DESCRIPTION OF SENATE FINANCE COMMITTEE CHAIRMAN'S MARK RELATING TO REFORM AND RESTRUCTURING OF THE INTERNAL REVENUE SERVICE

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

on March 31, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

On November 5, 1997, the House passed H.R. 2676, the "Internal Revenue Service Restructuring and Reform Act of 1997." Titles I-V of H.R. 2676, as passed by the House, were as reported by the House Committee on Ways and Means on October 31, 1997 (H. Rept. 105-364, Part I) and contain provisions relating to executive branch governance of the IRS, electronic filing, Taxpayer Bill of Rights 3, Congressional oversight, and a revenue offset. Title VI of H.R. 2676, as passed by the House, contains the "Tax Technical Corrections Act of 1997,"[1] which was added as a House amendment to H.R. 2676.

The Senate Finance Committee has scheduled a markup relating to Internal Revenue Service ("IRS") reform and restructuring proposals, including taxpayer protections, on March 31, 1998.

This document[2] prepared by the staff of the Joint Committee on Taxation, contains a description of the Finance Committee Chairman's mark relating to Executive Branch Governance of the IRS (Part I), Electronic Filing (Part II), Taxpayer Bill of Rights 3 (Part III), Congressional Accountability for the IRS (Part IV), and Revenue Offsets (Part V).[3]

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[1] The "Tax Technical Corrections Act of 1997" was reported by the House Committee on Ways and Means in H.R. 2645 (H.Rept. 105-356, October 29, 1997).

[2] This document may be cited as follows: Joint Committee on Taxation, *Description of Senate Finance Committee Chairman's Mark Relating to Reform and Restructuring of the Internal Revenue Service* (JCX-17-98), March 26, 1998.

[3] A separate document provides a description of the Chairman's mark relating to tax technical correction provisions.

I. EXECUTIVE BRANCH GOVERNANCE

A. IRS Restructuring and Creation of IRS Oversight Board

1. IRS restructuring and mission

Present Law

IRS organizational plan

Under Reorganization Plan No. 1 of 1952, the Internal Revenue Service ("IRS") is organized into a 3-tier geographic structure with a multi-functional National Office, Regional Offices, and District Offices. A number of IRS reorganizations have occurred since then, but no major changes have been made to the basic 3-tier structure. Presently, as a result of a 1995 reorganization, there is a Regional Commissioner, a Regional Counsel and a Regional Director of Appeals for each of the following 4 regions: (1) the Northeast Region (headquartered in New York); (2) the Southeast Region (Atlanta); (3) the Midstates Region (Dallas); and (4) the Western Region (San Francisco). There are 33 District Offices, 10 service centers, and 3 computing centers.

IRS mission statement

The IRS mission statement provides that:

> The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the qualify of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity and fairness.

Description of Proposal

The IRS Commissioner would be directed to restructure the IRS by eliminating the present-law 3-tier structure and replace it with an organizational structure that features operating units serving particular groups of taxpayers with similar needs. The legality of IRS actions would not be affected pending further appropriate statutory changes relating to such a reorganization (e.g., eliminating statutory references to obsolete positions).

The IRS would be directed to revise its mission statement to provide greater emphasis on serving the needs of taxpayers.

Effective Date

The proposal would be effective on the date of enactment.

2. Establishment and duties of IRS Oversight Board

Present Law

Under present law, the administration and enforcement of the internal revenue laws are performed by or under the supervision of the Secretary of the Treasury.[4]

Federal employees are subject to rules designed to prevent conflicts of interest or the appearance of conflicts of interest. The rules applicable to any particular employee depend in part on whether the employee is a regular, full-time Federal Government employee or a special government employee, the length of service of the employee and the pay grade of the employee. A "special government employee" is, in general, an officer or employee of the executive or legislative branch of the U.S. government who is appointed or employed to perform (with or without compensation) for not to exceed 130 days during any period of 365 days, temporary duties either on a full-time or intermittent basis. Violations of the ethical conduct rules are generally punishable by imprisonment for up to 1 year (5 years in the case of wilful conduct), a civil fine, or both. The amount of the fine with respect to each violation cannot exceed the greater of $50,000 or the compensation received by the employee in connection with the prohibited conduct.

Under the ethical conduct rules, all Federal Government employees (including special government employees) are precluded from participating in a matter in which the employee (or a related party) has a financial interest. In addition, special government employees cannot represent a party (whether or not for compensation) or receive compensation for representation of a party[5] in relation to a matter (1) in which the employee has at any time participated personally and substantially, or (2) which is pending in the department or agency of the Government in which the special government employee is serving. In the case of a special government employee who has served in a department no more than 60 days during the immediately preceding 365 days, item (2) does not apply. Thus, for example, such an individual can receive compensation for representational services with respect to matters pending in the department in which the employee serves, as long as it is not a matter involving parties in which the employee personally and substantially participated.[6]

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[4] Code sec. 7801(a).

[5] The prohibition on receipt of compensation applies regardless of whether the services are performed by the Federal employee or someone else. For example, it would preclude a Federal employee from sharing in the compensation received by a partner of the Federal employee with respect to covered matters.

[6] More stringent rules apply to regular Federal Government employees. Such employees cannot receive compensation for representational services (whether rendered by the individual or another) in matters in which the United States is a party or has a direct and substantial interest before any department, agency or court. In addition, a Federal Government employee cannot act

The conflict of interest rules also impose restrictions on what a Federal Government employee can do after leaving the Government. Under these rules, senior level officers and employees (including special government employees) cannot represent anyone other than the United States before the individual's former department or agency for 1 year after terminating employment. Whether an employee is a senior level officer or employee is determined by pay grade. The one-year post employment restriction does not apply to special government employees who serve less than 60 days during the 365-day period before termination of employment.[7]

Federal employees with pay grades above certain levels are required to file annually public financial disclosures.

Description of Proposal

Duties, responsibilities, and powers of the IRS Oversight Board

The proposal would provide for the establishment within the Treasury Department of the Internal Revenue Service Oversight Board (referred to as the "Board"). The general responsibilities of the Board would be to oversee the IRS in the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws. As part of its oversight responsibilities, the Board would have the responsibility to ensure that the organization and operation of the IRS allows it to carry out its mission. The Board would sunset September 30, 2008.

The Board would have the following specific responsibilities: (1) to review and approve strategic plans of the IRS, including the establishment of mission and objectives (and standards of performance) and annual and long-range strategic plans; (2) to review the operational functions of the IRS, including plans for modernization of the tax administration system,

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as agent or attorney (whether or not for compensation) for prosecuting any claim against the United States or act as agent or attorney for anyone before any department, agency, or court in which the United States is a party or has a direct and substantial interest.

[7] All Federal Government employees are permanently prohibited from representing a party other than the government in connection with a particular matter (1) in which the government is a party or has an interest, (2) in which the individual participated personally and substantially, and (3) which involved a specific party or parties at the time of their participation. In addition, Federal employees cannot, within 2 years after terminating employment represent, any person other than the United States in connection with any matter (1) in which the government is a party or has a direct and substantial interest, (2) which the person knows or reasonably should know was actually pending under his or her official responsibility within one year before termination of employment, and (3) which involved a specific party or parties at the time it was pending

outsourcing or managed competition, and training and education; (3) to provide for the review of the Commissioner's selection, evaluation and compensation of senior managers and executives; (4) to review and approve the Commissioner's plans for major reorganization of the IRS (other than the reorganization provided for under the proposal); and (5) to review operations of the IRS in order to ensure the proper treatment of taxpayers. In addition, the Board would review and approve the budget request of the IRS prepared by the Commissioner, submit such budget request to the Secretary, and ensure that the budget request supports the annual and long-range strategic plans of the IRS. The Secretary would be required to submit the budget request approved by the Board to the President, who would be required to submit such request, without revision, to the Congress together with the President's annual budget request for the IRS. The proposal would not affect the ability of the President to include, in addition, his own budget request relating to the IRS. As discussed below, the Board would also recommend candidates for the positions of IRS Commissioner and Taxpayer Advocate, and could recommend removal of either.

It is intended that the Board would reach a formal decision on all matters subject to its review. With respect to those matters over which the Board would have approval authority, the Board's decisions would be determinative. The Board shall consult with representatives of organizations that represent a substantial number of IRS employees on matters that impact IRS employees before it concludes its review and/or approval process.

The Board would have no responsibilities or authority with respect to the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws. In addition, the Board would have no authority (1) to intervene in specific taxpayer cases, including compliance activities involving specific taxpayers such as criminal investigations, examinations, and collection activities, (2) to engage in specific procurement activities of the IRS (e.g., selecting vendors or awarding contracts), or (3) to intervene in specific individual personnel matters.

Board members would have limited access to confidential tax return and return information under section 6103. This limited access would permit the Board to receive such information (i.e., information that has not been redacted to remove confidential tax return and return information) from the Treasury Inspector General in connection with reports made to the Board or as provided by the Commissioner. The Board members would be subject to the anti-browsing rules applicable to IRS employees under present law.[8]

In exercising its duties, it is expected that the members of the Board shall maintain appropriate confidentiality, e.g., regarding enforcement matters.

