

**DESCRIPTION OF MODIFICATIONS TO
SENATE FINANCE COMMITTEE
CHAIRMAN'S MARK RELATING TO
REFORM AND RESTRUCTURING OF THE
INTERNAL REVENUE SERVICE AND
TAX TECHNICAL CORRECTIONS PROVISIONS**

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

on March 31, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

March 31, 1998

JCX-21-98

INTRODUCTION

The Senate Finance Committee has scheduled a markup relating to Internal Revenue Service ("IRS") reform and restructuring proposals (including taxpayer protections), as well as tax technical correction provisions, on March 31, 1998. On March 26, 1998, the Chairman of the Finance Committee released his mark of these proposals.¹

This document² prepared by the staff of the Joint Committee on Taxation, contains a description of certain modifications to the Finance Committee Chairman's Mark. Parts I-V of this document relate to the proposals described in JCX-17-98 and Part VI of this document relates to the proposals described in JCX-18-98. The section numbers and headings of the modifications refer to the corresponding provisions in the Chairman's Mark.

¹ The Chairman's Mark is described in: Joint Committee on Taxation, *Description of Senate Finance Committee Chairman's Mark Relating to Reform and Restructuring of the Internal Revenue Service* (JCX-17-98), March 26, 1998, and *Description of Senate Finance Committee Chairman's Mark of Tax Technical Corrections Provisions* (JCX-18-98), March 26, 1998. The estimated revenue effects are set forth in: Joint Committee on Taxation, *Estimated Revenue Effects of the Senate Finance Committee Chairman's Mark Relating to Reform and Restructuring of the Internal Revenue Service* (JCX-20-98), March 30, 1998.

² This document may be cited as follows: Joint Committee on Taxation, *Description of Modifications to Senate Finance Committee Chairman's Mark Relating to Reform and Restructuring of the Internal Revenue Service and Tax Technical Corrections Provisions* (JCX-21-98), March 31, 1998.

I. EXECUTIVE BRANCH GOVERNANCE

A. IRS Restructuring and Creation of IRS Oversight Board

The modification would (1) provide that one of the duties of the IRS Oversight Board is to review procedures of the IRS relating to financial audits; and (2) provide that the Board can be reimbursed for travel expenses for visits to IRS offices and districts (as well as for Board meetings).

B. Appointment and Duties of IRS Commissioner

The modification would clarify that the IRS Commissioner can be reappointed for more than one 5-year term, and would provide that one of the qualifications for the IRS Commissioner is demonstrated ability in management.

C. Structure and Funding of the Employee Plans and Exempt Organizations Division (“EP/EO”)

The modification would eliminate the statutory requirement contained in section 7802(b) that there be an “Office of Employee Plans and Exempt Organizations” under the supervision and direction of an Assistant Commissioner. It is intended that a comparable structure be created administratively to ensure that adequate resources within the IRS are devoted to oversight of the tax-exempt sector.

For example, it is important to allocate sufficient funds for EP/EO staffing adequately to monitor and assist businesses in establishing and maintaining retirement plans. Recently, in Revenue Procedure 98-22, the IRS announced the expansion of the self-correction programs it offers employers to encourage companies to identify and correct errors without incurring significant penalties. These changes are welcomed, and it is not intended that the elimination of the statutory requirement contained in section 7802(b)(1) or the self-funding mechanism described in section 7802(b)(2) impede the implementation of these and EP/EO’s other programs and activities. Rather, it is intended that there be adequate funding for EP/EO, including these self-correction programs that will encourage the establishment and continuation of retirement plans to increase coverage of American workers while protecting the rights of employees to benefits under these plans and maintaining the integrity and purposes of the exemption provisions.

D. Taxpayer Advocate

The modification would provide that, during the period prior to the appointment of the IRS Oversight Board, the Commissioner will submit names to the Secretary of the Treasury, who will appoint the Taxpayer Advocate. As under the Chairman’s Mark, after appointment of the Board, the Taxpayer Advocate would be selected by the Secretary from names submitted by the Board. Under the modification, the Commissioner could recommend candidates for the Taxpayer Advocate to the Board.

