of such an eligible individual.

Qualified health insurance does not include coverage under a flexible spending or similar arrangement or any insurance if substantially all of the coverage is of excepted benefits.

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[18] For this purpose, "individual health insurance" means any insurance which constitutes medical care offered to individuals other than in connection with a group health plan. Such term does not include Federal- or State-based health insurance coverage.

[19] Creditable coverage is determined under the Health Care Portability and Accountability Act (Code sec. 9801(c)).

Other rules

Amounts taken into account in determining the credit may not be taken into account in determining the amount allowable under the itemized deduction for medical expenses or the deduction for health insurance expenses of self-employed individuals. Amounts distributed from a medical savings account are not eligible for the credit. The amount of the credit available through filing a tax return is reduced by any credit received on an advance basis. Married taxpayers filing separate returns are eligible for the credit; however, if both spouses are eligible individuals and the spouses file a separate return, then the spouse of the taxpayer is not a qualifying family member.

The Secretary of the Treasury is authorized to prescribe such regulations and other guidance as may be necessary or appropriate to carry out the provision.

Advance payment of refundable health insurance credit; reporting requirements

The credit is to be payable on an advance basis (i.e., prior to the filing of the taxpayer's return) pursuant to a program to be established by the Secretary of the Treasury no later than August 1, 2003. The disclosure of return information of certified individuals to providers of health insurance information is permitted to the extent necessary to carry out the advance payment mechanism. Any person who receives payments during a calendar year for qualified health insurance and claims a reimbursement for an advance credit amount is required to file an information return with respect to each individual from whom such payments were received or for whom such a reimbursement is claimed.

Description of Proposal

The proposal allows State-based coverage to meet the definition of qualified health insurance eligible for the refundable health insurance tax credit if the eligible individual elects to waive the requirements for State-based coverage, including the requirements that the State-based coverage would otherwise have to meet with respect to guaranteed issue, preexisting conditions, premiums, and similar benefits. Nothing in the proposal supercedes or otherwise affects the application of State law relating to consumer insurance protections (including State law implementing the applicable requirements of the Heath Insurance Portability and Accountability Act under part B of title XXVII of the Public Health Service Act).

Effective Date

The proposal is effective for eligible coverage months beginning after the date of enactment and before January 1, 2006.

J. Suspension of Tax-Exempt Status of Terrorist Organizations

Present Law

Under present law, the Internal Revenue Service generally issues a letter revoking recognition of an organization's tax-exempt status only after (1) conducting an examination of the organization, (2) issuing a letter to the organization proposing revocation, and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of an organization described in section 501(c)(3), the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization is no longer entitled to exemption. There is no procedure under present law for the IRS to suspend the tax-exempt status of an organization.

To combat terrorism, the Federal government has designated a number of organizations as terrorist organizations or supporters of terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945.

Description of Proposal

The proposal suspends the tax-exempt status of an organization that is exempt from tax under section 501(a) for any period during which the organization is designated or identified by U.S. Federal authorities as a terrorist organization or supporter of terrorism. The proposal also makes such an organization ineligible to apply for tax exemption under section 501(a). The period of suspension runs from the date the organization is first designated or identified (or from the date of enactment of the proposal, whichever is later) to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive order under which the designation or identification was made.

The proposal describes a terrorist organization as an organization that has been designated or otherwise individually identified (1) as a terrorist organization or foreign terrorist organization under the authority of section 212(a)(3)(B)(vi)(II) or section 219 of the Immigration and Nationality Act; (2) in or pursuant to an Executive order that is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive order that refers to the proposal and is issued under the authority of any Federal law if the organization is designated or otherwise individually identified in or pursuant to such Executive order as supporting or engaging in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act) or supporting terrorism (as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989). During the period of suspension, no deduction is allowed under the proposal for any contribution to a terrorist organization under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

No organization or other person may challenge, under section 7428 or any other provision of law, in any administrative or judicial proceeding relating to the Federal tax liability of such organization or other person, the suspension of tax-exemption, the ineligibility to apply for tax-exemption, a designation or identification described above, the timing of the period of suspension, or a denial of deduction described above. The suspended organization may maintain other suits or administrative actions against the agency or agencies that designated or identified the organization, for the purpose of challenging such designation or identification (but not the suspension of tax-exempt status under this provision).

If the tax-exemption of an organization is suspended and each designation and identification that has been made with respect to the organization is determined to be erroneous pursuant to the law or Executive order making the designation or identification, and such erroneous designation results in an overpayment of income tax for any taxable year with respect to such organization, a credit or refund (with interest) with respect to such overpayment shall be made. If the operation of any law or rule of law (including res judicata) prevents the credit or refund at any time, the credit or refund may nevertheless be allowed or made if the claim for such credit or refund is filed before the close of the one-year period beginning on the date that the last remaining designation or identification with respect to the organization is determined to be erroneous.

The proposal directs the IRS to update the listings of tax-exempt organizations to take account of organizations that have had their exemption suspended and to publish notice to taxpayers of the suspension of an organization's tax-exemption and the fact that contributions to such organization are not deductible during the period of suspension.

Effective Date

The proposal is effective for designations made before, on, or after the date of enactment.

