DESCRIPTION OF
THE "TAXPAYER BILL OF RIGHTS 2000"

Scheduled for Markup

By the

HOUSE COMMITTEE ON WAYS AND MEANS

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Prepared by the Staff

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JOINT COMMITTEE ON TAXATION

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I. INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Taxpayer Bill of Rights 2000," scheduled for markup in the House Committee on Ways and Means on April 5, 2000.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Taxpayer Bill of Rights 2000"*. (JCX-42-00), April 5, 2000.

I. PENALTIES AND INTEREST

A. Failure to Pay Estimated Tax (sec. 101 of the bill)

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 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, estate, or trust 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 literally interest, which is based on the time value of money.

Description of Proposal

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

Effective Date

The proposal would be effective for estimated tax payments made for taxable years beginning on or after December 31, 2000.

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 throughout the year solely through estimated tax. 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 a safe harbor applies).

Description of Proposal

There would be no interest charged for underpayments of estimated tax by an individual, estate, or trust if the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by both withholding and equally-paid estimated tax is less than $2,000.

Effective Date

The proposal would be effective for estimated tax payments made for taxable years beginning on or after December 31, 2000.

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 quarter, generally would require the use of two 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 would be aligned so that, for any given estimated tax underpayment period for individuals, estates, or trusts, only one interest rate would apply. The underpayment interest rate in effect on the first day of the quarter in which the pertinent estimated payment due date arises would be the interest rate that would apply during the entire underpayment period.

Effective Date

The proposal would be effective for estimated tax payments made for taxable years

beginning on or after December 31, 2000.

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

For individuals, estates, and trusts, the definition of "underpayment" would be changed to allow existing underpayment balances to be used in underpayment calculations for succeeding estimated payment periods. Thus, taxpayers could calculate their underpayment based upon a single, cumulative amount rather than performing separate calculations for each of the four estimated periods as required under present law.

Effective Date

The proposal would be effective for estimated tax payments made for taxable years beginning on or after December 31, 2000.

5. Require 365-day year for all estimated tax interest calculations for individuals, estates, and trusts

Present Law

Under current IRS procedures, taxpayers with outstanding underpayment balances that extend from a leap year through a non-leap year are required to make separate calculations solely to account for the different number of days in the two different years. For example, if a taxpayer has an underpayment outstanding from September 15, 2000, through January 15, 2000, then the taxpayer must account for the period from September 15, 2000, through December 31, 2000, by using a 366-day formula. The taxpayer then must account for the period from January 1, 2001, through January 15, 2001, under a 365-day formula. This calculation is required regardless of whether the interest rate changes on January 1, 2001.

Description of Proposal

A 365-day year would be used for all individual, estate, and trust estimated tax interest calculations.

Effective Date

The proposal would be effective for estimated tax payments made for taxable years beginning on or after December 31, 2000.

B. Exclusion for Interest on Overpayments of Federal Income Tax by Individual Taxpayers (sec. 102 of the bill)

Present Law

Interest on overpayments

In general, interest is 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.[2]

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.[3] Generally, this occurs on the date the appropriate IRS official signs the pertinent schedule of overassessments.[4]

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,[5] or may be disallowed if and to the extent it is determined to be a cost of earning tax exempt income under section 265.

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[2] Treas. Reg. sec. 1.61-7.

[3] Treas. Reg. sec. 1.451-1(a).

[4] Rev. Rul. 62-160, 1962-2 C.B. 451.

[5] Interest may be required to be capitalized under section 263A and similar sections.

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[6] 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."[7] The validity of the temporary regulation has been upheld in those Circuits that have considered the issue, including the Fourth,[8] Sixth,[9] Eighth,[10] and Ninth Circuits.[11]

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.[12]

Description of Proposal

The proposal would exclude overpayment interest that is paid to individual taxpayers on overpayments of Federal income tax from gross income.

Interest excluded under the proposal is not considered disqualified income that could limit the earned income credit. Interest excluded under the provision is not considered for any computation in which interest exempt from tax is otherwise required to be added to adjusted gross income, such as in determining what portion of a taxpayer's social security or tier 1 railroad retirement benefits are subject to tax (sec. 86) or whether a taxpayer has sufficient taxable

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[6] Treas. Reg. sec. 1.163-9T.

[7] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), p. 266.

[8] Allen v. U.S., 173 F. 3d 533 (1999).

[9] McDonnell v. U.S., 1999 U.S. App. LEXIS 10842 (1999).

[10] Miller v. U.S., 65 F. 3d 687 (1995).

[11] Redlark v. U.S., 141 F. 3d 936 (1998).

[12] Treas. Regs. sec. 1.163-9T(b)(2)(iii)(A).

income to be required to file a return (sec. 6012(d)).

Effective Date

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

C. Repeal of Penalty for Failure to Pay Tax and Imposition of Late Payment Service Charge (sec. 103 of the bill)

Present Law

Taxpayers who fail to pay their taxes are subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent.[13] If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return. If a return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of $100 or 100 percent of the amount required to be shown on the return. For any month in which an installment payment agreement with the IRS is in effect, the rate of the penalty is half the usual rate (0.25 percent instead of 0.5 percent), provided that the taxpayer filed the tax return in a timely manner (including extensions).[14]

Description of Proposal

The proposal would repeal the failure to pay taxes penalty.[15] Interest would continue to apply. A 5-percent annual late payment service charge would also apply to taxpayers that do not enter into installment agreements in a timely manner. A taxpayer could entirely avoid this service charge by entering into an installment payment agreement with the IRS and remaining current on that agreement.