F. Treasury Office of Inspector General; IRS Office of the Chief Inspector

The Description of Proposal set forth in the Chairman's Mark would be deleted and replaced with the following:

Description of Proposal

In general

The proposal would establish a new, independent, Office of Treasury Inspector General for Tax Administration ("Treasury IG for Tax Administration") within the Department of Treasury. The IRS Office of the Chief Inspector would be eliminated, and all of its powers and responsibilities would be transferred to the Treasury IG for Tax Administration. The Treasury IG for Tax Administration would have the powers and responsibilities generally granted to Inspectors General under the IG Act of 1978, without the limitations that currently apply to the Treasury IG under section D of the Act. The role of the existing Treasury IG would be redefined to exclude responsibility for the IRS. The Treasury IG for Tax Administration would be under the supervision of the Secretary of Treasury, with certain additional reporting to the Board and the Congress.

Appointment and qualifications of Treasury IG for Tax Administration

The Treasury IG for Tax Administration would be selected by the President, with the advice and consent of the Senate. The Treasury IG for Tax Administration could be removed from office by the President. The President would communicate the reasons for such removal to both Houses of Congress.

The Treasury IG for Tax Administration would be selected without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations. In addition, however, the Treasury IG for Tax Administration should have experience in tax administration and demonstrated ability to lead a large and complex organization. The Treasury IG for Tax Administration could not be employed by the IRS within the two years preceding and the five years following his or her appointment.

The Treasury IG for Tax Administration would be required to appoint an Assistant Inspector General for Auditing and an Assistant Inspector for Inspections. Under the proposal, such appointees, as well as any Deputy Inspector General(s) appointed by the Treasury IG for Tax Administration, could not be employed by the IRS within the two years preceding and the five years following their appointments.

Duties and responsibilities of Treasury IG for Tax Administration

The Treasury IG for Tax Administration would have the present-law duties and responsibilities currently delegated to the Treasury IG with respect to the IRS. In addition, the Treasury IG for Tax Administration would assume all of the duties and responsibilities currently delegated to the IRS Office of the Chief Inspector. The Treasury IG for Tax Administration would have jurisdiction over IRS matters, as well as matters involving the Board.

Accordingly, the Treasury IG for Tax Administration would be charged with conducting audits, investigations, and evaluations of IRS programs and operations (including the Board) to promote the economic, efficient and effective administration of the nation's tax laws and to detect and deter fraud and abuse in IRS programs and operations. In this regard, the Treasury IG for Tax Administration specifically would be directed to evaluate the adequacy and security of IRS technology on an ongoing basis. In addition, the Treasury IG for Tax Administration would be responsible for protecting the IRS against external attempts to corrupt or threaten its employees. The Treasury IG for Tax Administration would be charged with investigating allegations of criminal misconduct (e.g., Code sections 7212, 7213, 7214, 7216 and new section 7217), as well as administrative misconduct (e.g., violations of the Taxpayer Bill of Rights and the Taxpayer Bill of Rights 2, the Office of Government Ethics Standards of Ethical Conduct and the IRS Supplemental Standards of Ethical Conduct).

In addition, the proposal would direct the Treasury IG for Tax Administration to implement a program periodically to audit at least one percent of all determinations (identified through a random selection process) where the IRS has asserted either section 6103 (directly or in connection with the Freedom of Information Act or the Privacy Act) or law enforcement considerations (i.e., executive privilege) as a rationale for refusing to disclose requested information. The program would be implemented within 6 months after establishment of the Treasury IG for Tax Administration. The Treasury IG for Tax Administration would be directed to report any findings of improper assertion of section 6103 or law enforcement considerations to the Board.

Further, the Treasury IG for Tax Administration would be directed to establish a toll-free confidential telephone number for taxpayers to register complaints of misconduct by IRS employees and to publish the telephone number in IRS Publication 1.