TITLE IV - CONFIDENTIALITY AND DISCLOSURE

A. Collection Activities with Respect to a Joint Return Disclosable Based on Oral Request

Present Law

Section 6103(e) concerns disclosures to persons with a material interest. Section 6103(e)(1)(B) permits, upon written request, the inspection or disclosure of a joint return to either of the individuals with respect to whom the return is filed. Section 6103(e)(7) permits the IRS to disclose return information to the same persons who may have access to a return under the other provisions of section 6103(e). Requests for information pursuant to section 6103(e)(7) do not have to be in writing. Pursuant to section 6103(e)(7) and section 6103(e)(1)(B), either spouse may obtain return information regarding a joint return, including collection information.

In response to concerns that former spouses were not able to obtain information regarding collection activities relating to a joint return, the Taxpayer Bill of Rights 2 added section 6103(e)(8).[20] When a deficiency is assessed with respect to a joint return and the individuals are no longer married or no longer reside in the same household, upon request in writing by either of such individuals, the IRS is permitted to disclose: (1) whether the IRS has attempted to collect such deficiency from the other individual; (2) the general nature of such collection activities; and (3) the amount collected.[21]

Description of Proposal

The proposal eliminates the requirement for former spouses to make a written request for disclosure of collection activities with respect to a joint return.

Effective Date

The proposal is effective for requests made after the date of enactment.

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[20] "The IRS does not routinely disclose collection information to a former spouse that relates to tax liabilities attributable to a joint return that was filed when married." Joint Committee on Taxation, *General Explanation of Taxation Legislation Enacted in the 104th Congress* (JCS-12-96), December 18, 1996, at 29.

[21] Sec. 6103(e)(8).

B. Taxpayer Representatives Not Subject to Examination on Sole Basis of Representation of Taxpayers

Present Law

Under section 6103(h)(1), returns and return information are, without written request, open to inspection by or disclosure to officers and employees of the Department of the Treasury, including IRS employees, whose official duties require such inspection or disclosure for tax administration purposes. The Office of Chief Counsel issued an opinion stating that it was appropriate for a local IRS employee to examine tax records to determine whether taxpayer representatives who submit Form 2848 (Power of Attorney) are current in their tax obligations.[22] The opinion concluded that section 6103(h)(1) permits local IRS employees to access the Integrated Data Retrieval System[23] to determine whether a taxpayer's representative is current in his or her tax obligations.

Description of Proposal

The proposal clarifies that an IRS employee conducting an examination of a taxpayer is not authorized to inspect a taxpayer representative's return or return information solely on the basis of the representative's relationship to the taxpayer. Under the proposal, the supervisor of an IRS employee is required to approve such inspection after making a determination that other grounds justified such an inspection. The proposal does not affect the ability of employees of the IRS Director of Practice, or other employees whose assigned duties concern the regulation of practice before the IRS, to access returns and return information of a representative.

Effective Date

The proposal is effective 180 days after the date of enactment.

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[22] Internal Revenue Service, IRS Legal Memorandum ILM 199.

[23] The Integrated Data Retrieval System (commonly referred to as "IDRS") is the IRS's primary computer database for return information.

C. Disclosure in Judicial or Administrative Tax Proceedings of Return and Return Information of Persons Who Are Not Party to Such Proceedings

Present Law

Under section 6103(h)(4), a return or return information may be disclosed in a Federal or State judicial or administrative proceeding pertaining to tax administration under certain circumstances. Under section 6103(h)(4)(A), such information may be disclosed if the taxpayer is a party to the proceeding or if the proceeding arose out of, or in connection with, determining the taxpayer's liability with respect to any tax. Under section 6103(h)(4)(B), such information may be disclosed if the treatment of an item reflected on a return is directly related to the resolution of an issue in the proceeding. Under section 6103(h)(4)(C), such information may be disclosed if the return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding. Thus, the returns and return information of a nonparty taxpayer may be disclosed if one of these requirements are met. The statute does not require that the nonparty taxpayer be given notice or be consulted prior to disclosure.

Description of Proposal

The proposal requires that only the portions of a nonparty return or return information that directly relate to the resolution of an issue in the proceeding are to be disclosed in such proceeding. When nonparty returns and return information are to be disclosed under section 6103(h)(4)(B) and (C)[24], the proposal requires that a reasonable effort be made to give notice to the taxpayer prior to the disclosure. The notice must include a statement of the issue or issues for which such return or return information affects resolution. Finally, the nonparty taxpayer must be given an opportunity to request the deletion of certain matters from the return or return information that would be disclosed. For purposes of S corporations, partnerships, estates, and trusts, the notice is to be made at the entity level.

The proposal does not afford a right to intervene or for judicial review of the requested redactions. The notification requirements are not intended to apply to ex parte proceedings for securing a search warrant, orders for entry on premises or safe deposit boxes, or similar ex parte proceedings. The notification requirements do not apply to the disclosure of third party return information by indictment or criminal information. The notice provision also does not apply if it would seriously impair a criminal tax investigation or proceeding. The bill exempts from this provision actions to enjoin income tax return preparers,[25] to enjoin promoters of abusive tax shelters,[26] and to enjoin flagrant political expenditures of section 501(c)(3) organizations.[27]

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[24] Under the proposal these provisions would be redesignated as clauses ii, and iii of section 6103(h)(4)(A).

[25] Sec. 7407.

[26] Sec. 7408.

Effective Date

The proposal applies to proceedings commenced after the date of enactment.

[27] Sec. 7409.