This charge would operate in the following way. If a taxpayer does not enter into an installment agreement to pay amounts that have been assessed,[16] a 5-percent late payment service charge would be imposed on the balance that remains unpaid. With respect to amounts assessed

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[13] Sec. 6651(a)(2) and (3).

[14] Sec. 6651(h). This provision was added by section 3303 of the IRS Reform Act.

[15] Sec. 6651(a)(2) and (3).

[16] This provision would apply to both self-assessments (amounts shown on an original return but not paid with that return) as well as assessments later made by the IRS.

by July 15 of the year the tax return was required to be filed, the taxpayer has until August 15 to enter into an installment agreement to avoid imposition of the late payment service charge. With respect to amounts assessed after July 15, the taxpayer has 30 days to enter into an installment agreement to avoid imposition of the late payment service charge. Only a single 5-percent late payment service charge would be imposed annually[17] on each assessed amount. The 5-percent late payment service charge would be imposed each year a balance remains unpaid, unless the taxpayer has entered into an installment payment agreement with the IRS and has remained current on that agreement. Abrogation of the installment payment agreement by the taxpayer would also result in the imposition of the 5-percent late payment service charge.

Example 1.–An individual income tax return is filed on April 15 but the full amount shown as due on that return is not paid with that return. The taxpayer must either pay the assessed amount in full or enter into an installment agreement by August 15 to avoid paying the late payment service charge.

Example 2.–An individual income tax return is filed on April 15, the full amount shown as due on that return is paid with that return, but on May 15 the IRS sends the taxpayer a math error notice that additional tax is due. The taxpayer must either pay the assessed amount in full or enter into an installment agreement by August 15 to avoid paying the late payment service charge.

Example 3.–An individual income tax return is filed on April 15 of Year 1 and the full amount shown as due on that return is paid with that return. In Year 2, the IRS sends the taxpayer a notice that the taxpayer omitted from the return filed in Year 1 an item of income subject to information reporting. The taxpayer does not dispute the omission and the amount is assessed on September 15 of Year 2. The taxpayer must either pay the assessed amount in full or enter into an installment agreement by October 15 of Year 2 to avoid paying the late payment service charge.

The proposal would also provide that taxpayers who enter into installment agreements would not be required to pay the present-law $43 fee for installment agreements[18] only for so long as an automated withdrawal of each installment payment is made directly from their bank account.

Effective Date

The proposals relating to the failure to file penalty would be effective for amounts

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[17] For purposes of determining the annual imposition of the 5-percent late service charge, the year is considered to start on August 15 and end the following August 14.

[18] The IRS charges a user fee of $43 upon approval of an application to enter into an installment agreement.

assessed in calendar quarters beginning more than 30 days after the date of enactment. The prohibition on the fee for installment agreements using automated withdrawals would be effective for installment agreements entered into more than 30 days after the date of enactment.

D. Abatement of Interest (sec. 104 of the bill)

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 unreasonable errors and delays by the Internal Revenue Service, as well as to erroneous written advice furnished by the Internal Revenue Service. The Secretary may abate interest where, in his judgement, 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.

Abatements due to unreasonable error or delay by the IRS

If any part of an underpayment of a tax described in section 6212(a)[19] is attributable to an unreasonable error or delay by an officer or employee of the Internal Revenue Service, acting in

[19] The taxes described in section 6212(a) are those with respect to which a deficiency may be assessed. These include the income, estate, gift, generation skipping, and certain excise taxes.

his official capacity, in the performance of a ministerial or managerial act, the Secretary may abate all or a part of the interest on the underpayment. Similarly, if a delay in the payment of tax is attributable to such an officer or employee being erroneous or dilatory in performing a ministerial or managerial act, the Secretary may abate all the interest that would otherwise accrue for that period.

Prior to 1986, the IRS generally did not have the authority to abate interest charges that were properly calculated and based on a correctly determined underpayment. This was the case even if the IRS errors or delays had prevented the earlier satisfaction of the taxpayer's underpayment and resulted in the accrual of additional interest. The Tax Reform Act of 1986 provided the IRS the authority to abate interest where an IRS official fails either to perform a ministerial act in a timely manner or makes an error in performing a ministerial act. The term 'ministerial act' means "a nondiscretionary act when all of the prerequisites to the (a)ct, such as fact gathering, analysis, decision-making, and conferencing and review by supervisors, have taken place."[20] Abatement is available under this authority only where "no significant aspect of the error or delay can be attributable to the taxpayer"[21] and relates only to periods after the taxpayer has been contacted for examination.[22] The rule authorizes, but does not require the abatement of interest. Abatement is at the discretion of the Secretary. "Congress did not intend that this provision be used routinely to avoid the payment of interest; rather, it intended that the provision be utilized in instances where failure to perform a ministerial act results in the imposition of interest, and the failure to abate the interest would be widely perceived as grossly unfair."[23]

In 1996, the authority to abate interest was expanded to permit the IRS to abate interest with respect to any unreasonable error or delay resulting from the managerial as well as ministerial acts. A managerial act is an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgement or discretion relating to the management of personnel.[24] This allows interest to be abated where extensive delays result from managerial acts such as the loss of records by the IRS, IRS personnel transfers, extended illnesses, extended personnel training, or extended leave. "For this purpose, delays resulting from managerial acts do not include delays resulting from general

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[20] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* ("Bluebook") (JCS-10-87), at 1310.