There would be no restrictions on the Treasury IG for Tax Administration's ability to refer matters to the Department of Justice. Thus, the Treasury IG for Tax Administration would be required to report to the Attorney General whenever the Treasury IG for Tax Administration has reasonable grounds to believe that there has been a violation of Federal criminal law.

Authority of Treasury IG for Tax Administration

The Treasury IG for Tax Administration would report to and be under the general supervision of the Secretary of Treasury. Under the proposal, the Secretary could not prevent or prohibit the Treasury IG for Tax Administration from initiating, carrying out, or completing any audit or investigation or from issuing any subpoena during the course of any audit or investigation.

Under the proposal, the Treasury IG for Tax Administration would provide to the Board all reports regarding IRS matters on a timely basis and would conduct audits or investigations requested by the Board. The Treasury IG for Tax Administration also would, in a timely manner, conduct such audits or investigations and provide such reports as may be requested by the Commissioner.

In carrying out the duties and responsibilities described above, the Treasury IG for Tax Administration would have the present-law authority generally granted to Inspectors General under the IG Act of 1978. The limitations on the authority of the Treasury IG under such Act would not apply to the Treasury IG for Tax Administration. In addition, the Treasury IG for Tax Administration would have the authority granted to the IRS Office of the Chief Inspector under present-law Code section 7608, including the right to execute and serve search and arrest warrants, to serve subpoenas and summonses, to make arrests without warrant, to carry firearms, and to seize property subject to forfeiture under the Code.

Resources

To ensure that the Treasury IG for Tax Administration has sufficient resources to carry out his or her duties and responsibilities under the proposal, all but 300 FTEs from the IRS Office of the Chief Inspector would be transferred to the Treasury IG for Tax Administration. Such FTEs would include all of the FTEs performing investigative functions in the Office of the Chief Inspector Internal Security and Integrity Investigations and Activities. In addition, the 21 FTEs previously transferred from Inspection to Treasury IG pursuant to the 1990 MOU to perform oversight of the IRS would be transferred to Treasury IG for Tax Administration.

The Commissioner would be permitted to retain approximately 300 FTEs from the Office of Inspection to staff an audit function (including support staff) for internal IRS management purposes. Like other IRS functions, however, this audit function would be subject to oversight and review by the Treasury IG for Tax Administration.

Access to taxpayer returns and return information

Taxpayer returns and return information would be available for inspection by the Treasury IG for Tax Administration pursuant to section 6103(h)(1). Thus, the Treasury IG for Tax Administration would have the same access to taxpayer returns and return information as does the Chief Inspector under present law.

Reporting requirements

The Treasury IG for Tax Administration would be subject to the semiannual reporting requirements set forth in section 5 of the IG Act of 1978. As under present law, reports would be made to the Committees on Government Reform and Oversight and Ways and Means of the House and the Committees on Governmental Affairs and Finance of the Senate. The reports would be required to contain the information that is required to be reported by the Treasury IG with respect to the IRS under present law, as well certain additional information (e.g., regarding the source, nature and status of allegations received by the Treasury IG for Tax Administration, the implementation of various taxpayer rights protections, and IRS employee terminations and mitigations) required by this proposal.

Treasury IG

The Treasury IG generally would continue to have its present-law responsibilities and authority with respect to all Treasury functions other than the IRS and the Board. However, the Treasury IG generally would not have access to taxpayer returns and return information under section 6103 (unless the Secretary specifically authorizes such access).

The Treasury IG for Tax Administration would operate independently of the Treasury IG. In the event that investigations or audits undertaken by either the Treasury IG for Tax Administration or the Treasury IG necessitate access to information within the other's area of responsibility, the two Inspectors General shall notify the Secretary and shall formulate a plan (which must be approved by the Secretary) for proceeding with such investigation or audit.

The Treasury IG would continue to have responsibility for providing an opinion on the Department of Treasury's consolidated financial statement as required under the Chief Financial Officer Act. The Treasury IG for Tax Administration would be responsible for rendering an opinion on the IRS custodial and administrative accounts (to the extent the Government Accounting Office does not exercise its option to preempt under the CFO Act).