D. Prohibition of Disclosure of Taxpayer Identification Information with Respect to Disclosure of Accepted Offers-in-Compromise

Present Law

Section 6103 permits the IRS to disclose return information to members of the general public to permit inspection of accepted offers in compromise.[28] The IRS makes summaries of the accepted offers in compromise, Form 7249 - Offer Acceptance Report, available for public inspection in the IRS district offices. Currently, this form contains the taxpayer identification number of the taxpayer, e.g., the social security number in the case of an individual taxpayer, along with the taxpayer's name and full address.

Description of Proposal

The proposal prohibits the disclosure of the taxpayer's address and taxpayer identification number as part of the publicly available summaries of accepted offers in compromise.

Effective Date

The proposal applies to disclosures made after the date of enactment.

[28] Sec. 6103(k)(l).

E. Compliance By Contractors with Confidentiality Safeguards

Present Law

Section 6103 permits the disclosure of returns and return information to State agencies, as well as to other Federal agencies for specified purposes. Section 6103(p)(4) requires, as conditions of receiving returns and return information, that State agencies (and others) provide safeguards as prescribed by the Secretary of the Treasury by regulation to be necessary or appropriate to protect the confidentiality of returns or return information.[29] It also requires that a report be furnished to the Secretary at such time and containing such information as prescribed by the Secretary regarding the procedures established and utilized for ensuring the confidentiality of returns and return information.[30] After an administrative review, the Secretary may take such actions as are necessary to ensure these requirements are met, including the refusal to disclose returns and return information.[31]

Under present law, employees of a State tax agency may disclose returns and return information to contractors for tax administration purposes.[32] These disclosures can be made only to the extent necessary to procure contractually equipment, other property, or the providing of services, related to tax administration.[33]

The contractors can make redisclosures of returns and return information to their employees as necessary to accomplish the tax administration purposes of the contract, but only to contractor personnel whose duties require disclosure.[34] Treasury regulations prohibit redisclosure to anyone other than contractor personnel without the written approval of the IRS.[35]

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[29] Sec. 6103(p)(4)(D).

[30] Sec. 6103(p)(4)(E).

[31] Sec. 6103(p)(4) (flush language) and (7); Treas. Reg. sec. 301.6103(p)(7)-1.

[32] Sec. 6103(n) and Treas. Reg. sec. 301.6103(n)-1(a). "Tax administration" includes "the administration, management, conduct, direction, and supervision of the execution and application of internal revenue laws or related statutes (or equivalent laws and statutes of a State)…" Sec. 6103(b)(4).

[33] Treas. Reg. sec. 301.6013(n)-1(a). Such services include the processing, storage, transmission or reproduction of such returns or return information, the programming, maintenance, repair, or testing of equipment or other property, or the providing of other services for purposes of tax administration.

[34] Treas. Reg. sec. 301.6103(n)-1(a) and (b). A disclosure is necessary if such procurement or the performance of such services cannot otherwise be reasonably, properly, or economically accomplished without such disclosure. Treas. Reg. sec. 301.6103(n)-1(b). The regulations limit the quantity of information to that needed to perform the contract.

[35] Treas. Reg. sec. 301.6103(n)-1(a).

By regulation, all contracts must provide that the contractor will comply with all applicable restrictions and conditions for protecting confidentiality prescribed by regulation, published rules or procedures, or written communication to the contractor.[36] Failure to comply with such restrictions or conditions may cause the IRS to terminate or suspend the duties under the contract or the disclosures of returns and return information to the contractor.[37] In addition, the IRS can suspend disclosures to the State tax agency until the IRS determines that the conditions are or will be satisfied.[38] The IRS may take such other actions as deemed necessary to ensure that such conditions or requirements are or will be satisfied.[39]

Description of Proposal

The proposal requires that a State, local or Federal agency conduct annual on-site reviews of all of its contractors or other agents receiving Federal returns and return information. If the duration of the contract or agreement is less than one year, a review is required at the mid-point of the contract. The purpose of the review is to assess the contractor's efforts to safeguard Federal returns and return information. This review is intended to cover secure storage, restricting access, computer security, and other safeguards deemed appropriate by the Secretary. Under the provision, the State, local or Federal agency is required to submit a report of its findings to the IRS and certify annually that such contractors and other agents are in compliance with the requirements to safeguard the confidentiality of Federal returns and return information. The certification is required to include the name and address of each contractor or other agent with the agency, the duration of the contract, and a description of the contract or agreement with the State, local, or Federal agency.

This proposal does not alter or affect in any way the right of the IRS to conduct safeguard reviews of State, local, or Federal agency contractors or other agents. It also does not affect the right of the IRS to initially approve the safeguard language in the contract or agreement and the safeguards in place prior to any disclosures made in connection with such contracts or agreements.

Effective Date

The proposal is effective for disclosures made after December 31, 2003. The first certification is required to be made with respect to calendar year 2004.

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[36] Treas. Reg. sec. 301.6103(n)-1(d).

[37] Treas. Reg. sec. 301.6103(n)-1(d)(1).

[38] Treas. Reg. sec. 301.6103(n)-1(d)(2).

[39] Treas. Reg. sec. 301.6103(n)-1(d).

F. Higher Standards for Requests for and Consents to Disclosure

Present Law

In general

Under section 6103(c), a taxpayer may designate in a request or consent to the disclosure by the IRS of his or her return or return information to a third party. Treasury regulations set forth the requirements for such consent.[40] The Treasury regulations require that the taxpayer sign and date the consent. The taxpayer must also indicate in the written document (1) the taxpayer's taxpayer identity information; (2) the identity of the person to whom disclosure is to be made; (3) the type of return (or specified portion of the return) or return information (and the particular data) that is to be disclosed; and (4) the taxable year covered by the return or return information. The regulations also require that the consent be submitted within 60 days of the date signed and dated, however, at the time of submission, the IRS generally is unaware of whether a consent form was completed or dated after the taxpayer signs it. Present law does not require that a recipient receiving returns or return information by consent maintain the confidentiality of the information received. Under present law, the recipient is also free to use the information for purposes other than for which the information was solicited from the taxpayer.