[21] H.Rept. No. 99-841 (Conference Report on the Tax Reform Act of 1986), at II-811.

[22] *Id.*

[23] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* ("Bluebook") (JCS-10-87), at 1310.

[24] Treas. regs. sec. 301.6404-2(b).

administrative decisions. For example, the taxpayer could not claim that the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system resulted in an unreasonable delay in the Service's action on the taxpayer's tax return, and so the interest on any subsequent deficiency should be waived."[25]

The authority to abate interest under this rule does not apply where an underpayment or delay in payment of tax is attributable to an error or delay by an officer or employee of the IRS in the performance of an act that is not managerial or ministerial. Ministerial and managerial acts do not include a decision as to the application of any Federal or state law, including any Federal tax law.[26]

The proposed regulations provide a number of examples of situations in which abatement of interest under this rule would or would not be allowed. Abatement is generally limited to situations where resolution of the taxpayer's liability is delayed because the IRS has failed to assign appropriate personnel to a taxpayer's case (a managerial act), there is an unaccountable delay in the issuance of a notice by the IRS (a ministerial act), an IRS employee requests an insufficient amount of payment because he misreads the amount on the taxpayer's master file (a ministerial act), or the IRS loses or misplaces vital information (a managerial act). Abatement is not available where the delay in resolving the taxpayer's liability is attributable to excessive time spent by the IRS in interpreting the tax laws, to erroneous interpretations and calculations made by the IRS, to the IRS' decision to examine other returns prior to the examination of the taxpayer's return, or to other failures to resolve a taxpayer's liability in a timely manner.

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.[27] Since the taxpayer has 21 days from the date of demand to pay without interest,[28] 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.

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[25] H.Rept. 104-506 (Taxpayer Bill of Rights 2).

[26] Treas. Reg. sec. 301.6404-2(b).

[27] Sec. 6404(e)(2).

[28] Sec. 6601(e)(3).

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.[29]

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.

Suspension of the accrual of interest for taxpayers serving in a combat zone[30]

Taxpayers serving in a combat zone generally are not required to file tax returns or pay taxes until 180 days after their service in the combat zone is completed. Accordingly, the accrual of interest on any underpayment is suspended during that period.[31] This suspension of interest applies to the underpayment of any tax, whether or not related to a return that would otherwise have been due while the taxpayer was serving in the combat zone.

A taxpayer is serving in a combat zone if serving in the Armed Forces of the United States in an area designated as a "combat zone" during the period of combatant activities. An individual who becomes a prisoner of war is considered to continue in such active service. An individual serving in support of the Armed Forces of the United States in the combat zone, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces, are also considered to be serving in the combat zone for this purpose. The designation of a combat zone may be made by the President in an Executive Order, or may be declared legislatively by the Congress. The President must also designate the period of combatant activities in the combat zone (the starting date and the termination date of combat).

The suspension of interest applies during the period of combatant activities in the combat

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[29] Sec. 6404(f).

[30] The relief available to taxpayers serving in combat zones is discussed more fully in Joint Committee on Taxation, *Description of Present Law and a Proposal Relating to Tax Relief for Personnel in the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Northern Ionian Sea* (JCX-18-99).

[31] Sec. 7508.

zone, as well as (1) any time of continuous qualified hospitalization resulting from injury received in the combat zone or (2) time in missing in action status, plus the next 180 days.

Taxpayers located in a Presidentially declared disaster area

In the case of a Presidentially declared disaster, the Secretary of the Treasury has the authority to extend the filing date for returns of taxpayers that are located in the disaster area. The Secretary may also extend the payment date for any taxes shown on such an extended return. If the Secretary extends the filing and payment dates, any interest that would otherwise be accrued during the period of the extension must be abated.[32]

Suspension of interest where the Secretary fails to contact a taxpayer

For individual taxpayers who have filed a timely Federal income tax return, the accrual of interest is suspended after 1 year if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. With respect to taxable years beginning before January 1, 2004, the 1-year period is increased to 18 months. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The rule applies separately with respect to each item or adjustment[33] and does not apply where a taxpayer has self-assessed the tax. The suspension does not apply in the case of fraud.[34] Any interest that is assessed with respect to the suspension period is required to be abated.

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.[35]

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.

Where abatement of interest is sought separate from any redetermination of tax the

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[32] Sec. 6404(h).

[33] For example, if the IRS sends a math error notice to a taxpayer 2 months after the return is filed and also sends a notice of deficiency related to a different item 2 years later, the suspension of interest applies to the item reflected on the second notice (notwithstanding that the first notice was sent within the applicable time period).

[34] Sec. 6404(g).

[35] Rev. Proc. 87-43, 1987-2 C.B. 590.

availability of judicial review depends upon the basis on which abatement is sought. If the IRS is required to abate the interest, judicial review is available to determine if the facts exist that mandate abatement. The Taxpayer Bill of Rights 2 specifically granted jurisdiction to the Tax Court to review for abuse of discretion any decision by the IRS not to abate interest that is attributable to unreasonable error or delay by Service employees in the performance of a ministerial or managerial act, effective for requests for abatement filed after July 30, 1996.[36] Otherwise, review of the Secretary's failure to use his or her discretion to abate interest may not be available. The courts have held that judicial review of the IRS' failure to use its discretion to abate interest is generally not available, unless jurisdiction is specifically granted by statute or a standard for review has been established.[37]

Description of Proposal

Allow the abatement of interest if a gross injustice would otherwise result if interest were to be charged

The proposal would grant the Secretary the authority to abate interest if a gross injustice would otherwise result if interest were to be charged and no significant aspect of the events giving rise to the accrual of the interest can be attributed to the taxpayer. This authority is intended to allow the Secretary to address those extraordinary situations where normally appropriate rules could result in a gross injustice if strictly applied. It is anticipated that such authority will be used infrequently and will be determined on a case-by-case basis.