Effective Date

The proposal would be effective 180 days after the date of enactment.

G. IRS Personnel Flexibilities

The modification would clarify two of the grounds for termination of an IRS employee. Under the modification, the provision in the Chairman's Mark regarding termination for perjury would be amended to provide that termination would occur for providing a false statement under oath material to a matter involving a taxpayer. The provision in the Chairman's Mark regarding termination for falsifying or destroying documents to cover up employee mistakes would be amended to provide that termination would occur for falsifying or destroying documents to avoid uncovering mistakes made by the employee with respect to a matter involving a taxpayer.

III. TAXPAYER BILL OF RIGHTS 3

B. Proceedings by Taxpayers

1. Expansion of authority to award costs and certain fees

The modification would clarify that attorneys' fees may also be recovered in an action for civil damages for unauthorized inspection or disclosure of taxpayer returns and return information.

C. Relief for Innocent Spouses and Persons with Disabilities

The modification would require the IRS to notify all taxpayers who have filed joint returns of their rights to elect to limit joint and several liability by requiring information to be included in (1) appropriate IRS publications (including IRS Publication 1) and (2) in every collection-related notice sent to the taxpayers.

E. Protections for Taxpayers Subject to Audit or Collection

3. Expansion of authority to issue taxpayer assistance orders

The modification would expand the authority of the Taxpayer Advocate to issue taxpayer assistance orders when there are circumstances that the Taxpayer Advocate believes are appropriate for the issuance of an assistance order.

12. Require IRS to notify taxpayer before contacting third parties regarding IRS examination or collection activities with respect to the taxpayer

The modification would clarify that the provision in the Chairman's Mark requiring the IRS to notify taxpayers before the IRS contacts third parties regarding the examination of the taxpayer's tax return also applies to summonses of third parties.

F. Disclosures to Taxpayers

The Chairman's Mark would include the following new item 6:

6. Statement to taxpayers with installment agreements

The modification would require that the IRS send every taxpayer in an installment agreement an annual statement of the initial balance owed, the payments made during the year, and the remaining balance.

K. Offers-in-Compromise

The Chairman's Mark would include the following new item 8:

8. Appeals review of rejected offers-in-compromise

The amendment would codify the IRS practice of having an appeals officer review all rejected offers-in-compromise. The IRS would be required to notify taxpayers of this right on the application form for an offer-in-compromise.

L. Additional Items

The Chairman's Mark would include the following new items 7, 8, 9, and 10:

7. IRS telephone numbers

The modification would require the IRS to publish addresses and local telephone numbers of local IRS offices in appropriate local telephone directories.

8. Notice of interest charges

The modification would require that every IRS notice that imposes interest that is sent to an individual taxpayer will include a detailed computation of the interest charged and a citation to the Code section under which such interest is imposed.

9. Alternatives to Social Security numbers for return preparers

The modification would authorize the IRS to approve alternatives to Social Security numbers to identify tax return preparers.

10. Expand Alternative Dispute Resolution

The modification would expand the Alternative Dispute Resolution provision to require the IRS to establish a pilot program of binding arbitration (subject to election by both parties) regardless of the amount in dispute.

IV. CONGRESSIONAL ACCOUNTABILITY FOR THE IRS

A. Funding for Century Date Change

The modification would require the IRS to report to the Committee within 14 days after the bill is reported by the Committee with respect to (1) the overall impact the Committee bill will have on the ability of the IRS to address the Year 2000 computer conversion, and (2) provisions in the Committee bill that require significant computer reprogramming prior to December 31, 1999.