Section 6103(c) consents are often used in connection with mortgage loan applications. Mortgage originators qualify loan applicants as meeting or not meeting the requirements for loan approval. This process involves the verification and investigation of information and conditions. If the loan is granted, the mortgage originator may use its own money to fund the loan. Alternatively, another entity, an "investor," may buy the loan and provide the money. Investors typically perform a re-investigation of loans received for funding. Such re-investigations may include verification through the IRS of the tax return provided by the taxpayer to the mortgage originator.

Usually the mortgage originator does not know which investor will ultimately fund the loan. Thus, at the time of application, the originator asks the borrower/taxpayer to sign a consent (Form 4506) designating the originator as the third party to receive the taxpayer's returns. Subsequently, at closing, the investor may request that the originator obtain another Form 4506 naming the investor as the third party to receive the taxpayer's return.

Ostensibly to avoid confusion over why the taxpayer would be authorizing a party other than the originator to receive his tax return, the taxpayer may be asked to sign a blank Form 4506 at closing. In some cases, mortgage originators ask taxpayers not to date the Form 4506. This allows the form to be submitted to the IRS at a later date, often months or years later, for purposes of mortgage resale.

Criminal penalties

[40] Treas. Reg. sec. 301.6103(c)-1.

Under section 7206, it is a felony to willfully make and subscribe any document that contains or is verified by a written declaration that it is made under penalties of perjury and which such person does not believe to be true and correct as to every material matter.[41] Upon conviction, such person may be fined up to $100,000 ($500,000 in the case of a corporation) or imprisoned up to 3 years, or both, together with the costs of prosecution.

Under section 7213, criminal penalties apply to: (1) willful unauthorized disclosures of returns and return information by Federal and State employees and other persons; (2) the offering of any item of material value in exchange for a return or return information and the receipt of such information pursuant to such an offer; and (3) the unauthorized disclosure of return information received by certain shareholders under the material interest provision of section 6103. Under section 7213, a court can impose a fine up to $5,000, up to five years imprisonment, or both, together with the costs of prosecution. If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

The willful and unauthorized inspection of returns and return information can subject Federal and State employees and others to a maximum fine of $1,000 up to a year in prison, or both, in addition to the costs of prosecution. If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

Civil damage remedies for unauthorized disclosure or inspection

If a Federal employee makes an unauthorized disclosure or inspection, a taxpayer can bring suit against the United States in Federal district court. If a person other than a Federal employee makes an unauthorized disclosure or inspection, suit may be brought directly against such person. No liability results from a disclosure based on a good faith, but erroneous, interpretation of section 6103. A disclosure or inspection made at the request of the taxpayer will also relieve liability.

Upon a finding of liability, a taxpayer can recover the greater of $1,000 per act of unauthorized disclosure (or inspection), or the sum of actual damages plus, in the case of an inspection or disclosure that was willful or the result of gross negligence, punitive damages. The taxpayer may also recover the costs of the action and, if found to be a prevailing party, reasonable attorney fees.

The taxpayer has two years from the date of the discovery of the unauthorized inspection or disclosure to bring suit. The IRS is required to notify a taxpayer of an unauthorized inspection or disclosure as soon as practicable after any person is criminally charged by indictment or information for unlawful inspection or disclosure.

Description of Proposal

The proposal renders invalid a consent that does not designate a recipient or is not dated at the time of execution. The person submitting the consent to the IRS is required to verify under

[41] Sec. 7206(1).

penalties of perjury that the form was complete and dated at the time it was signed by the taxpayer. Inspection or disclosure of a return or return information pursuant to an invalid consent is unauthorized under section 6103. Thus, a person making such unauthorized disclosure or inspection could be liable for civil damages, as well as criminal penalties for willful unauthorized disclosure or inspection. The proposal is not intended to validate consents that do not otherwise comply with the Treasury regulations. For example, a consent that does not contain tax years or type of tax at the time of execution is not valid, and this provision does not authorize disclosures pursuant to such consents.

The proposal requires the consent form prescribed by the IRS to contain a warning, prominently displayed, informing the taxpayer that he or she should not sign the form unless it is complete. The proposal requires the consent form to state that if the taxpayer believes there is an attempt to coerce him to sign and incomplete or blank form, the taxpayer should report the matter to the Treasury Inspector General for Tax Administration. The telephone number and address for the Treasury Inspector General for Tax Administration must be included on the form. Under the provision, all third parties receiving returns and return information by consent are required to: (1) ensure that the information received will be kept confidential; (2) use the information only for the purpose for which it was requested; and (3) not further disclose the information except to accomplish that purpose, unless a separate consent from the taxpayer is obtained.

The Treasury Inspector General for Tax Administration is required to submit a report to Congress on compliance with the designation and certification requirements no later than 18 months after the date of enactment. Such report must evaluate (on the basis of random sampling) whether the provision is achieving its purpose, whether requesters and submitters are continuing to evade the purpose of the provision, whether the sanctions are adequate, and such recommendations as considered necessary or appropriate to better achieve the purposes of the provision.