Abatement under this authority would be solely within the discretion of the Secretary.

Allow the abatement of interest for periods attributable to any unreasonable IRS error or delay

The proposal would grant the Secretary the authority to abate interest for any period that is attributable to unreasonable IRS errors or delays, whether or not related to managerial or ministerial acts. Such authority may be exercised with regard to errors and delays occurring in periods both before and after the taxpayer is contacted for examination, as well as situations where the error or delay occurs as a result of general administrative decisions. Abatement would not be available to the extent the taxpayer contributed to the delay by providing erroneous information or failing to provide required information.

It is not expected that this expansion of authority will result in an abatement of interest solely because the taxpayer is not able to resolve its tax liability as quickly as the taxpayer would

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[36] Sec. 6404 (as amended by section 301 of the Taxpayer Bill of Rights 2).

[37] Horton Homes, Inc. v. United States, 727 F. Supp. 1450 (M.D. Ga. 1990) aff'd., 936 F.2d 548 (11th Cir. 1991).

like. Interest owed by a taxpayer would not be abated solely because other taxpayers had their returns examined first, or because the determination of the taxpayer's liability proved difficult and required additional time. Abatement is expected to be available only where the additional time needed to resolve the taxpayer's liability is the result of unreasonable error or delay by the IRS, considering all the facts and circumstances applicable to the taxpayer's case.

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 would eliminate the $50,000 threshold for abatement of interest on erroneous refunds. Under the proposal, the Secretary would be 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 would require 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 proposals would be effective with respect to interest accruing on or after the date of enactment.

E. Deposits to Stop the Running of Interest on Potential Underpayments (sec. 105 of the bill)

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,[38] but interest will begin to accrue once the taxpayer is properly notified. No similar suspension is available for other taxpayers.

[38] Sec. 6404(g).

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, it 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 it wins. However, the taxpayer will generally lose access to the Tax Court if it follows this alternative.[39] 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.[40]

The taxpayer may also make a deposit in the nature of a cash bond. The procedures for making a deposits in the nature of a cash bond are provided in Rev. Proc. 84-58.[41]

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.[42] 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

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[39] The taxpayer may, however, sue the IRS for the refund in either the U.S. District Court or the U.S. Court of Federal Claims.

[40] The amount of any overpayment, including interest thereon, may be credited against any other internal revenue tax liability of the taxpayer (sec. 6402(a)). In addition, the overpayment and any overpayment interest may be used to offset past due support payments (sec. 6402(c)), debts owed to other Federal agencies (sec. 6402(d)), and past due, legally enforceable State income tax obligations of residents of the same State (sec. 6402(e)).

[41] 1984-2 C.B. 501.

[42] Rev. Proc. 84-58, sec. 4.02(1).

designated, but the taxpayer may request that the deposit be applied to a different year under certain circumstances.[43]

Description of Proposal

In general

The proposal allows a taxpayer to deposit funds in a qualified dispute reserve account. The taxpayer may subsequently designate all or a part of such deposit to offset an underpayment of tax. Interest will not be charged on the portion of the underpayment that is offset by the designated amount for the period the amount designated as an offset was on deposit. Generally, funds deposited in a qualified dispute reserve account may be withdrawn at any time and will earn interest at the applicable Federal rate if they are not used to offset underpayments of tax.

The amount of funds that may be deposited in a qualified dispute reserve account is generally limited to the amount potentially in dispute with respect to disclosed issues for the taxable year. Amounts deposited in excess of this limit will be treated in the same manner as a deposit in the nature of a cash bond under present law.

Use of a qualified dispute reserve fund to offset underpayments of tax

The taxpayer may designate any amounts in a qualified dispute reserve account to offset an underpayment of tax that is ultimately determined for the taxable year to which the deposit relates. If an underpayment is offset in this manner, the taxpayer will not be charged underpayment interest on the portion of the underpayment that is offset for the period the funds were on deposit in a qualified dispute reserve account.

For example, a calendar year individual taxpayer deposits $20,000 in a dispute reserve account for taxable year 2000 on May 15, 2002. On April 15, 2005, an examination of the taxpayer's return is completed; the taxpayer and the IRS agree that the taxable year 2000 taxes were underpaid by $25,000, the taxpayer designates the amount in the qualified dispute reserve account as an offset to the underpayment, and pays the balance. In this case, the taxpayer will owe underpayment interest from April 15, 2001 (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 offset by the dispute reserve account. The taxpayer will owe underpayment interest on the remaining $20,000 of the underpayment only from April 15, 2001 to May 15, 2002, the date the $20,000 was deposited in the qualified dispute reserve account.