[8] The proposal would not affect the Commissioner's access to section 6103 information or the application of the anti-browsing rules to the Commissioner.

The Board would be required to report each year to the President and the Congress regarding the conduct of its responsibilities. In addition, the Board would be required to report to the Ways and Means and Finance Committees upon a determination that problems identified by the Board are not being adequately addressed by the IRS.

Composition of the Board

The Board would be composed of 7 members. Six of the members would be so-called "private-life" members who are not otherwise Federal officers or employees. These private-life members would be appointed by the President, with the advice and consent of the Senate. The other member would be the Commissioner of the IRS.

The private-life members of the Board would be appointed based solely on their expertise in the following areas: management of large service organizations; customer service; the Federal tax laws, including administration and compliance; information technology; organization development; and the needs and concerns of taxpayers. In the aggregate, the private-life members of the Board should collectively bring to bear expertise in these enumerated areas. The private-life members would be appointed to the Board without regard to political affiliation.

The private-life members could be removed at the will of the President. The IRS Commissioner would be removed from the Board upon his or her termination of employment as the Commissioner.

Compensation of Board members

The private-life members of the Board would be compensated at a rate of $30,000 per year, except that the Chair would be compensated at a rate of $50,000 a year. The IRS Commissioner would receive no compensation for his or her services as a Board member. The members of the Board would be entitled to travel expenses in connection with attending Board meetings.

Ethical conduct rules

Under the proposal, the private-life Board members would be subject to the public financial disclosure rules applicable to Federal government employees above certain pay grades.

The ethical conduct rules applicable to private-life Board members would depend on whether such members are determined to be "special government employees" under the present-law rules. It is expected that they generally will be. In that case, they will be subject, at a minimum, to the ethical conduct rules applicable to special government employees. In addition, during their term as a Board member, a private-life Board member could not represent any party (whether or not for compensation) before the Board, the IRS, or with respect to any tax-related matter before the Treasury department . Thus, for example, the day after appointment to the Board, the Board member could not meet with representatives of the IRS or Treasury on behalf of a client or the Board member's corporate employer with respect to proposed tax regulations. On the other hand, the Board member could, for example, represent clients before the U.S. Customs Service. The special rules applicable to private-life Board members would not preclude the Board member from sharing in compensation from representation of clients by another person (e.g., a partner of the Board member) before the IRS. In addition, private-life Board members would be subject to the 1-year post employment restriction applicable to individuals above certain pay grades (whether or not the members are special government employees under the present-law rules).

If the Board members are determined not to be special government employees under the present-law rules, then they would be subject to the ethical conduct rules relating to regular Federal Government employees.

Administrative matters

Term of appointments

The 6 private-life Board members would be appointed for 5-year terms. The private-life members could serve no more than two 5-year terms. Each 5-year term would begin upon appointment. Board member terms would be staggered, as a result of a special rule providing that some private-life members first appointed to the Board would serve terms of less than 5 years. Under this rule, 2 members first appointed would serve for 2 years, 2 for 4 years, and 2 for 5 years.

Chair of the Board

The members of the Board would elect a Chair from the private-life members for a 2-year term. Except as otherwise provided by a majority of the Board, the authority of the Chair would include the authority to hire staff, call meetings, establish subcommittees, establish the agenda for meetings, and develop rules for the conduct of business.

Meetings

The Board would be required to meet on a regular basis (as determined necessary by the Chair), but no less frequently than quarterly. The Board would be able to meet privately, and would not be subject to public disclosure laws.

A quorum of 4 members would be required in order for the Board to conduct business. Actions of the Board could be taken by a majority vote of those members present and voting.

Staffing

The Board would be authorized to have its own permanent staff. In addition, the Board would have such staff as detailed by the Commissioner or from another Federal agency at the request of the Chair of the Board. The Chair could procure temporary and intermittent services under section 3109(b) of title 5 of the U.S. Code.

Claims against Board members

The private-life members of the Board would have no personal liability under Federal law with respect to any claim arising out of or resulting form an act or omission by the Board member within the scope of service as a Board member. The proposal would not limit personal liability for criminal acts or omissions, wilful or malicious conduct, acts or omissions fro private gain, or any other act or omission outside the scope of service as a Board member. The proposal would not affect any other immunities and protections that may be available under applicable law or any other right or remedy against the United States under applicable law, or limit or alter the immunities that are available under applicable law for Federal officers and employees.

Effective Date

The provisions of the proposal relating to the Board would be effective on the date of enactment. The President would be directed to submit nominations for Board members to the Senate within 6 months of the date of enactment. The legality of the actions of the IRS would not be affected pending appointment of the Board.

B. Appointment and Duties of IRS Commissioner and Chief Counsel

1. IRS Commissioner

Present Law

Within the Department of the Treasury is a Commissioner of Internal Revenue, who is appointed by the President, with the advice and consent of the Senate. The Commissioner has such duties and powers as may be prescribed by the Secretary.[9] The Secretary has delegated to the Commissioner the administration and enforcement of the internal revenue laws.[10] The Commissioner generally does not have authority with respect to tax policy matters.[11]

The Secretary is authorized to employ such persons as the Secretary deems appropriate for the administration and enforcement of the internal revenue laws and to assign posts of duty.

Description of Proposal

As under present law, the Commissioner would be appointed by the President, with the advice and consent of the Senate, and could be removed at will by the President. The Commissioner would be appointed to a 5-year term, beginning with the date of appointment. The Board would recommend candidates to the President for the position of Commissioner; however, the President would not be required to nominate for Commissioner a candidate recommended by the Board. The Board would have the authority to recommend the removal of the Commissioner.

The Commissioner would have such duties and powers as prescribed by the Secretary. Unless otherwise specified by the Secretary, such duties and powers would include the power to administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party and to recommend to the President a candidate for Chief Counsel (and recommend the removal of the Chief Counsel). The Commissioner would exercise the IRS' final authority concerning the substantive interpretation of the tax laws. If the Secretary determines not to delegate such specified duties to the Commissioner, such determination would not take effect until 30 days after the Secretary notifies the House Committees on Ways and Means, Government Reform and

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[9] Code sec. 7802(a).

[10] Treasury Order 150-10 (April 22, 1982).

[11] See, e.g., Treasury Order 111-2 (March 16, 1981), which delegates to the Assistant Secretary (Tax Policy) the exclusive authority to make the final determination of the Treasury Department's position with respect to issues of tax policy arising in connection with regulations, published Revenue Rulings and Revenue Procedures, and tax return forms and to determine the time, form and manner for the public communication of such position.

Oversight, and Appropriations, the Senate Committees on Finance, Government Affairs, and Appropriations, and the Joint Committee on Taxation. The Commissioner would consult with the Board on all matters within the Board's authority (other than the recommendation of candidates for Commissioner and the recommendation to remove the Commissioner).

Unless otherwise specified by the Secretary, the Commissioner would be authorized to employ such persons as the Commissioner deems proper for the administration and enforcement of the internal revenue laws and would be required to issue all necessary directions, instructions, orders, and rules applicable to such persons. Unless otherwise provided by the Secretary, the Commissioner would determine and designate the posts of duty.

The Commissioner would be compensated as under present law.

Effective Date

The provisions of the proposal relating to the Commissioner would be effective on the date of enactment. The provision relating to the 5-year term of office would apply to the Commissioner in office on the date of enactment. The 5-year term would run from the date of appointment.

2. IRS Chief Counsel

Present Law

The President is authorized to appoint, by and with the consent of the Senate, an Assistant General Counsel of the Treasury, who is the Chief Counsel of the IRS. The Chief Counsel is the chief law officer for the IRS and has such duties as may be prescribed by the Secretary. The Secretary has delegated authority over the Chief Counsel to the Treasury General Counsel. The Chief Counsel does not report to the Commissioner, but to the Treasury General Counsel. As delegated by the Treasury General Counsel, the duties of the Chief Counsel include: (1) to be the legal advisor to the Commissioner and his or her officers and employees; (2) to furnish such legal opinions as may be required in the preparation and review of rulings and memoranda of technical advice and the performance of other duties delegated to the Chief Counsel; (3) to prepare, review, or assist in the preparation of proposed legislation, treaties, regulations and Executive Orders relating to laws affecting the IRS; (4) to represent the Commissioner in cases before the Tax Court; (5) to determine what civil actions should be brought in the courts under the laws affecting the IRS and to prepare recommendations to the Department of Justice for the commencement of such actions and to authorize or sanction commencement of such actions.

Description of Proposal

As under present law, the Chief Counsel would be appointed by the President, with the advice and consent of the Senate. The Chief Counsel would not be an Assistant General Counsel of the Treasury and would report directly to the Commissioner.

The Chief Counsel would have such duties and powers as prescribed by the Secretary. Unless otherwise specified by the Secretary, these duties would include the duties currently delegated to the Chief Counsel. If the Secretary determined not to delegate such specified duties to the Chief Counsel, such determination would be subject to the same notice requirement applicable to changes in the delegation of authority with respect to the Commissioner.

Effective Date

The proposal would be effective 90 days after the date of enactment.