Effective Date

The proposal applies to requests and consents made after three months after the date of enactment.

G. Notice to Taxpayer Concerning Administrative Determination of Browsing; Annual Report

Present Law

Present law requires the IRS to notify a taxpayer that an unlawful disclosure or inspection of the taxpayer's return or return information has occurred when the offender has been charged by criminal indictment or information.[42] If the offender is not so charged, present law does not require the IRS to give notice to the taxpayer, even though the Treasury Inspector General for Tax Administration has concluded that an inspection or disclosure in violation of section 6103 has occurred.

The IRS is required under present law to provide, for disclosure to the public, an annual report to the Joint Committee on Taxation regarding authorized disclosures of returns and return information.[43] The IRS is not required to submit a report to Congress on unauthorized disclosures or inspections of returns and return information.

Description of Proposal

Under the proposal, the IRS is required to notify a taxpayer at the point the Treasury Inspector General for Tax Administration substantiates that a taxpayer's return or return information has been willfully disclosed or inspected without authorization. Thus, if the facts verified by the investigation establish the elements of the offense, the taxpayer is to be notified. The proposal further requires the IRS to provide certain information relating to unauthorized disclosures or inspections of return and return information in its public annual report to the Joint Committee on Taxation.

Effective Date

The proposal is effective upon date of enactment as it relates to notifying the taxpayer of determinations of an unlawful disclosure or inspection. As to the annual report requirement, the proposal is effective for calendar years ending after the date of enactment.

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[42] Sec. 7431(e).

[43] *See* sec. 6103(p)(3)(C).

H. Expanded Disclosure in Emergency Circumstances

Present Law

Section 6103(i)(3)(B) permits the IRS to disclose return information to the extent necessary to apprise Federal or State law enforcement officials of circumstances involving an imminent danger of death or physical injury to an individual.

Description of Proposal

The proposal expands present law to permit disclosure of return information to local law enforcement authorities.

Effective Date

The proposal is effective on the date of enactment.

I. Disclosure of Taxpayer Identity for Tax Refund Purposes

Present Law

When the IRS is unable to find a taxpayer due a refund, present law provides that the IRS may use "the press or other media" to notify the taxpayer of the refund.[44] Section 6103(m) allows the IRS to give the press taxpayer identity information for this purpose.[45]

The IRS believes that the current statutory framework of "press and other media" does not permit disclosures via the Internet. The legislative history of the present-law provision does not address the meaning of "press and other media." At the time of the statute's enactment in 1976, the press (newspapers and periodicals) and other traditional media were the only means available for the IRS to distribute undelivered refund information to the public. Thus, the IRS interprets the term "other media" to exclude the Internet.

Description of Proposal

The proposal allows the IRS to use any means of "mass communication," including the Internet, to notify the taxpayer of an undelivered refund.

Effective Date

The proposal is effective upon date of enactment.

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[44] Sec. 6103(m)(1). This section provides:

> The Secretary may disclose taxpayer identity information to the press or other media for purposes of notifying persons entitled to tax refunds when the Secretary, after reasonable effort and lapse of time, has been unable to locate such persons.

[45] Sec. 6103(m)(1), and (b)(6) (definition of "taxpayer identity").

J. Disclosure to State Officials of Proposed Actions Related to Section 501(c)(3) Organizations

Present Law

In the case of organizations that are described in section 501(c)(3) and exempt from tax under section 501(a) or that have applied for exemption as an organization so described, present law (sec. 6104(c)) requires the Secretary to notify the appropriate State officer of (1) a refusal to recognize such organization as an organization described in section 501(c)(3), (2) a revocation of a section 501(c)(3) organization's tax-exempt status, and (3) the mailing of a notice of deficiency for any tax imposed under section 507, chapter 41, or chapter 42.[46] In addition, at the request of such appropriate State officer, the Secretary is required to make available for inspection and copying, such returns, filed statements, records, reports, and other information relating to the above-described disclosures, as are relevant to any State law determination. An appropriate State officer is the State attorney general, State tax officer, or any State official charged with overseeing organizations of the type described in section 501(c)(3).

In general, return and return information (as such terms are defined in section 6103(b)) is confidential (sec. 6103(a)) and may not be disclosed or inspected unless expressly provided by law. Present law requires the Secretary to keep records of disclosures and requests for inspection (sec. 6103(p)(3)) and requires that persons authorized to receive return and return information maintain various safeguards to protect such information against unauthorized disclosure (sec. 6103(p)(4)). Willful unauthorized disclosure or inspection of return or return information is subject to a fine and/or imprisonment (secs. 7213 and 7213A). The knowing or negligent unauthorized inspection or disclosure of returns or return information gives the taxpayer a right to bring a civil suit (sec. 7431). Such present-law protections against unauthorized disclosure or inspection of return and return information do not apply to the disclosures or inspections, described above, that are authorized by section 6104(c).