Withdrawal of amounts

A taxpayer may request the withdrawal of any amount in a qualified dispute reserve

[43] Id. sec. 4.02(4).

account at any time. The Secretary must comply with the withdrawal request unless the amount has already been designated to offset an underpayment of tax or the Secretary properly determines that assessment and collection of tax is in jeopardy. Interest is paid on amounts that are withdrawn from a dispute reserve account 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.[44]

For example, a calendar year individual taxpayer deposits $20,000 in a qualified dispute reserve account for taxable year 2000 on May 15, 2002. On April 15, 2005, an examination of the taxpayer's return is completed, the taxpayer and the IRS agree that the 2000 taxes were underpaid by $15,000, and the taxpayer designates the amount in the qualified dispute reserve account as an offset to the underpayment. In this case, the taxpayer will owe underpayment interest from April 15, 2001 (the original due date of the return) to May 15, 2002, the date the $20,000 was deposited in the dispute reserve account. Simultaneously with the designation of the $15,000 to offset the deficiency, the taxpayer requests the return of the remaining $5,000 in the qualified dispute reserve account. This amount must be returned to the taxpayer with interest determined at the short-term applicable Federal rate from the May 15, 2002 to a date not more than 30 days preceding the date of the check repaying the $5,000 to the taxpayer.

Limitations on amounts deposited in a qualified dispute reserve account

The amount on deposit in a qualified dispute reserve account for any taxable year may not exceed the amount necessary to offset the disputable items for the taxable year that have been identified by the taxpayer. 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. The taxpayer must include a reasonable estimate of the potential underpayment as part of its identification of the disputable item. The amount on deposit in the qualified dispute reserve account for the taxable year may not exceed the sum of such reasonable estimates.

All items included in a 30-day letter to a taxpayer are deemed to be identified for this purpose. Thus, once a 30-day latter has been issued, the deposit limit 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.

If the taxpayer deposits an amount in excess of the limit, that amount will be a cash bond deposit that is not part of a qualified dispute reserve account. Such amounts will be treated in the same manner as deposits in the nature of a cash bond under present law.

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[44] This 30-day period is consistent with other determinations of interest owed to a taxpayer.

Deposits in dispute reserve accounts are not payments of tax

An amount deposited in a dispute reserve account is not a payment of tax prior to the time it is designated to offset an underpayment. Thus, the interest earned on withdrawn amounts would not be eligible for the proposed exclusion from income of an individual. Similarly, withdrawal of an amount from a qualified dispute reserve account 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 rate interest rate on a similar amount of underpayment for the same period.

Application of amounts to different years

A taxpayer may change the taxable year to which an amount in a qualified dispute reserve account relates. Such an amount will continue to be considered to have been deposited on its original deposit date for the purpose of determining the period of interest on any underpayment it is designated to offset or the period for which interest is owed to the taxpayer should the deposit be withdrawn.

Effective Date

The proposal would apply to periods after the date of enactment. Amounts already on deposit as of the date of enactment will be treated as deposited in a qualified dispute reserve account as of the date the taxpayer makes the required identification.

TITLE II - CONFIDENTIALITY AND DISCLOSURE

A. Disclosure and Privacy Rules Relating to Returns and Return Information (sec. 201 of the bill)

Present Law

Section 6103

Under section 6103, returns and return information are confidential and cannot be disclosed unless authorized by the Internal Revenue Code.[45] The Code defines return information broadly. Return information includes:

- a taxpayer's identity, the nature, source or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments;

- whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing; or

- any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.[46]

Section 6103 contains a number of exceptions to the general rule of confidentiality, which authorize disclosure in particular circumstances.[47] The IRS may disclose returns and return information to, among others, the taxpayer, the taxpayer's designee, and to certain other persons having a material interest.[48] The IRS may withhold documents when their disclosure would "seriously impair federal tax administration."[49]

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[45] Sec. 6103(a).

[46] Sec. 6103(b)(2)(A).

[47] Sec. 6103(c) through (o).

[48] Sec. 6103(c) and (e).

[49] Sec. 6103(c) and (e)(7).

Freedom of Information Act

The Freedom of Information Act ("FOIA"), enacted in 1966, established a statutory right to access government information.[50] While the purpose of section 6103 is to restrict access to returns and return information, the basic purpose of the FOIA is to ensure that the public has access to government documents. In general, the FOIA provides that any person has a right of access to Federal agency records, except to the extent that such records (or portions thereof) are protected from disclosure by one of nine exemptions or by one of three special law enforcement record exclusions. Returns and return information that cannot be disclosed under section 6103 is exempt from disclosure under the FOIA.[51] However, persons seeking access to information have used the FOIA as an alternative method to attempt to compel disclosure of information arguably protected under section 6103.

Under the FOIA, the IRS (as do other agencies) has twenty days (excluding Saturdays, Sundays, and legal holidays) to respond to a FOIA request. The IRS can respond by either providing the records sought, or notifying the requestor of the reasons why the IRS is denying access and the right to appeal such denial.[52] If the requestor appeals, the IRS has twenty days to rule on such appeal.[53] If the IRS upholds the denial on administrative appeal, the IRS notifies the requestor of his or her right to seek judicial review in a United States District Court.[54]

The Privacy Act

The Privacy Act was enacted in 1974 to regulate the collection, use, dissemination, and maintenance of personal information about individuals by Federal agencies.[55] The Privacy Act applies only to the records of individuals. Thus, the Privacy Act does not protect records of

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[50] 5 U.S.C. sec. 552.

[51] Courts use two approaches to reach this result. Some courts have held that section 6103 preempts the FOIA. Most courts, however, have held that section 6103 meets the requirements of exemption 3 of the FOIA, which allows the withholding of information prohibited from disclosure by another statute if certain requirements are met.

[52] 5 U.S.C. sec. 552(a)(6)(A)(i).

[53] 5 U.S.C. sec. 552(a)(4)(A)(ii). The average FOIA request to the IRS takes six months to process and appeals can take nearly a year. National Commission on Restructuring the Internal Revenue Service, *Report of the National Commission on Restructuring the Internal Revenue Service: A Vision for a New IRS* at 47 (June 25, 1997).