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

Present Law

Prior to 1974, no one specific office in the IRS had primary responsibility for employee plans and tax-exempt organizations. As part of the reforms contained in the Employee Retirement Income Security Act of 1974 ("ERISA"), Congress statutorily created the Office of Employee Plans and Exempt Organizations ("EP/EO") under the direction of an Assistant Commissioner.[12] EP/EO was created to oversee deferred compensation plans governed by sections 401-414 of the Code and organizations exempt from tax under Code section 501(a).

In general, EP/EO was established in response to concern about the level of IRS resources devoted to oversight of employee plans and exempt organizations. The legislative history of Code section 7802(b) states that, with respect to administration of laws relating to employee plans and exempt organizations, "the natural tendency is for the Service to emphasize those areas that produce revenue rather than those areas primarily concerned with maintaining the integrity and carrying out the purposes of exemption provisions."[13]

To provide funding for the new EP/EO office, ERISA authorized the appropriation of an amount equal to the sum of the section 4940 excise tax on investment income of private foundations (assuming a rate of 2 percent) as would have been collected during the second preceding year plus the greater of the same amount or $30 million.[14] However, amounts raised by the section 4940 excise tax have never been dedicated to the administration of EP/EO, but are transferred instead to general revenues. Thus, the level of EP/EO funding, like that of the rest of the IRS, is dependent on annual Congressional appropriations to the Treasury Department.

Description of Proposal

Because the funding formula for EP/EO set forth in section 7802(b)(2) would, if utilized, result in an unstable level of funding that may bear little or no relation to the amount of financial resources actually required by the EP/EO division, the proposal would repeal the funding mechanism. Thus, the appropriate level of funding for EP/EO would, consistent with current practice, be subject to annual Congressional appropriations, as are other functions within the IRS. In this regard, however, given the magnitude of the sectors EP/EO is charged with regulating, as well as the unique nature of its mandate, an adequately funded EP/EO is extremely

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[12] Code section 7802(b).

[13] S. Rept. 93-383, 108 (1973). See also H. Rept. 93-807, 104 (1974).

[14] Code section 7802(b)(2).

important to the efficient and fair administration of the Federal tax system.[15] Accordingly, financial resources for EP/EO should not be constrained on the basis that EP/EO is a "non-core" IRS function; rather, EP/EO, like all functions of the IRS, should be funded so as to promote the efficient and fair administration of the Federal tax system.

Effective Date

The proposal would be effective on the date of enactment.

[15] To facilitate the reorganization of the IRS, the proposal would permit the elimination of the statutory requirement contained in section 7802(b) that there be an "Office of Employee Plans and Exempt Organizations" under the supervision and direction of an Assistant Commissioner. In the event such statutory authority is eliminated, however, it is intended that a comparable structure be created administratively to ensure that adequate resources within the IRS are devoted to oversight of the tax-exempt sector.

D. Taxpayer Advocate

Present Law

In 1996, the Taxpayer Bill of Rights 2 ("TBOR 2") established the position of Taxpayer Advocate, which replaced the position of Taxpayer Ombudsman, created in 1979 by the IRS. The Taxpayer Advocate is appointed by and reports directly to the IRS Commissioner.

TBOR 2 also created the Office of the Taxpayer Advocate. The functions of the office are (1) to assist taxpayers in resolving problems with the IRS, (2) to identify areas in which taxpayers have problems in dealings with the IRS, (3) to propose changes (to the extent possible) in the administrative practices of the IRS that will mitigate those problems, and (4) to identify potential legislative changes that may mitigate those problems.

Under present law, the direct point of contact for taxpayers seeking taxpayer assistance orders is a problem resolution officer appointed by a District Director or a Regional Director of Appeals. The Taxpayer Advocate has designated the authority to issue taxpayer assistance orders to the local and regional problem resolution officers.

Description of Proposal

The proposal would provide for the selection of a National Taxpayer Advocate by the Secretary of the Treasury Department from one of three candidates recommended by the IRS Oversight Board. The candidates should be individuals with a background in customer service as well as tax law.

As under present law, the National Taxpayer Advocate would be required to annually report to the tax-writing committees of Congress on various matters. In addition to the matters required to be addressed under current law, the National Taxpayer Advocate would be required to identify areas of the tax law that impose significant compliance burdens on taxpayers and identify the 10 most litigated issues for each category of taxpayer, and any other information that the National Taxpayer Advocate may deem advisable.

The National Taxpayer Advocate would be required to appoint local Taxpayer Advocates, at least one for each State, who would report directly to the National Taxpayer Advocate. In contrast to the present law problem resolution system, the local Taxpayer Advocates would be employees of the Taxpayer Advocate's Office, independent from the IRS examination, collection, and appeals functions. The National Taxpayer Advocate would monitor the coverage and geographical allocation of the local Taxpayer Advocates and would have the responsibility to evaluate and take personnel actions (including dismissal) with respect to any local Taxpayer Advocate or any employee in the Office of the National Taxpayer Advocate. In conjunction with the Commissioner, the National Taxpayer Advocate would be required to develop career paths for local Taxpayer Advocates. In addition, the National Taxpayer Advocate would be required to develop guidance on the criteria for referral of taxpayer inquiries to local Taxpayer Advocates and ensure that access to local Taxpayer Advocates would be readily available to the public.

Each local Taxpayer Advocate would report directly to the National Taxpayer Advocate and would operate separately from the local IRS office (including having its own telephone and fax lines and a separate listing in the telephone book) and would so inform the taxpayer at the initial meeting. The local Taxpayer Advocate would not be required to disclose to the IRS any contact with or information provided by the taxpayer.

The IRS would be required to publish the taxpayer's right to contact the local Taxpayer Advocate on the statutory notice of deficiency.

The National Taxpayer Advocate cannot have been employed by the IRS during the two years preceding the appointment and would be required to agree not to accept any employment with the IRS for at least 5 years after ceasing to be the National Taxpayer Advocate.

Effective Date

The proposal would be effective on the date of enactment.

E. Prohibition on Executive Branch Influence Over Taxpayer Audits

Present Law

There is no explicit prohibition in the Code on high-level Executive Branch influence over taxpayer audits and collection activity.

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

Description of Proposal

The proposal would make it unlawful for a specified person to request that any officer or employee of the IRS conduct or terminate an audit or otherwise investigate or terminate the investigation of any particular taxpayer with respect to the tax liability of that taxpayer. The prohibition would apply to the President, the Vice President, and employees of the executive offices of either the President or Vice President, as well as any individual (except the Attorney General) serving in a position specified in section 5312 of Title 5 of the United States Code (generally Cabinet-level positions). The prohibition would apply to both direct requests and requests made through an intermediary.

Any request made in violation of this rule must be reported by the IRS employee to whom the request was made to the Treasury Inspector General. The Inspector would have the authority to investigate such violations and to refer any violations to the Department of Justice for possible prosecution, as appropriate. Anyone convicted of violating this provision will be punished by imprisonment of not more than 5 years or a fine not exceeding $5,000 (or both).

Three exceptions to the general prohibition apply. First, the prohibition does not apply to a request made to a specified person by a taxpayer or a taxpayer's representative that is forwarded by the specified person to the IRS. This exception is intended to cover two types of situations. The first situation is where a taxpayer (or a taxpayer's representative) writes to a specified person seeking assistance in resolving a difficulty with the IRS. This exception permits the specified person who receives such a request to forward it to the IRS for resolution without violating the general prohibition.

The second situation that this first exception is intended to cover is an audit or investigation by the IRS of a Presidential nominee. Under present law (sec. 6103(c)), nominees for Presidentially appointed positions consent to disclosure of their tax returns and return information so that background checks may be conducted. Sometimes an audit or other investigation is initiated as part of that background check. The Committee anticipates that any such audit or investigation that is part of such a background check will be encompassed within this first exception.

The second exception to the general prohibition applies to requests for disclosure of returns or return information under section 6103 if the request is made in accordance with the requirements of section 6103.

The third exception to the general prohibition applies to requests made by the Secretary of the Treasury as a consequence of the implementation of a change in tax policy.

Any audit or investigation covered by an exception to this rule would have to be justified in writing.

Effective Date

The proposal would apply to violations occurring after the date of enactment.

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

Present Law

Treasury Inspector General

The Treasury Office of Inspector General ("Treasury IG") was established in 1988 and charged with conducting independent audits, investigations and review to help the Department of Treasury accomplish its mission, improve its programs and operations, promote economy, efficiency and effectiveness, and prevent and detect fraud and abuse. The Treasury IG derives its statutory authority under the Inspector General Act of 1978, as amended ("IG Act of 1978").

Appointment and qualifications

The IG Act of 1978 provides that the Treasury IG is selected by the President, with the advice and consent of the Senate, without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations. The Treasury IG can be removed from office by the President. The President must communicate the reasons for such removal to both Houses of Congress.

Duties and responsibilities

The Treasury IG generally is authorized to conduct, supervise and coordinate internal audits and investigations relating to the programs and operations of the Treasury, including all of its bureaus and offices.[16] Special rules apply, however, with respect to the Treasury IG's jurisdiction over ATF, Customs, the Secret Service and the IRS--the four so-called "law enforcement bureaus." Upon its establishment, the Treasury IG assumed the internal audit functions previously performed by the offices of internal affairs of ATF, Customs and the Secret Service. Although the Treasury IG was granted oversight responsibility for the internal investigations performed by the Office of Internal Affairs of ATF, the Office of Internal Affairs of Customs, and the Office of Inspections of the Secret Service, the internal investigation or inspection functions of these offices remained with the respective bureaus. The Treasury IG did not assume responsibility for either the internal audit or inspection functions of the IRS Office of the Chief Inspector. However, it was directed to oversee the internal audits and internal investigations performed by the IRS Office of the Chief Inspector.