Description of Proposal

The proposal provides that upon written request by an appropriate State officer, the Secretary may disclose: (1) a notice of proposed refusal to recognize an organization as a section 501(c)(3) organization, (2) a notice of proposed revocation of tax-exemption of a section 501(c)(3) organization, (3) the issuance of a proposed deficiency of tax imposed under section 507, chapter 41, or chapter 42, (4) the names, addresses, and taxpayer identification numbers of organizations that have applied for recognition as section 501(c)(3) organizations, and (5) return

[46] The applicable taxes include the termination tax on private foundations; taxes on public charities for certain excess lobbying expenses; taxes on a private foundation's net investment income, self-dealing activities, undistributed income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures (some of these taxes also apply to certain non-exempt trusts); taxes on the political expenditures and excess benefit transactions of section 501(c)(3) organizations; and certain taxes on black lung benefit trusts and foreign organizations.

and return information[47] of organizations with respect to which information has been disclosed under (1) through (4) above. Disclosure or inspection is permitted for the purpose of, and only to the extent necessary in, the administration of State laws regulating section 501(c)(3) organizations, such as laws regulating tax-exempt status, charitable trusts, charitable solicitation, and fraud. Such disclosure or inspection may be made only to or by an appropriate State officer or to an officer or employee of the State who is designated by the appropriate State officer, and may not be made by or to a contractor or agent. The Secretary also may disclose or open to inspection the return and return information of an organization that is recognized as tax-exempt under section 501(c)(3), or that has applied for such recognition, to an appropriate State officer if the Secretary determines that disclosure or inspection may facilitate the resolution of Federal or State issues relating to the organization. Appropriate State officer means the State attorney general or the any other State official that is charged with overseeing organizations of the type described in section 501(c)(3).

In addition, the proposal provides that return and return information disclosed under section 6104(c) may be disclosed in civil administrative and civil judicial proceedings pertaining to the enforcement of State laws regulating section 501(c)(3) organizations in a manner prescribed by the Secretary. Returns and return information shall not be disclosed under section 6104(c), or in such an administrative or judicial proceeding, to the extent that the Secretary determines that such disclosure would seriously impair Federal tax administration. The proposal makes disclosures of returns and return information under section 6104(c) subject to many of the provisions of section 6103, including that the Secretary maintain a permanent system of records of requests for disclosure (sec. 6103(p)(3)) and that the appropriate State officer maintain various safeguards that protect against unauthorized disclosure (sec. 6103(p)(4)). The proposal provides that the willful unauthorized disclosure of return or return information described in section 6104(c) is a felony subject to a fine of up to $5,000 and/or imprisonment of up to five years (sec. 7213(a)(2)), the willful unauthorized inspection of return or return information described in section 6104(c) is subject to a fine of up to $1,000 and/or imprisonment of up to one year (sec. 7213A), and provides the taxpayer the right to bring a civil action for damages in the case of knowing or negligent unauthorized disclosure or inspection of such information (sec. 7431(a)(2)).

Effective Date

The proposal is effective on the date of enactment but does not apply to requests made before such date.

[47] Such information also may be open to inspection by an appropriate State officer.

K. Enhanced Confidentiality of Taxpayer Communications with the Office of the Taxpayer Advocate

Present Law

The Taxpayer Advocate is permitted not to disclose to the IRS any contact with, or information provided by, a taxpayer.[48] It may be unclear how this provision interacts with the provision of the Code requiring disclosure to the IRS when an employee of the IRS has knowledge or information regarding a violation of any provision of the Code.[49]

Description of Proposal

The proposal enhances the confidentiality of taxpayer communications with the office of the Taxpayer Advocate by: (1) permitting the National Taxpayer Advocate to authorize her employees to withhold from the IRS or Department of Justice any information provided by, or regarding contact with, any taxpayer; and (2) permitting the National Taxpayer Advocate to issue guidance (under specified circumstances) superceding provisions of the Internal Revenue Manual relating to the disclosure of information obtained from a taxpayer.

Effective Date

The proposal is effective on the date of enactment.

[48] Sec. 7803(c)(4)(A).

[49] Sec. 7214(a)(8).

TITLE V - MISCELLANEOUS

A. Clarification of Definition of Church Tax Inquiry

Present Law

Under present law, the IRS may begin a church tax inquiry only if an appropriate high-level Treasury official reasonably believes, on the basis of the facts and circumstances recorded in writing, that an organization (1) may not qualify for tax exemption as a church, (2) may be carrying on an unrelated trade or business, or (3) otherwise may be engaged in taxable activities. A church tax inquiry is defined as any inquiry to a church (other than an examination) that serves as a basis for determining whether the organization qualified for tax exemption as a church or whether it is carrying on an unrelated trade or business or otherwise is engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church or a type contained in church records, other than routine requests for information or inquiries regarding matters that do not primarily concern the tax status or liability of the church itself.

Description of Proposal

The proposal clarifies that the present-law church tax inquiry procedures do not apply to contacts made by the IRS for the purpose of educating churches with respect to the law governing tax-exempt organizations. For example, the proposal clarifies that the IRS does not violate the church tax inquiry procedures when written materials are provided to a church or churches for the purpose of educating such church or churches with respect to the types of activities that are not permissible under section 501(c)(3).

Effective Date

The proposal is effective on the date of enactment.

B. Extension of Declaratory Judgment Procedures to Non-501(c)(3) Tax-Exempt Organizations

Present Law

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it generally must file an application for recognition of exemption with the IRS and receive a favorable determination of its status. Similarly, for most organizations, a charitable organization's eligibility to receive tax-deductible contributions is dependent upon its receipt of a favorable determination from the IRS. In general, a section 501(c)(3) organization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases in which an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS is authorized to revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

In situations in which the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on such application, or in which the IRS informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status, present law authorizes the organization to seek a declaratory judgment regarding its tax status (sec. 7428). Section 7428 provides a remedy in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3). A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization, although it also can include a proposed revocation of an organization's tax-exempt status or public charity classification. Section 7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS. An organization is deemed to have exhausted its administrative remedies at the expiration of 270 days after the date on which the request for a determination was made if the organization has taken, in a timely manner, all reasonable steps to secure such determination.