B. Tax Law Complexity Analysis

The modification would require the Joint Committee on Taxation (in consultation with the IRS and Treasury) to provide an analysis of complexity or administrability concerns raised by tax provisions of widespread applicability to individuals or small businesses. The analysis would be included in any Committee Report or Conference Report containing tax provisions and would appear in the report after the explanation of provision, or would be provided to the Members of the relevant Committee or Committees as soon as practicable after the report is filed. The analysis would include (1) an estimate of the number of taxpayers affected, and (2) if applicable, the income level of affected individual taxpayers. In addition, the analysis could discuss the following factors: (1) the extent to which existing tax forms would require revision and whether a new form or forms would be required; (2) whether and to what extent taxpayers would be required to keep additional records; (3) the extent to which enactment of the provision would require the IRS to develop or modify regulatory guidance; (4) whether and to what extent the provision can be expected to lead to disputes between taxpayers and the IRS; and (5) how the IRS can be expected to respond to the provision (including the impact on internal training, whether the Internal Revenue Manual would require revision, whether the change would require reprogramming of computers, and the extent to which the IRS would be required to divert or redirect resources in response to the provision). The provision would be effective with respect to legislation considered on or after January 1, 1999.

V. REVENUE OFFSETS

The Chairman's Mark would include the following new item F:

F. Add Vaccines Against Rotavirus Gastroenteritis to the List of Taxable Vaccines

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chicken pox). The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers. All persons immunized after September 30, 1998, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

Description of Proposal

The proposal would add vaccines against rotavirus gastroenteritis to the list of taxable vaccines.

Effective Date

The proposal would be effective for vaccine purchases the day after the date of enactment. No floor stocks tax would be collected for amounts held for sale on that date.

VI. TECHNICAL CORRECTIONS

The Chairman's Mark would include the following additional technical correction provisions:

1. Treatment of amounts received under the work requirements of the Personal Responsibility and Work Opportunity Act of 1996 (sec. 1085(c) of the 1997 Act and sec. 32(c)(2)(B)(v) of the Code)

The Taxpayer Relief Act of 1997 (the "1997 Act") provided that, to the extent subsidized under the relevant State program, workfare payments under the Personal Responsibility and Work Opportunity Act of 1996 are not wages for purposes of the earned income credit. The technical correction would make a clerical amendment to the provision.

2. Clarification of provision expanding the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts (sec. 1084 of the 1997 Act and sec. 264 of the Code)

The 1997 Act provision limiting the deductibility of certain interest and premiums is effective generally with respect to contracts issued after June 8, 1997. To the extent of additional covered lives under a contract after June 8, 1997, the contract is treated as a new contract.

The technical correction would clarify that this treatment of additional covered lives applies only with respect to coverage provided under a master contract, provided that coverage for each insured individual is treated as a separate contract for purposes of Code sections 817(h), 7702 and 7702A, and the master contract or any coverage provided thereunder is not a group life insurance contract within the meaning of Code section 848(e)(2).

This clarification would conform the language of the effective date to the definition of a master contract contained in section 609(i)(3) of H.R. 2676, the Tax Technical Corrections Act of 1997, as passed by the House on November 5, 1997.

3. Clarify that the 1997 provision allowing wine imported in bulk to be transferred to a U.S. winery without payment of tax applies only to wine that would be treated as a "natural wine" if produced in the United States (sec. 1422 of the 1997 Act and sec. 5364 of the Code)

Under present law, wine is subject to an excise tax ranging from \$1.07 per gallon to \$3.40 per gallon, depending on its alcohol content. Distilled spirits are subject to excise tax at a rate of \$13.50 per proof gallon. A tax credit equal to the difference between the distilled spirits tax rate and the wine tax rate is allowed for wine that is blended into distilled spirits products (sec. 5010). The wine excise tax is imposed on removal of the beverage from a winery, or on importation. The 1997 Act included a provision allowing wine to be imported in bulk and

transferred to a U.S. winery without payment of tax (generally until the wine is removed from the winery).

U.S. law defines wine generally as alcohol that is derived from fruit or fruit residues. Wine may not be fortified with grain alcohol if produced in the U.S. Certain other countries allow wine to be fortified with alcohol from other sources. U.S. law follows the laws of the country of origin in classifying imported wine.

The provision would clarify that the 1997 Act's provision liberalizing rules for bulk importation of wine applies only to alcohol that would qualify as a natural wine if produced in the United States. The provision would be effective as if included in the 1997 Act.