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[16] The Treasury Department organization includes the Departmental offices as well as the Bureau of Alcohol, Tobacco and Firearms ("ATF"), the Office of the Comptroller of the Currency ("OCC"), the U.S. Customs Service ("Customs"), the Bureau of Engraving and Printing, the Federal Law Enforcement Training Center, the Financial Management Service, the U.S. Mint, the Bureau of the Public Debt, the U.S. Secret Service ("Secret Service"), the Office of Thrift Supervision, and the IRS.

The Commissioner and the Treasury IG have entered into two Memorandums of Understanding ("MOUs")[17] to clarify the respective roles of the IRS Office of the Chief Inspector and the Treasury IG in two primary areas: (1) the investigation of allegations of wrongdoing by IRS executives and employees in situations where the independence of the Office of the Chief Inspector could be questioned, and (2) oversight by the Treasury IG of the IRS Office of the Chief Inspector.[18] Pursuant to the 1990 MOU, the Commissioner agreed to transfer 21 FTEs and $1.9 million from the IRS appropriation to the Treasury IG appropriation to be used for the following purposes: (1) oversight of the operations of the Office of the Chief Inspector; (2) conduct of special reviews of IRS operations; (3) investigation of allegations of misconduct concerning the Commissioner, the Senior Deputy Commissioner, and employees of the IRS Office of the Chief Inspector; and (4) investigation of allegations of misconduct where the independence of the IRS Office of the Chief Inspector might be questioned. With respect to item (4), the Commissioner and Treasury IG agreed that all allegations of misconduct involving IRS executives and managers (Grade 15 and above), as well as any other allegation involving "significant or notorious" matters were to be referred to the Treasury IG, and that investigations arising out of such referrals generally would be conducted by the Treasury IG.

In general, under the IG Act of 1978, Inspectors General are instructed to report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law. However, in matters involving criminal violations of the Internal Revenue Code, the Treasury IG may report to the Attorney General only those offenses under section 7214 of the Code (unlawful acts of revenue officers or agents, including extortion, bribery and fraud) without the consent of the Commissioner.

Authority

The Treasury IG reports to and is under the general supervision of the Secretary of Treasury, acting through the Deputy Secretary. In general, the Secretary cannot prevent or prohibit the Treasury IG from initiating, carrying out, or completing any audit or investigation or from issuing any subpoena during the course of any audit or investigation.

However, section 8D of the IG Act of 1978 grants the Secretary authority to prohibit audits or investigations by the Treasury IG under certain circumstances. In particular, the Treasury IG is under the authority, direction, and control of the Secretary with respect to audits

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[17] The first MOU was entered into in 1990 and the second in 1994.

[18] Treasury Directive 40-01 (September 21, 1992) reiterates that the Treasury IG is responsible for investigating alleged misconduct on the part of IRS employees at the grade 15 level and above, all employees of the Office of the Chief Inspector. In addition, Treasury Directive 40-01 states that the Treasury IG is responsible for investigating alleged misconduct on the part of Office of Chief Counsel employees (excluding employees of the National Director, Office of Appeals).

or investigations, or the issuance of subpoenas, which require access to sensitive information concerning: (1) ongoing criminal investigations or proceedings; (2) undercover operations; (3) the identity of confidential sources, including protected witnesses; (4) deliberations and decisions on policy matters, including documented information used as a basis for making policy decisions, the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior; (5) intelligence or counterintelligence matters; (6) other matters the disclosure of which would constitute a serious threat to national security or to the protection of certain persons. With respect to audits, investigations or subpoenas that require access to the above-listed information, the Secretary may prohibit the Treasury IG from carrying out such audit, investigation or subpoena if the Secretary determines that such prohibition is necessary to prevent the disclosure of such information or to prevent significant impairment to the national interests of the United States. The Secretary must provide written notice of such a prohibition to the Treasury IG, who must, in turn, transmit a copy of such notice to the Committees on Governmental Affairs and Finance of the Senate and the Committees on Government Reform and Oversight and Ways and Means of the House.

<u>Access to taxpayer returns and return information</u>

The Treasury IG has access to taxpayer returns and return information under section 6103(h)(1) of the Code. However, such access is subject to certain special requirements, including the requirement that the Treasury IG notify the IRS Office of the Chief Inspector (or the Deputy Commissioner in certain circumstances) of its intent to access returns and return information.

<u>Reporting requirements</u>

Under the IG Act of 1978, the Treasury IG reports to the Congress semiannually on its activities. Reports from the Treasury IG are transmitted to the Committees on Government Reform and Oversight and Ways and Means of the House and the Committees on Governmental Affairs and Finance of the Senate.

<u>Resources</u>

For fiscal year 1997, the Treasury IG had 296 FTEs and total funding of $29.7 million. 174 FTEs were assigned to the Treasury IG's audit function and 61 were assigned to the investigative function. The remaining FTEs were divided among the following functions: evaluations, legal, program, technology and administrative support. Of the total Treasury IG FTEs, approximately 23 were used for IRS oversight activities in fiscal year 1997.

<u>IRS Office of Chief Inspector</u>

The IRS Office of the Chief Inspector (also known as the "Inspection Service") was established on October 1, 1951, in response to publicity revealing widespread corruption in the IRS. At the time of its creation, President Harry S. Truman stated, "A strong, vigorous inspection service will be established and will be made completely independent of the rest of the Internal Revenue Service."

Appointment of the Chief Inspector

In 1952, the Office of the Assistant Commissioner (Inspection) was established. The office was redesignated as the Office of the Chief Inspector on March 25, 1990. The Chief Inspector is appointed by the Commissioner. In this regard, pursuant to Treasury Director 40-01, the Commissioner must consult with the Treasury IG before selecting candidates for the position of Chief Inspector (and all other senior executive service ("SES") positions in the Office of the Chief Inspector). The Commissioner must also consult with the Treasury IG regarding annual performance appraisals for the Chief Inspector and other SES officials.

The Office of the Chief Inspector consists of a National Office and the offices of the Regional Inspectors. The offices of the Regional Inspectors are located in the same cities and have the same geographic boundaries as the offices of the four IRS Regional Commissioners. The Regional Inspectors report directly to the Chief Inspector.

Duties and responsibilities

The Office of the Chief Inspector generally is responsible for carrying out internal audits and investigations that: (1) promote the economic, efficient, and effective administration of the nation's tax laws; (2) detect and deter fraud and abuse in IRS programs and operations; and (3) protect the IRS against external attempts to corrupt or threaten its employees. The Chief Inspector reports directly to the Commissioner and Deputy Commissioner of the IRS.

The IRS Inspection Service is divided into three functions: Internal Security, Internal Audit, and Integrity Investigations and Activities. Internal Security's responsibilities include criminal investigations (employee conduct, bribery, assault and threat and investigations of non-IRS employees for acts such as impersonation, theft, enrolled agent misconduct, disclosure, and anti-domestic terrorism) investigative support activities (including forensic lab, computer investigative support, and maintenance of law enforcement equipment), protection, and background investigations.

Internal Audit is responsible for providing IRS management with independent reviews and appraisals of all IRS activities and operations. In addition, Internal Audit makes recommendations to improve the efficiency and effectiveness of programs and to assist IRS officials in carrying out their program and operational responsibilities. In this regard, Internal Audit generally conducts performance reviews (program audits, system development audits, internal control audits) and financial reviews (financial statement audits and financial related reviews).

Integrity Investigations and Activities are joint internal audit and internal security operations undertaken as a proactive effort to detect and deter fraud and abuse within the IRS.

Integrity Investigations and Activities also includes the UNAX Central Case Development Center. The Center was developed in October, 1997, in response to the Taxpayer Browsing Protection Act of 1997. Its purpose is to detect unauthorized accesses to IRS computer systems by IRS employees and to refer such instances to Internal Security investigators for further investigation.

Authority

The Chief Inspector derives specific and general authority from delegation by the Commissioner and Deputy Commissioner. In addition, under section 7608(b) of the Code, the Chief Inspector is authorized to perform certain functions in connection with the duty of enforcing any of the criminal provisions of the Code, including executing and serving search and arrest warrants, serving subpoenas and summonses, making arrests without warrant, carrying firearms, and seizing property subject to forfeiture under the Code.

Access to taxpayer returns and return information

The Office of the Chief Inspector has full access to taxpayer returns and return information.

Reporting requirements

The Office of the Chief Inspector reports facts developed through its internal audit and internal security activities to IRS management officials, who are charged with the responsibility of reviewing IRS activities. The results of the Chief Inspector's internal audit and internal security activities also are reported to the Treasury IG and are included in the Treasury IG's semiannual reports to Congress.

Internal audit reports prepared by the Office of the Chief Inspector are provided monthly to the Government Accounting Office, as well as to the House and Senate Appropriations Committees. In addition, a monthly list of Internal Audit reports is provided to Treasury and the Office of Management and Budget. Reports of Investigation regarding criminal conduct are referred to the Department of Justice for prosecution.