[54] 5 U.S.C. sec. 552(a)(4)(A)(ii).

[55] 5 U.S.C. sec. 552a.

corporations. The Privacy Act has four principal provisions. These provisions: (1) restrict the disclosure of personally identifiable records maintained by agencies; (2) allow individuals to access agency records maintained about the individual; (3) allow an individual to request amendment of agency records pertaining to the individual if the individual believes the records are not accurate, relevant, timely, or complete; and (4) require agencies to comply with statutory guidelines for collection, maintenance, and dissemination of records.

In general, the provisions of the Privacy Act prohibit the disclosure of an individual's records without the consent of the individual. The Privacy Act predated section 6103 by two years. Courts disagree on whether the Privacy Act is preempted by section 6103.

Description of Proposal

The proposal would clarify that the Internal Revenue Code exclusively governs the disclosure and inspection of returns and return information. It would provide a 20-day period in which the IRS must respond to requests by the taxpayer and persons with a material interest in such information, and an administrative appeal process to contest the IRS decision to withhold information. Under the proposal *de novo* judicial review of the IRS decision to withhold returns and return information would be provided. Attorneys fees to the prevailing party under section 7430 would also be available. The proposal would also authorize the Secretary of the Treasury to issue regulations to implement the proposal, and to set fees for document production.

Effective Date

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

B. Expansion of Type of Advice Available for Public Inspection (sec. 202 of the bill)

Present Law

Section 6110 makes the text of any written determination issued by the IRS (and related background file document) available for public inspection. A written determination is any ruling, determination letter, technical advice memorandum, or Chief Counsel advice. Before making written determinations and background file documents available for public inspection, section 6110 requires the IRS to delete specific categories of information. Any part of a written determination or background file that is not disclosed under section 6110 constitutes confidential "return information" under section 6103.[56] Section 6110 also provides administrative and

[56] Section 6103(b)(2)(B) provides that the term "return information" means any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110.

judicial procedures to resolve disputes over the scope of the information the IRS will disclose.[57]

Section 6110 defines Chief Counsel advice as that issued by the national office component of the Office of Chief Counsel to IRS field or service center employees, or regional or district employees of the Office of Chief Counsel.[58] By definition, Chief Counsel advice conveys: (1) a legal interpretation of a revenue provision, (2) the IRS or Chief Counsel position or policy concerning a revenue provision, or (3) a legal interpretation of any law (Federal, State, or foreign) relating to the assessment or collection of liability under a revenue provision.[59] The definition of Chief Counsel advice does not encompass advice issued from one National Office component of the Office of Chief Counsel to another. Nor does it encompass advice issued by the regional or district office of the Office of Chief Counsel to IRS employees. The term "Chief Counsel advice" also does not encompass any advice or instructions issued by non Chief Counsel IRS personnel.

Description of Proposal

The proposal would remove the limitation that the advice be issued by a national office component of the Office of Chief Counsel. It would also eliminate the requirement that the recipient of the advice be either an IRS field or service center employee or an Office of Chief Counsel district or regional employee. The proposal would require disclosure of all advice and instructions issued to IRS or Chief Counsel employees that convey (1) a legal interpretation of a revenue provision, (2) an IRS or Chief Counsel policy concerning a revenue provision, or (3) a legal interpretation of State law, foreign law, or other Federal law relating to the assessment or collection of any liability under a revenue provision. Thus, a communication would not be required to be disclosed if it is factual in nature with regard to a particular taxpayer and does not contain a discussion of the applicable law. It would replace the term "Chief Counsel advice" with "official advice." Official advice, however, would be subject to the same procedural rules, and administrative and judicial remedies currently applicable to present law Chief Counsel advice. The proposal would also require that official advice be made available electronically within one year after issuance.

Effective Date

The proposal would be effective for official advice issued more than 90 days after the date of enactment. Under the proposal, if by regulation the Secretary determined that additional advice or instructions would be treated as official advice, such additional official advice would be made available for public inspection in accordance with the effective date set forth in the

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[57] Sec. 6110(d)(3), (d)(4), (f), and (j).

[58] Sec. 6110(i)(A)(i).

[59] Sec. 6110(i)(A)(ii).

regulation.

C. Collection Activities with Respect to a Joint Return Disclosable Based on Oral Request (sec. 203 of the bill)

Present Law

Section 6103(e) concerns disclosures to persons with a material interest. 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). Pursuant to this section 6103(e)(7) and section 6103(e)(1)(B), either spouse may obtain return information regarding a joint return. This includes collection information. Requests for information pursuant to this section do not have to be in writing.

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).[60] When a deficiency is assessed with respect to a joint return, upon written request, section 6103(e)(8) permits the IRS 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.[61] This provision applies if individuals who filed the joint return are no longer married or no longer reside in the same household. Requests under this section must be in writing.

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 would apply to requests made after the date of enactment.

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[60] "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 Tax Legislation Enacted in the 104th Congress* (JCS-12-96), December 18, 1996 at 29.

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

D. Taxpayer Representatives Not Subject to Examination On Sole Basis of Representation of Taxpayers (sec. 204 of the bill)

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.[62] The opinion concluded that section 6103(h)(1) permits local IRS employees to access the Integrated Data Retrieval System[63] to determine whether a taxpayer's representative is current in his or her tax obligations.