If an organization (other than a section 501(c)(3) organization) files an application for recognition of exemption and receives a favorable determination from the IRS, the determination of tax-exempt status is usually effective as of the date of formation of the organization if its purposes and activities during the period prior to the date of the determination letter were consistent with the requirements for exemption. However, if the organization files an application for recognition of exemption and later receives an adverse determination from the IRS, the IRS may assert that the organization is subject to tax on some or all of its income for open taxable

years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

Under present law, a non-charity (i.e., an organization not described in section 501(c)(3)) may not seek a declaratory judgment with respect to an IRS determination regarding its tax-exempt status. The only remedies available to such an organization are to petition the U.S. Tax Court for relief following the issuance of a notice of deficiency or to pay any tax owed and sue for refund in federal district court or the U.S. Court of Federal Claims.

Description of Proposal

The proposal extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) and 501(d) determinations. The proposal limits jurisdiction over controversies involving such determinations to the United States Tax Court.

Effective Date

The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations is effective for pleadings with respect to determinations made after the date of enactment.

C. Employee Misconduct Report to Include Summary of Complaints by Category

Present Law

The Treasury Inspector General for Tax Administration is subject to the semi-annual reporting requirements set forth in section 5 of the Inspector General Act of 1978. Under present law, reports are made to the Committees on Government Reform and Oversight and Ways and Means in the House of Representatives and the Committees on Governmental Affairs and Finance in the Senate. Each semi-annual report is required to include information regarding the source, nature and status of taxpayer complaints and allegations of serious misconduct by IRS employees received by the IRS or by the Treasury Inspector General for Tax Administration.

Description of Proposal

The proposal modifies the semi-annual reporting requirement for the Treasury Inspector General for Tax Administration to require that the reporting with respect to allegations of serious IRS employee misconduct include a summary (by category) of the 10 most common complaints made and the number of such common complaints (by category).

Effective Date

The proposal is effective for reporting periods ending after the date of enactment.

D. Annual Report on Awards of Costs and Certain Fees in Administrative and Court Proceedings

Present Law

The Code requires that the IRS pay a taxpayer's reasonable administrative and litigation expenses under specified circumstances. Among other requirements, the IRS is not required to pay these amounts if the IRS can demonstrate that its position was substantially justified.

Description of Proposal

The proposal requires TIGTA to publish annually statistics on the number of payments (whether as a result of a settlement or judicial decision) made pursuant to section 7430 and the amount of each such payment. TIGTA also is required to publish an analysis of the administrative issues that gave rise to the necessity of making these payments and the changes (if any) that will be implemented by the IRS as a result of TIGTA's analysis, as well as any other changes that TIGTA recommends on the basis of its analysis. This would permit the Congress to assess the extent to which the IRS may be inappropriately pursuing an issue and to pursue potential remedies to alleviate this problem.

Effective Date

The first annual report is required for fiscal year 2004. The reports must be published no later than three months following the close of the fiscal year.

E. Annual Report on Abatements of Penalties

Present Law

Some penalties in the Code are imposed automatically (such as for failure to file or failure to pay), while others are imposed in response to the specific factual situation presented on a tax return (such as negligence). In addition, some penalties can be abated automatically, while others are abated in response to a specific factual presentation made by the taxpayer. In general, most penalties can be abated for reasonable cause, but the details of what constitutes reasonable cause can vary somewhat from penalty to penalty as a reflection of the differences in the types of behaviors that the different penalties are designed to deter.

Description of Proposal

The proposal requires TIGTA to report to the Congress annually on penalty abatements and the reasons and criteria for abatements. Better statistical information will enable more rigorous analysis of the systems to occur, which will provide the opportunity for problems to surface and be dealt with in a systematic manner.

Effective Date

The first annual report is required for fiscal year 2004. The reports must be provided to the Congress no later than six months following the close of the fiscal year.

F. Better Means of Communicating with Taxpayers

Present Law

The IRS generally communicates with taxpayers (or their designated representatives) in one of three methods: by mail, by telephone, or in person. Many telephone or in person contacts are initiated by the taxpayer, whereas many mail contacts are initiated by the IRS.

Description of Proposal

The proposal requires TIGTA to issue a report to the Congress evaluating whether technological advances, such as e-mail and the fax, permit the utilization of alternate means of communicating with taxpayers to eliminate some of the difficulties with the present system.

Effective Date

The report must be issued no later than 18 months after the date of enactment.

G. Information Regarding Statute of Limitations

Present Law

In general, a taxpayer must file a refund claim within three years of the filing of the return or within two years of the payment of the tax, whichever period expires later (if no return is filed, the two-year limit applies). A refund claim that is not filed within these time periods is rejected as untimely.

A special rule applies during periods of disability. Equitable tolling of the statute of limitations for refund claims of an individual taxpayer applies during any period in which an individual is unable to manage his or her financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months. Equitable tolling does not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters.

There is no requirement that IRS publications contain information that both describes this statute of limitations provision and explains the consequences of failing to file within the time period prescribed by the statute of limitations.