Resources

The IRS Office of the Chief Inspector had 1,202 FTEs for 1997 and total funding of $100.1 million. Of these FTEs, approximately 442 performed Internal Audit functions, 511 performed Internal Security functions, and 94 performed Integrity Investigations and Activities. Of the remaining FTES, approximately 95 were dedicated to information technology functions and 60 staffed the offices of the Chief Inspector and the Regional Inspectors.

Description of Proposal

In general

Under the proposal, the IRS Office of the Chief Inspector would be eliminated, and all of its powers and responsibilities would be transferred to the Treasury IG. The Treasury IG would have its existing powers and responsibilities under the IG Act of 1978, as well as certain additional powers and responsibilities. The Treasury IG would be under the supervision of the Secretary of Treasury, with certain additional reporting to the Board and the Congress.

Appointment and qualifications of Treasury IG

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

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

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

Duties and responsibilities of Treasury IG

The Treasury IG would have all of its present law duties and responsibilities. In addition, the Treasury IG would assume all of the duties and responsibilities currently delegated to the IRS Office of the Chief Inspector.

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

The present law restrictions on the Treasury IG's ability to refer matters to the Department of Justice would be removed. Thus, the Treasury IG would be required to report to the Attorney General whenever the Treasury IG has reasonable grounds to believe that there has been a violation of Federal criminal law.

Authority of Treasury IG

As under present law, the Treasury IG would report to and be under the general supervision of the Secretary of Treasury. In general, the Secretary cannot prevent or prohibit the Treasury IG from initiating, carrying out, or completing any audit or investigation or from issuing any subpoena during the course of any audit or investigation. The present-law authority of the Secretary to prohibit audits, investigations or the issuance of subpoenas by the Treasury IG under certain circumstances (described above) would not extend to audits, investigations or subpoenas relating to the IRS.

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

In carrying out the duties and responsibilities described above, the Treasury IG would have its present-law authority. In addition, the Treasury IG would have the authority granted to the IRS Office of the Chief Inspector under present-law Code section 7608, including the right to execute and serve search and arrest warrants, to serve subpoenas and summonses, to make arrests without warrant, to carry firearms, and to seize property subject to forfeiture under the Code.

Resources

To ensure that the Treasury IG has sufficient resources to carry out his or her duties and responsibilities under the proposal, approximately 900 FTEs currently assigned to IRS Office of the Chief Inspector would be transferred to the Treasury IG. Such FTEs would include all of the FTEs performing investigative functions in the Office of the Chief Inspector Internal Security and Integrity Investigations and Activities. The proposal would require that at least 900 of Treasury IG FTEs (but not necessarily the same employees who are transferred to the Treasury IG) should be dedicated to IRS matters on an ongoing basis.

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

Access to taxpayer returns and return information

Taxpayer returns and return information would be available for inspection by the Treasury IG pursuant to section 6103(h)(1). Thus, the present law written notice requirements contained in section 8D(e) of the IG Act of 1978 would be repealed, and the Treasury IG would have the same access to taxpayer returns and return information as does the Chief Inspector under present law.

Reporting requirements

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

Effective Date

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

G. IRS Personnel Flexibilities

Present Law

The IRS is subject to the personnel rules and procedures set forth in title 5, United States Code. Under these rules, IRS employees generally are classified under the General Schedule or the Senior Executive Service.

Description of Proposal

In general

The proposal would amend title 5 of the United States Code to provide certain personnel flexibilities to the IRS. In general, the proposal would provide that the IRS exercise the personnel flexibilities consistently with existing rules relating to merit system principles, prohibited personnel practices, and preference eligibles. In those cases where the exercise of personnel flexibilities would affect members of the employees' union, such employees' would not be subject to the exercise of any flexibility unless there is a written agreement between the IRS and the employees' union. Negotiation impasses between the IRS and the employees' union could be appealed to the Federal Services Impasse Panel.

Senior management and technical positions

Streamlined critical pay authority

The proposal would provide a streamlined process for the Secretary of the Treasury, or his delegate, to fix the compensation of, and appoint up to 40 individuals to, designated critical technical and professional positions, provided that: (1) the positions require expertise of an extremely high level in a technical or professional field and are critical to the IRS; (2) exercise of the authority is necessary to recruit or retain an individual exceptionally well qualified for the position; (3) designation of such positions is approved by the Secretary; (4) the terms of such appointments are limited to no more than four years; (5) appointees to such positions are not IRS employees immediately prior to such appointment; and (6) the total annual compensation for any position (including performance bonuses) does not exceed the rate of pay of the Vice President (currently $175,400).

These appointments would not be subject to the otherwise applicable requirements under title 5. All such appointments would be excluded from the collective bargaining unit and the appointments would not be subject to approval of the Office of Management and Budget ("OMB") or the Office of Personnel Management ("OPM").

The streamlined authority would be limited to a period of 10 years.

Critical pay authority

The proposal would provide OMB with approval authority to increase the pay level for certain critical pay positions requested by the Secretary. These critical pay positions would be critical, technical and professional positions other than those designated under the streamlined authority described above. Under the proposal, OMB would be authorized to approve requests for critical position pay up to the highest total compensation that does not exceed the rate of pay of the Vice President (currently $175,400).

Recruitment, retention and relocation incentives

The proposal would provide the Secretary with authority to provide recruitment, retention and relocation incentives for certain executive and hard-to-fill positions. The authority would be for a period of 10 years and would be subject to OPM approval.

Career-reserve Senior Executive Service ("SES") positions

The proposal would broaden the definition of a "career reserved position" in the SES to include a limited emergency appointee or a limited term appointee who, immediately upon entering the career-reserved position, was serving under a career or a career-conditional appointment outside the SES or whose limited emergency or limited term appointment is approved in advance by OPM. The number of appointments to these SES positions would be limited to up to 10 percent of the total number of SES positions available to the IRS. These positions would be limited to a 3 year term, with the option of extending the term for 2 more 3-year terms.

Variable compensation

The proposal would provide the Secretary with the authority to provide performance bonus awards to IRS senior executives of up to one-third of the individual's annual compensation. The bonus award would be based on meeting preset performance goals established by the IRS. An individual's total annual compensation, including the bonus, could not exceed the rate of pay of the Vice President. The authority would not be subject to OPM approval.

It is anticipated that the bonuses would not be available to more than 25 IRS senior executives annually.

General workforce

Performance management system

The proposal would require the Secretary to establish a performance management system which would maintain individual accountability by: (1) establishing one or more retention standards for each employee related to the work of the employee and expressed in terms of performance; (2) providing for periodic performance evaluations to determine whether employees are meeting the applicable retention standard; and (3) taking appropriate action, in accordance with applicable laws, with respect to any employee whose performance does not meet established retention standards.

The proposal would require that the performance management system provide for: (1) establishing goals or objectives for individual, group or organizational performance and taxpayer service surveys; (2) communicating such goals or objectives to employees; and (3) using such goals or objectives to make performance distinctions among employees or groups of employees.

It is intended that in no event would performance measures be used which rank employees or groups of employees based on enforcement results, establish dollar goals for assessments or collections, or otherwise undermine fair treatment of taxpayers.

Awards

The proposal would provide the Secretary the authority to establish an awards program for IRS employees. The program would be designed to provide incentives for and recognition of individual, group and organizational achievements. The Secretary would have the authority to provide awards of up to $25,000 without OPM approval.

These awards would be based on performance under the new performance management system, and in no case would awards be made (or performance measured) based on tax enforcement results.

Workforce classification and pay banding

The proposal would provide the Secretary with authority to establish one or more broad band pay systems covering all or any portion of the IRS workforce, subject to OPM criteria. At a minimum, the OPM criteria would have to: (1) ensure that the pay band system maintain the concept of equal pay for substantially equal work; (2) establish the minimum and maximum number of grades that may be combined into pay bands; (3) establish requirements for setting minimum and maximum rates of pay in a pay band; (4) establish requirements for adjusting the pay of an employee within a pay band; (5) establish requirements for setting the pay of a supervisory employee in a pay band; and (6) establish requirements and methodologies for setting the pay of an employee upon conversion to a broad-banded system, initial appointment, change of position or type of appointment and movement between a broad-banded system and another pay system.

Workforce staffing

The proposal would provide the IRS with flexibility in filling certain permanent appointments with qualified temporary employees. A qualified temporary employee would be defined as a temporary employee of the IRS with at least two years of continuous service, who has met all applicable retention standards and who meets the minimum qualifications for the vacant position.

The proposal would authorize the IRS to establish category rating systems for evaluating job applicants, under which qualified candidates are divided into two or more quality categories on the basis of relative degrees of merit, rather than assigned individual numerical ratings. Managers would be authorized to select any candidate from the highest quality category, and would not be limited to the three highest ranked candidates. In administering these category rating systems, the IRS generally would be required to list preference eligibles ahead of other individuals within each quality category. The appointing authority, however, could select any candidate from the highest quality category, as long as existing requirements relating to passing over preference eligibles were satisfied.