Description of Proposal

The proposal would clarify 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 relationship to the taxpayer. Under the proposal, the supervisor of the IRS employee would have to approve such inspection after making a determination that other grounds justified such an inspection. The proposal would not affect the ability of employees of the IRS Director of Practice to access returns and return information of a representative.

Effective Date

The proposal would be effective on the date of enactment.

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[62] Internal Revenue Service, IRS Legal Memorandum ILM 199941038 (August 19, 1999) *reprinted in Disclosure Provisions Don't Bar IRS Access to Integrated Data Retrieval System*, Tax Notes Today, 1999 TNT 200-54 (October 18, 1999).

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

E. Disclosure in Judicial or Administrative Tax Proceedings of Return and Return Information of Persons Who Are Not Party to Such Proceedings (sec. 205 of the bill)

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 would require that only the portions of a nonparty return or return information that directly relate to the resolution of an issue in the proceeding would be disclosed in such proceeding. When nonparty returns and return information are to be disclosed under section 6103(h)(4)(A) through (C)[64], the proposal would give notice to the taxpayer prior to the disclosure. The notice would include a statement of the issue or issues for which such return or return information affects resolution. Finally, the nonparty taxpayer would be given an opportunity to request the deletion of certain matters from return or return information that would be disclosed.

Effective Date

The proposal would apply to proceedings commenced after the date of enactment.

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

F. Prohibition of Disclosure of Taxpayer Identification Information with Respect to Disclosure of Accepted Offers-in-Compromise (sec. 206 of the bill)

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.[65] 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 would prohibit 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 would apply to disclosures made after the date of enactment.

G. Compliance By State Contractors with Confidentiality Safeguards (sec. 207 of the bill)

Present Law

Section 6103(d) permits the disclosure of returns and return information to State tax agencies. Section 6103(p)(4) requires, as conditions of receiving returns and return information, that State agencies (and others) provide safeguards as prescribed the Secretary of the Treasury by regulation to be necessary or appropriate to protect the confidentiality of returns or return information.[66] 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.[67] After an administrative review, the Secretary may take such actions as are necessary to ensure these

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[65] Sec. 6103(k)(1).

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

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

requirements are met, including the refusal to disclose returns and return information.[68]

Under present law, employees of a State tax agency may disclose returns and return information to contractors for tax administration purposes.[69] 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.[70]

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.[71] Treasury regulations prohibit redisclosure to anyone other than contractor personnel without the written approval of the IRS.[72]

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.[73] 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.[74] In addition, the IRS can suspend disclosures to the State tax agency until the IRS determines that the conditions are or will be satisfied.[75] The IRS may take such other actions as deemed necessary to

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

[69] 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).

[70] Treas. Reg. sec. 301.6103(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.

[71] 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.

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

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

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

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

ensure that such conditions or requirements are or will be satisfied.[76]

Description of Proposal

The proposal would require that a State conduct annual on-site reviews of all of its contractors receiving Federal returns and return information. If the duration of the contract is less than one year, a review would be 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. The State would be required to submit a report of its findings to the IRS and certify annually that all contractors are in compliance with the requirements to safeguard the confidentiality of Federal returns and return information. The certification would include the name and address of each contractor, duration of the contract, and a description of its contract with the State.

Effective Date

The proposal would be effective for disclosures made after December 31, 2001. The first certification would be made with respect to calendar year 2002.

H. Higher Standards for Requests for and Consents to Disclosure (sec. 208 of the bill)

Present Law

Under section 6103(c), a taxpayer may designate, or request that, a third party to receive his or her return or return information from the IRS. Treasury regulations set forth the requirements for such consent.[77] 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.

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

[77] Treas. Reg. 301.6103(c)-1.

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.

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.[78] 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.

Description of Proposal

The proposal would render 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 would be required to verify under 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 would be unauthorized under section 6103. Thus, a person making such unauthorized disclosure or inspection could be liable for civil damages under section 7431, and criminal penalties under section 7213 or 7213A for willful unauthorized disclosure or inspection.

The proposal would require 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 would require 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

[78] Sec. 7206(1).

number and address for the Treasury Inspector General for Tax Administration would be included on the form. Under the proposal, all third parties receiving returns and return information by consent would be 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 would be 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 would evaluate (on the basis of random sampling) whether the proposal is achieving its purpose, whether requesters and submitters are continuing to evade the purpose of the proposal, whether the sanctions are adequate, and such recommendations as considered necessary or appropriate to better achieve the purposes of the proposal.

Effective Date

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

I. Notice to Taxpayer Concerning Administrative Determination of Browsing; Annual Report (sec. 209 of the bill)

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.[79] If the offender is not so charged, present law does not require the IRS to give notice to the taxpayer, even though a determination has been made administratively 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 accountings of authorized disclosures of returns and return information[80] The IRS is not required to report on unauthorized disclosures or inspections of returns and return information.

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[79] Sec. 7431(e).

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

Description of Proposal

The IRS would be required to notify a taxpayer at the point the Treasury Inspector General for Tax Administration determines that a taxpayer's return or return information has been disclosed or inspected without authorization. The proposal would further require the IRS to provide information on unauthorized disclosures or inspections of return and return information in its public annual report to the Joint Committee on Taxation.

Effective Date

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

J. Disclosure of Taxpayer Identity for Tax Refund Purposes (sec. 210 of the bill)

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.[81] Section 6103(m) allows the IRS to give the press taxpayer identity information for this purpose.[82]

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 would allow the IRS to use any means of "mass communication," including

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

> The Secretary may disclose taxpayer identify 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.