Description of Proposal

The proposal requires the IRS to revise Publication 1 ("Your Rights as a Taxpayer") by adding an explanation of the consequences of failing to file within the time period prescribed by the statute of limitations to the section on refunds that describes the statute of limitations. The proposal also requires the IRS to revise the instructions that accompany all of the Form 1040 packages (including 1040A and 1040EZ) in a similar manner to add a description of this statute of limitations and an explanation of the consequences of failing to file within the time period prescribed by the statute of limitations.

Effective Date

The revisions to Publication 1 are required to be made as soon as practicable, but not later than 180 days after the date of enactment. The revisions to the Form 1040 instructional packages are required to be made for instructions for taxable years beginning after December 31, 2002.

H. Amendment to Treasury Auction Reforms

Present Law

Member of the Treasury Borrowing Advisory Committee are prohibited from disclosing anything relating to the securities to be auctioned in a midquarter refunding by the Secretary until the Secretary makes a public announcement of the refunding.

Description of Proposal

The proposal permits earlier disclosure upon the release by the Secretary of the minutes of the meeting.

Effective Date

The proposal applies to meetings held after the date of enactment.

I. Enrolled Agents

Present Law

Treasury Department Circular No. 230 provides rules relating to practice before the IRS by attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others.

Description of Proposal

The proposal adds a new section to the Code permitting the Secretary to prescribe regulations to regulate the conduct of enrolled agents in regard to their practice before the IRS and to permit enrolled agents meeting the Secretary's qualifications to use the credentials or designation "enrolled agent", "EA", or "E.A.".

Effective Date

The proposal is effective on the date of enactment.

J. Allow the Financial Management Service to Retain Transaction Fees from Levied Amounts

Present Law

To facilitate the collection of tax, the IRS can generally levy upon all property and rights to property of a taxpayer (sec. 6331). With respect to specified types of recurring payments, the IRS may impose a continuous levy of up to 15 percent of each payment, which generally continues in effect until the liability is paid (sec. 6331(h)). Continuous levies imposed by the IRS on specified Federal payments are administered by the Financial Management Service (FMS) of the Department of the Treasury. FMS is generally responsible for making most non-defense related Federal payments. FMS is required to charge the IRS for the costs of developing and operating this continuous levy program. The IRS pays these FMS charges out of its appropriations.

Description of Proposal

The proposal allows FMS to retain a portion of the levied funds as payment of these FMS fees. The amount credited to the taxpayer's account would not, however, be reduced by this fee.

Effective Date

The proposal is effective on the date of enactment.

K. Extension of IRS User Fees

Present Law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104-117[50] extended the statutory authorization for these user fees[51] through September 30, 2003.

Description of Proposal

The proposal extends the statutory authorization for these user fees through September 30, 2013. The proposal also moves the statutory authorization for these fees into the Code.[52]

Effective Date

The proposal, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

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[50] An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[51] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Pub. Law No. 100-203, December 22, 1987).

[52] The provision also moves into the Code the user fee provision relating to pension plans that was enacted in section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. 107-16, June 7, 2001).

TITLE VI - LOW-INCOME TAXPAYER CLINICS

A. Low-Income Taxpayer Clinics

Present Law

The Code provides that the Secretary is authorized to provide up to $6 million per year in matching grants to certain low-income taxpayer clinics.

Explanation of Provision

The proposal increases this authorization to $9 million for 2004, to $12 million for 2005, and to $15 million for 2006 and thereafter. The proposal also authorizes the IRS to promote the benefits and encourage the use of low-income taxpayer clinics and clarifies the definition of a clinic. The proposal prohibits the use of grants for overhead expenses of any institution sponsoring a clinic.

Effective Date

The proposal is effective on the date of enactment.

TITLE VII - UNEMPLOYMENT ASSISTANCE

A. Unemployment Assistance[53]

Present Law

States set unemployment benefit rules within a broad federal framework. The maximum length of benefits is 26 weeks in all but two states. Under the regular Federal-State Extended Benefits Program, up to an additional 13 weeks of 50 percent federally funded benefits are available in states suffering severe economic distress. As of March 23, 2003 unemployed workers in three states were eligible for benefits under the regular extended benefits program.

Under P.L. 107-147 and P.L. 108-1, up to 13 weeks of 100 percent federally funded temporary extended unemployment benefits are available nationwide for eligible displaced workers. In states continuing to experience a high rate of unemployment (including those with an insured unemployment rate of at least 4 percent, among other criteria) displaced workers who exhaust their up to 13 weeks of temporary extended unemployment benefits as described above are eligible for up to an additional 13 weeks of 100 percent federally funded temporary extended unemployment benefits. As of March 23, 2003 unemployed workers in five states were receiving benefits under this program.

The 100 percent federally funded temporary extended unemployment benefits program applies to weeks of unemployment ending before June 1, 2003 and does not allow benefit payments after August 30, 2003. Transition periods are provided for weeks beginning after May 31, 2003.

Description of Proposal

The proposal makes a technical change to ensure unemployed workers in New York state are eligible for Federal temporary extended unemployment benefits on an equal basis with unemployed workers in other states. Currently, New York state uses a different definition of "week" than other states for purposes of the provision of unemployment benefits. In all other states, "weeks" are defined as ending on Saturday; in New York state, "weeks" end on Sunday. Thus the proposal provides that current law is to apply to weeks of unemployment ending *on* Sunday, June 1, 2003, rather than *before* that date, providing for the same eligibility period in all states, including New York.

Effective Date

The proposal would be effective upon enactment.

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[53] This item prepared by the staff of the Subcommittee on Human Resources of the Committee on Ways & Means.