The proposal would authorize the IRS to establish probation periods for IRS employees of up to 3 years, when it is determined that a shorter period would not be sufficient for an employee to demonstrate proficiency in a position.

Voluntary separation incentives

The proposal would provide authority to the IRS to use Voluntary Separation Incentive Pay ("buyouts") through December 31, 2002, without regard to the requirement regarding reductions in full-time equivalents.

Demonstration projects

The proposal would provide the IRS with authority to conduct one or more demonstration projects through a streamlined process. The authority would enable the IRS to test new approaches to human resource management. The proposal would provide authority to the Secretary and OPM to waive the termination of a demonstration project, thereby making it permanent. At least 90 days prior to waiving the termination date OPM would be required to publish a notice of such intent in the Federal Register and inform the appropriate Committees (including the House Ways and Means Committee, the House Government Reform and Oversight Committee, the Senate Finance Committee and the Senate Governmental Affairs Committee) of both Houses of Congress in writing.

Performance measures

The IRS would be directed to develop employee performance measures that favor taxpayer service and prohibit awarding merit pay or bonuses that are based on quotas, goals, or statistics.

Violations for which IRS employees may be terminated

The proposal would require the IRS to terminate an employee for certain proven violations committed by the employee in connection with the performance of official duties. The violations include: (1) failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets; (2) perjury (e.g., false testimony in a taxpayer's case, failure to provide truthful information in the course of a criminal investigation, or false information in a deposition or affidavit); (3) falsifying or destroying documents concerning a particular taxpayer to cover-up employee mistakes; (4) assault or battery on a taxpayer or other IRS employee; (5) violation of the civil rights of a taxpayer or other IRS employee; (6) violations of the Internal Revenue Code, Treasury Regulations, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating or harassing a taxpayer or other IRS employee; and (7) wilful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry.

The proposal would provide non-delegable authority to the Commissioner to not terminate an employee for one of the enumerated violations if the Commissioner determines that there are factors that mitigate against terminating the employee. Whether a proposed termination should be reviewed for mitigation factors or whether such factors exist would be in the sole discretion of the Commissioner. The Treasury IG would be required to track employee terminations and terminations that would have occurred had the Commissioner not determined that there were mitigating factors and include such information in the IG's annual report.

IRS employee training program

The proposal would require the IRS to place a high priority on employee training and to adequately fund employee training programs. The proposal would also require the IRS to provide to the Congressional tax writing committees a comprehensive multi-year plan to: (1) ensure adequate customer service training; (2) review the organizational design of customer service; (3) implement a performance development system; and (4) provide, in fiscal year 1999, sixteen to twenty-four hours of conflict management training for collection employees.

Effective Date

The proposal, other than the IRS employee training program proposal, would be effective on the date of enactment. The proposal relating to the IRS employee training program would be effective 90 days after the date of enactment.

II. ELECTRONIC FILING

A. Electronic Filing of Tax and Information Returns

Present Law

Treasury Regulations section 1.6012-5 provides that the Commissioner may authorize a taxpayer to elect to file a composite return in lieu of a paper return. An electronically filed return is a composite return consisting of electronically transmitted data and certain paper documents that cannot be electronically transmitted.

The IRS periodically publishes a list of the forms and schedules that may be electronically transmitted, as well as a list of forms, schedules, and other information that cannot be electronically filed.

During the 1997 tax filing season, the IRS received approximately 20 million individual income tax returns electronically.

Description of Proposal

The proposal would state that the policy of Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least 80 percent of all tax returns in electronic form by the year 2007. The proposal would require the Secretary of the Treasury to establish a strategic plan to increase taxpayer use of electronic filing. The proposal would require all returns prepared in electronic form but filed in paper form to be filed electronically, to the extent feasible, by the year 2002.

The proposal would require the Secretary to create an electronic commerce advisory group and to report annually to the tax-writing committees on the IRS's progress in implementing its plan to meet the goal of 80 percent electronic filing by 2007.

Effective Date

The proposal would be effective on the date of enactment.

B. Time for Filing Certain Information Returns

Present Law

Information such as the amount of dividends, partnership distributions, and interest paid during the calendar year must be supplied to taxpayers by the payors by January 31 of the following calendar year. The payors must file an information return with the IRS with the information by February 28 of the year following the calendar year for which the return must be filed. Under present law, the due date for filing information returns with the IRS is the same whether such returns are filed on paper, on magnetic media, or electronically. Most information returns are filed on magnetic media (such as computer tapes), which are physically shipped to the IRS.

Description of Proposal

The proposal would provide an incentive to filers of information returns to use electronic filing by extending the due date for filing such returns from February 28 (under present law) to March 31 of the year following the calendar year to which the return relates.

The proposal would also require the Treasury to issue a study evaluating the merits and disadvantages, if any, of extending the deadline for providing taxpayers with copies of information returns from January 31 to February 15 (Forms W-2 would still be required to be furnished by January 31).

Effective Date

The extension of the due date for filing returns would apply to information returns required to be filed after December 31, 1999. The Treasury study would be due on December 31, 1998.

C. Paperless Electronic Filing

Present Law

Code section 6061 requires that tax forms be signed as required by the Secretary. The IRS will not accept an electronically filed return unless it has received a Form 8453 providing signature information on the filer. Form 8453 is a paper form that must be received by the IRS before any electronically filed return is complete. Form 8453 provides signature information to the IRS.

A return generally is considered timely filed when it is received by the IRS on or before the due date of the return. If the requirements of Code section 7502 are met, timely mailing is treated as timely filing. If the return is mailed by registered mail, the dated registration statement is prima facie evidence of delivery. As an electronically filed return is not mailed, section 7502 does not apply.

The IRS periodically publishes a list of the forms and schedules that may be electronically transmitted, as well as a list of forms, schedules, and other information that cannot be electronically filed.

Description of Proposal

The proposal would require the Secretary to develop procedures that would eliminate the need to file a paper form relating to signature information. Until the procedures are in place, the proposal would authorize the Secretary to provide for alternative methods of signing all returns, declarations, statements, or other documents. A document filed using an alternative method of signature would be treated identically, for both civil and criminal purposes, as a signature on a paper form.

The proposal also would provide rules for determining when electronic returns are deemed filed, and for authorization for return preparers to communicate with the IRS on matters included on electronically filed returns.

The proposal would require the Secretary to establish procedures, to the extent practicable, to receive all forms electronically for taxable periods beginning after December 31, 1998.

Effective Date

The proposal would be effective on the date of enactment.

D. Return-Free Tax System

Present Law

Under present law, taxpayers generally are required to calculate their own tax liabilities and submit returns showing their calculations.

Description of Proposal

The proposal would require the Secretary or his delegate to study the feasibility of, and develop procedures for, the implementation of a return-free tax system for appropriate individuals for taxable years beginning after 2007. The Secretary would be required annually to report to the tax-writing committees on the progress of the development of such system. The Secretary would be required to make the first report on the development of the return-free filing system to the tax-writing committees on June 30, 1999.

Effective Date

The proposal would be effective on the date of enactment.

E. Access to Account Information

Present Law

Taxpayers who file their returns electronically cannot review their accounts electronically.

Description of Proposal

The proposal would require the Secretary to develop procedures not later than December 31, 2006, under which a taxpayer filing returns electronically could review the taxpayer's own account electronically, but only if all necessary privacy safeguards are in place by that date. The Secretary would be required to issue an interim progress report to the tax-writing committees by December 31, 2003.

Effective Date

The proposal would be effective on the date of enactment.

III. TAXPAYER BILL OF RIGHTS 3

A. Burden of Proof

Present Law

Under present law, a rebuttable presumption exists that the Commissioner's determination of tax liability is correct.[19] "This presumption in favor of the Commissioner is a procedural device that requires the plaintiff to go forward with prima facie evidence to support a finding contrary to the Commissioner's determination. Once this procedural burden is satisfied, the taxpayer must still carry the ultimate burden of proof or persuasion on the merits. Thus, the plaintiff not only has the burden of proof of establishing that the Commissioner's determination was incorrect, but also of establishing the merit of its claims by a preponderance of the evidence".[20]

The general rebuttable presumption that the Commissioner's determination of tax liability is correct is a fundamental element of the structure of the Internal Revenue Code. Although this presumption is judicially based, rather than legislatively based, there is considerable evidence that the presumption has been repeatedly considered and approved by the Congress. This is the case because the Internal Revenue Code contains a number of civil provisions that explicitly place the burden of proof on the Commissioner in specifically designated circumstances. The Congress would have enacted these provisions only if it recognized and approved of the general rule of presumptive correctness of the Commissioner's determination. A list of these civil provisions follows.

(1) Fraud.--Any proceeding involving the issue of whether the taxpayer has been guilty of fraud with intent to evade tax (secs. 7454(a) and 7422(e)).

(2) Required reasonable verification of information returns.--In any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information returned filed with the Secretary by a third party and the taxpayer has fully cooperated with the Secretary (including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer as reasonably requested by the Secretary), the Secretary has the burden of producing reasonable and probative information concerning such deficiency in addition to such information return (sec. 6201(d)).

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[19] Welch v. Helvering, 290 U.S. 111, 115 (1933).

[20] Danville Plywood Corp. v. U.S. , U.S. Cl. Ct., 63 AFTR 2d 89-1036, 1043 (1989); citations omitted.