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

the Internet, to notify the taxpayer of an undelivered refund.

Effective Date

The proposal would be effective upon date of enactment.

TITLE III.--OTHER REQUIREMENTS

A. Clarification of Definition of Church Tax Inquiry (sec. 301 of the bill)

Present Law

Under present law, the IRS may begin a church tax inquiry only if the IRS regional commissioner (or a higher official) reasonably believes, on the basis of 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.[83] 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 request 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 would clarify 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 would clarify that the IRS would 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).

B. Extension of Declaratory Judgment Procedures to Non-501(c)(3) Tax-exempt Organizations and Failure of IRS to Act on Determinations Treated as Exhaustion of Remedies (sec. 302 of the bill)

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),

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[83] Sec. 7611.

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 would extend declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) determinations. Jurisdiction over controversies involving such determinations would be limited to the United States Tax Court.[84]

In addition, the proposal would modify the present-law declaratory judgment procedures to provide that an organization would be deemed to have exhausted its administrative remedies under the declaratory judgment procedures at the expiration of (1) 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, or (2) in the case of a failure by any office of the IRS (other than the office responsible for initial determinations with respect to the organization (the "initial office"), 180 days after any request with respect to such determination was made by the initial office if the organization has taken, in a timely manner, all reasonable steps to secure such determination.

Effective Date

The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations would be effective for pleadings with respect to determinations made after the date of enactment. The proposal to modify the time that an organization is deemed to have exhausted it administrative remedies would be effective on the date of enactment.

C. Employee Misconduct Report to Include Summary of Complaints by Category (sec. 303 of the bill)

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 would modify the semi-annual reporting requirement for the Treasury

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[84] This limitation currently applies to declaratory judgments relating to tax qualification for certain employee retirement plans (sec. 7476).

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 would be effective for reporting periods ending after the date of enactment.

D. Increase Joint Committee on Taxation Refund Review Threshold to $2 Million (sec. 304 of the bill)

Present Law

No refund or credit in excess of $1,000,000 of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation (sec. 6405). A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues.

Description of Proposal

The proposal would increase the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from $1,000,000 to $2,000,000. The staff of the Joint Committee on Taxation would continue to exercise its existing statutory authority to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues, and the IRS is expected to cooperate fully in this expanded program.

Effective Date

The proposal would be effective on the date of enactment, except that the higher threshold would not apply to a refund or credit with respect to which a report was made before the date of enactment.

E. Annual Report on Awards of Costs and Certain Fees in Administrative and Court Proceedings (sec. 305 of the bill)

Present Law

The Code requires that the IRS pay a taxpayer's reasonable administrative and litigation expenses under specified circumstances.[85] Among other requirements, the IRS is not required to pay these amounts if the IRS can demonstrate that its position was substantially justified.

[85] Sec. 7430.

Accordingly, the fact that the IRS paid these expenses may be an indication that its position was not substantially justified, as well as an indication that the IRS may be inappropriately pursuing an issue. The lack of published statistics and analytical information hinders the Congress and taxpayers from assessing the extent to which the IRS may be inappropriately pursuing an issue and from pursuing potential remedies to alleviate this problem.

Description of Proposal

The proposal would require 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 total amount paid out. TIGTA would also be required to publish an analysis of the administrative issues that gave rise to the necessity of making these payments and how these issues were resolved by the IRS. Both of these actions will 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 would be required for fiscal year 2000. The reports must be published no later than December 31 following the close of the fiscal year.

F. Annual Report on Abatements of Penalties (sec. 306 of the bill)

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. Both the manner in which penalties are imposed and the manner in which they are abated can present issues for consideration with respect to the uniformity of penalty administration.

The system of penalty administration has a number of goals and it is not always possible to reconcile them completely. One goal is uniformity of application of penalties (both in their original imposition and in their abatement) for similarly situated taxpayers. Another goal is to reflect the individual circumstances surrounding the failure for which the taxpayer is being penalized. Another goal is to provide rapid resolution for taxpayers of disputes with the IRS, including disputes over penalties. Accomplishing this goal entails giving “front line” IRS employees the authority to resolve disputes (within certain parameters) on their own authority.

One challenge in providing proper tax administration is balancing all of these goals so that one does not predominate at the expense of the others. For example, one theoretical way to maximize uniformity might be to centralize the administration of penalties in one office. This would, however, make it more difficult for taxpayers to reach a rapid resolution of their disputes with the IRS, because it could be more difficult for taxpayers to deal with a centralized penalty administration structure than with the current locally-based structure. It could also present administrative difficulties, such as divorcing decisions concerning penalties from decisions concerning the underlying liability, when in reality the two may be inextricably interconnected. On the other hand, the maximization of the goal of reflecting individual circumstances could adversely affect both uniformity and the rapid resolution of disputes. Similarly, maximizing the rapid resolution of disputes could adversely affect both uniformity and individualization.

Balancing these goals necessarily means that any one of them will not be maximized. Accordingly, a balanced approach means that some compromises will have to be made to permit the most appropriate balancing of these goals.

Description of Proposal

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

Effective Date

The first annual report would be required for fiscal year 2000. The reports must be provided to the Congress no later than six months following the close of the fiscal year.

G. Better Means of Communicating with Taxpayers (sec. 307 of the bill)

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. Many of the difficulties taxpayers encounter in the course of communicating with the IRS are inherent to mail communications: documents missing in the mail, difficulties in forwarding documents, maintaining updated address records, etc.

Description of Proposal

The proposal would require 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.