(3) Foundation managers.--Any proceeding involving the issue of whether a foundation manager has knowingly participated in prohibited transactions (sec. 7454(b)).

(4) Transferee liability.--Any proceeding in the Tax Court to show that a petitioner is liable as a transferee of property of a taxpayer (sec. 6902(a)).

(5) Review of jeopardy levy or assessment procedures.--Any proceeding to review the reasonableness of a jeopardy levy or jeopardy assessment (sec. 7429(g)(1)).

(6) Property transferred in connection with performance of services.--In the case of property subject to a restriction that by its terms will never lapse and that allows the transferee to sell only at a price determined under a formula, the price is deemed to be fair market value unless established to the contrary by the Secretary (sec. 83(d)(1)).

(7) Illegal bribes, kickbacks, and other payments.--As to whether a payment constitutes an illegal bribe, illegal kickback, or other illegal payment (sec. 162(c)(1) and (2)).

(8) Golden parachute payments.--As to whether a payment is a parachute payment on account of a violation of any generally enforced securities laws or regulations (sec. 280G(b)(2)(B)).

(9) Unreasonable accumulation of earnings and profits.--In any Tax Court proceeding as to whether earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, provided that the Commissioner has not fulfilled specified procedural requirements (sec. 534).

(10) Expatriation.--As to whether it is reasonable to believe that an individual's loss of citizenship would result in a substantial reduction in the individual's income taxes or transfer taxes (secs. 877(e), 2107(e), 2501(a)(4)).

(11) Public inspection of written determinations.--In any proceeding seeking additional disclosure of information (sec. 6110(f)(4)(A)).

(12) Penalties for promoting abusive tax shelters, aiding and abetting the understatement of tax liability, and filing a frivolous income return.--As to whether the person is liable for the penalty (sec. 6703(a)).

(13) Income tax return preparers' penalty.--As to whether a preparer has willfully attempted to understate tax liability (sec. 7427).

(14) Status as employees.--As to whether individuals are employees for purposes of employment taxes (pursuant to the safe harbor provisions of section 530 of the Revenue Act of 1978).[21]

Description of Proposal

The proposal would provide that the Secretary shall have the burden of proof in any court proceeding with respect to a factual issue if the taxpayer introduces credible evidence with respect to the factual issue relevant to ascertaining the taxpayer's income tax liability. Four conditions apply. First, the taxpayer must comply with the requirements of the Internal Revenue Code and the regulations issued thereunder to substantiate any item (as under present law). Second, the taxpayer must maintain records (as under present law). Third, the taxpayer must cooperate with reasonable requests by the Secretary for meetings, interviews, witnesses, information, and documents. Fourth, taxpayers other than individuals must meet the net worth limitations that apply for awarding attorney's fees (accordingly, no net worth limitation would be applicable to individuals).

The proposal would also provide that in any instance in which the Secretary uses arbitrary statistics to determine the taxpayer's income (such as average income for the area in which the taxpayer lives), the burden of proof would be on the Secretary with respect to that issue.

Finally, the proposal would provide that, in any court proceeding, the Secretary must initially come forward with evidence that it is appropriate to apply a particular penalty to the taxpayer before the court can impose the penalty.

Effective Date

The proposal would apply to court proceedings arising in connection with examinations commencing after the date of enactment.

[21] Public Law 95-600 (November 6, 1978), as amended by section 1122 of the Small Business Job Protection Act of 1996 (Public Law 104-188; August 20, 1996).

B. Proceedings by Taxpayers

1. Expansion of authority to award costs and certain fees

Present Law

Any person who substantially prevails in any action by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding. Reasonable administrative costs are defined as (1) any administrative fees or similar charges imposed by the IRS and (2) expenses, costs and fees related to attorneys, expert witnesses, and studies or analyses necessary for preparation of the case, to the extent that such costs are incurred before earlier of the date of the notice of decision by IRS Appeals or the notice of deficiency (sec. 7430(c)(2)). Net worth limitations apply.

Reasonable litigation costs include reasonable fees paid or incurred for the services of attorneys, except that the attorney's fees will not be reimbursed at a rate in excess of $110 per hour (indexed for inflation) unless the court determines that a special factor, such as the limited availability of qualified attorneys for the proceeding, justifies a higher rate.

Rule 68 of the Federal Rules of Civil Procedure (FRCP) provides a procedure under which a party may recover costs if the party's offer for judgment was rejected and the subsequent court judgment was less favorable to the opposing party than the offer. The offering party's costs are limited to the costs (excluding attorney's fees) incurred after the offer was made. The FRCP generally apply to tax litigation in the district courts and the United States Court of Federal Claims.

Description of Proposal

The proposal would:

(1) move the point in time after which reasonable administrative costs can be awarded to the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals is sent;

(2) permit awards of reasonable attorney's fees at the prevailing rate for the locality;

(3) permit the award of attorney's fees to specified persons who represent for no more than a nominal fee a taxpayer who is a prevailing party;

(4) provide that in determining whether the position of the United States was substantially justified, the court shall take into account whether the United States has lost in other courts of appeal on substantially similar issues; and

(5) provide that if a taxpayer makes an offer after the taxpayer has a right to administrative review in the IRS Office of Appeals, the IRS rejects the offer, and later the IRS obtains a judgment against the taxpayer in an amount that is equal to or less than the taxpayer's offer for the amount of the tax liability (excluding interest), reasonable costs and attorney's fees from the date of the offer would be awarded.

The above awards would apply subject to the same net worth limitations as under present law.

Effective Date

The proposal would apply to eligible costs and services incurred more than 180 days after the date of enactment.

2. Civil damages with respect to unauthorized collection actions

Present Law

A taxpayer may sue the United States for up to $1 million of civil damages caused by an officer or employee of the IRS who recklessly or intentionally disregards provisions of the Internal Revenue Code or Treasury regulations in connection with the collection of Federal tax with respect to the taxpayer.

Description of Proposal

The proposal would permit (1) up to $100,000 in civil damages caused by an officer or employee of the IRS who negligently disregards provisions of the Internal Revenue Code or Treasury regulations in connection with the collection of Federal tax with respect to the taxpayer, and (2) up to $1 million in civil damages caused by an officer or employee of the IRS who willfully disregards provisions of the Bankruptcy Code relating to automatic stays or discharges. The proposal would also provide that persons other than the taxpayer may sue for civil damages for unauthorized collection actions. No person would be entitled to seek civil damages in a court of law without first exhausting administrative remedies.

Effective Date

The proposal would be effective with respect to actions of officers or employees of the IRS occurring after the date of enactment.

3. Increase in size of cases permitted on small case calendar

Present Law

Taxpayers may choose to contest many tax disputes in the Tax Court. Special small case procedures apply to disputes involving $10,000 or less, if the taxpayer chooses to utilize these procedures (and the Tax Court concurs) (sec. 7463). The IRS cannot require the taxpayer to use the small case procedures. The Tax Court generally concurs with the taxpayer's request to use the small case procedures, unless it decides that the case involves a tax policy issue that should be heard under the normal procedures. After the case has commenced, the Tax Court may order that the small case procedures should be discontinued only if (1) there is reason to believe that the amount in controversy will exceed $10,000 or (2) justice would require the change in procedure.

Small tax cases are conducted as informally as possible. Neither briefs nor oral arguments are required and strict rules of evidence are not applied. Most taxpayers represent themselves in small tax cases, although they may be represented by anyone admitted to practice before the Tax Court. Decisions in a case conducted under small case procedures are neither precedent for future cases nor reviewable upon appeal by either the government or the taxpayer.

Description of Proposal

The proposal would increase the cap for small case treatment from $10,000 to $50,000.

Effective Date

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

4. Expand Tax Court jurisdiction to include determination of penalties under section 6672 of the Code

Present Law

In general, employers are required to withhold income taxes (sec. 3402) and social security taxes (sec. 3102) from their employee's wages. These withheld taxes constitute a trust in favor of the United States from the time that the employer deducts them from the employee's wages, and the employer is liable to the government for the payment of such taxes (sec. 7501(a)). Section 6672 subjects all persons considered responsible for the withholding and payment of taxes to a penalty equal to the amount of taxes due where the employer fails to turn over such funds to the government (the "responsible person" penalty, also known as the "100 percent" penalty). Generally, the determination of whether a person is a "responsible person" is a question of the person's status, duty, and authority in the context of the business which has failed to collect and pay over taxes required to be withheld. A responsible person penalty may also be imposed on a payroll lender (sec. 3505).

The Tax Court has no jurisdiction over the determination of the correctness of the assessment of the responsible person penalty. Accordingly, as the Tax Court is the only pre-payment forum for the determination of tax liability, the imposition of the responsible person penalty can only be challenged in a refund suit in the appropriate district court or the U.S. Court of Federal Claims after payment of such penalty. The responsible person penalty is a divisible tax. Thus, unlike a refund suit for income taxes, a responsible person need not pay the full amount of the assessment to invoke the jurisdiction of the district court or the U.S. Court of Federal Claims. Instead, the alleged responsible person may commence a refund suit after payment of the portion of the penalty attributable to one employee for one quarter.

Description of Proposal

The proposal would provide Tax Court jurisdiction over the "responsible person" penalty. Accordingly, the responsible person would not have to make a payment before challenging the imposition of the penalty.

Effective Date

The proposal would apply to penalties imposed after the date of enactment.

5. Actions for refund with respect to certain estates which have elected the installment method of payment

Present Law

In general, the U.S. Court of Federal Claims and the U.S. district courts have jurisdiction over suits for the refund of taxes, as long as full payment of the assessed tax liability has been made. Flora v. United States, 357 U.S. 63 (1958), aff'd on reh'g, 362 U.S. 145 (1960). Under Code section 6166, if certain conditions are met, the executor of a decedent's estate may elect to pay the estate tax attributable to certain closely-held businesses over a 14-year period. Courts have held that U.S. district courts and the U.S. Court of Federal Claims do not have jurisdiction over claims for refunds by taxpayers deferring estate tax payments pursuant to section 6166 unless the entire estate tax liability has been paid (i.e., timely payment of the installments due prior to the bringing of an action is not sufficient to invoke jurisdiction). See, e.g., Rocovich v. United States, 933 F.2d 991 (Fed. Cir. 1991), Abruzzo v. United States, 24 Ct. Cl. 668 (1991). Under section 7479, the U.S. Tax Court has limited authority to provide declaratory judgments regarding initial or continuing eligibility for deferral under section 6166.

Description of Proposal

The proposal would grant the U.S. Court of Federal Claims and the U.S. district courts jurisdiction to determine the correct amount of estate tax liability (or refund) in actions brought by taxpayers deferring estate tax payments under section 6166, as long certain conditions are met. In order to qualify for the proposal, (1) the estate must have made an election pursuant to section 6166, (2) the estate must have fully paid each installment of principal and/or interest due (and all non-6166-related estate taxes due) before the date the suit is filed, (3) no portion of the payments due may have been accelerated, (4) there must be no suits for declaratory judgment pursuant to section 7479 pending, and (5) there must be no outstanding deficiency notices against the estate. In general, to the extent that a taxpayer has previously litigated its estate tax liability, the taxpayer would not be able to take advantage of this procedure under principles of res judicata. Taxpayers would not be relieved of the liability to make any installment payments that become due during the pendency of the suit (i.e., failure to make such payments would subject the taxpayer to the existing provisions of section 6166(g)(3)).

The proposal further would provide that once a final judgment has been entered by a district court or the U.S. Court of Federal Claims, the IRS would not be permitted to collect any amount disallowed by the court, and any amounts paid by the taxpayer in excess of the amount the court finds to be currently due and payable would be refunded to the taxpayer, with interest. Lastly, the proposal would provide that the two-year statute of limitations for filing a refund action would be suspended during the pendency of any action brought by a taxpayer pursuant to section 7479 for a declaratory judgment as to an estate's eligibility for section 6166.

Effective Date

The proposal would be effective with respect to claims for refunds filed after the date of enactment.

6. Provide Tax Court jurisdiction to review an adverse IRS determination of a bond issue's tax-exempt status

Present Law

Interest earned on bonds or other debt obligations issued by States or political subdivisions of States generally is excluded from gross income (sec. 103(a)). However, interest on bonds issued by state and local governments may be taxed when the proceeds of the bond are not used for traditional governmental purposes (sec. 103(b)). Bonds used for nontraditional governmental purposes include private activity bonds, arbitrage bonds, and bonds that are not issued in registered form.

A prospective issuer of bonds, the interest on which is intended to be excludable from gross income under Code section 103(a), can request a ruling from the IRS that is subject to the declaratory judgment procedures of Code section 7478. Code section 7478 permits the prospective issuer to obtain a declaratory judgment with respect to the tax-exempt status of the bonds. The governmental issuer has no opportunity to litigate the tax-exempt status of the bonds once they are issued.

Description of Proposal

The proposal would extend the declaratory judgment procedures currently applicable to prospective bond issuers to issuers of outstanding bonds.

Effective Date

The proposal would apply to petitions filed after the date of enactment.

C. Relief for Innocent Spouses and Persons With Disabilities

1. Innocent spouse relief

Present Law

Relief from liability for tax, interest and penalties is available for "innocent spouses" in certain circumstances. To qualify for such relief, the innocent spouse must establish: (1) that a joint return was made; (2) that an understatement of tax, which exceeds the greater of $500 or a specified percentage of the innocent spouse's adjusted gross income for the preadjustment (most recent) year, is attributable to a grossly erroneous item of the other spouse; (3) that in signing the return, the innocent spouse did not know, and had no reason to know, that there was an understatement of tax; and (4) that taking into account all the facts and circumstances, it is inequitable to hold the innocent spouse liable for the deficiency in tax. The specified percentage of adjusted gross income is 10 percent if adjusted gross income is $20,000 or less. Otherwise, the specified percentage is 25 percent.

The proper forum for contesting the Secretary's denial of innocent spouse relief is determined by whether an underpayment is asserted or the taxpayer is seeking a refund of overpaid taxes. Accordingly, the Tax Court may not have jurisdiction to review all denials of innocent spouse relief.

Description of Proposal

In general

The proposal would modify the innocent spouse provisions to permit a spouse to elect to limit his or her liability for unpaid taxes on a joint return to the spouse's separate liability amount. In the case of a deficiency arising from a joint return, a spouse would be liable only to the extent items giving rise to the deficiency are allocable to the spouse.

The allocation of items would be accomplished without regard to community property laws. The election by a spouse to limit the spouse's liability to the separate liability amount could be made without regard to whether the spouse knew, or had a reason to know, that an item allocable to the other spouse was erroneous.

The separate liability election would apply to all unpaid taxes under subtitle A of the Internal Revenue Code, including the income tax and the self-employment tax. The election could be made at any time not later than 2 years after collection activities begin with respect to the electing spouse.

The Tax Court would have jurisdiction of disputes arising from the separate liability election. For example, a spouse who makes the separate liability election could petition the Tax Court to determine the limits on liability applicable under this proposal. The Tax Court would be authorized to establish rules that would allow the Secretary of the Treasury and the electing spouse to require, with adequate notice, the other spouse to become a party to any proceeding before the Tax Court. The Secretary of the Treasury would be required to develop a separate form with instructions for taxpayers to use in electing to limit liability.

Special rules would apply to prevent the inappropriate use of the proposal. First, relief under the proposal would not be available to the extent of the value of any property that was transferred to the electing spouse by the other spouse if the principal purpose of the transfer was avoidance of tax (including the avoidance of payment of tax). A rebuttable presumption would exist that a transfer is made for tax avoidance purposes if the transfer was made less than one year before the earlier of the date of assessment or notice of deficiency. The rebuttable presumption would not apply to transfers incident to a decree of divorce or separate maintenance. The presumption may be rebutted by a showing that the principal purpose of the transfer was not the avoidance of tax. Second, if the IRS demonstrates that assets were transferred between the spouses in a fraudulent scheme joined in by both spouses to reduce total liability, neither spouse would be eligible to make the election under the proposal (and consequently joint and several liability would apply to both spouses).

<u>**Allocations of items**</u>

Under the proposal, allocation of items of income and deduction would follow the present-law rules determining which spouse is responsible for reporting an item when the spouses use the married, filing separate filing status. The Secretary of the Treasury would be granted authority to prescribe regulations providing simplified methods of allocating items.

In general, apportionment of items of income would follow the source of the income. Wage income would be allocated to the spouse performing the job and receiving the Form W-2. Business and investment income (including any capital gains) would be allocated in the same proportion as the ownership of the business or investment that produces the income. Where ownership of the business or investment is held by both spouses as joint tenants, it is expected that any income would be allocated equally to each spouse, in the absence of clear and convincing evidence supporting a different allocation.

The allocation of business deductions would follow the ownership of the business. Personal deduction items are expected to be allocated equally between spouses, unless the evidence shows that a different allocation is appropriate. For example, a charitable contribution would normally be expected to be allocated equally to both spouses. However, if the wife were to provide evidence that the deduction relates to the contribution of an asset that was the sole property of the husband, any deficiency assessed because it is later determined that the value of the property was overstated would be allocated to the husband.

Items of loss or deduction would be allocated to a spouse only to the extent that income attributable to the spouse was offset by the deduction or loss. Any remainder would be allocated to the other spouse.

Income tax withholding would be allocated to the spouse from whose paycheck the tax was withheld. Estimated tax payments would be allocated to the spouse who made the payments; if the payments were made jointly, the payments would be allocated equally to each spouse, in the absence of evidence supporting a different allocation.

The allocation of items would be accomplished without regard to the community property laws of any jurisdiction.

If, considering all the facts and circumstances, it would be inequitable to hold a spouse responsible for any unpaid tax or deficiency attributable to an item, such item may be equitably reallocated to the other spouse. In cases where the IRS proves fraud, the IRS would have the power to distribute, apportion, or allocate any item between spouses.

Tax deficiencies

If a spouse elects separate liability, the liability for deficiencies determined after a joint return is filed would be allocated to the spouse whose item gives rise to the deficiency. For example, if a deficiency is assessed after an IRS audit that relates to the husband's income that he failed to report on the return, the entire deficiency would be allocated to the husband. If the wife elects separate liability, she would owe none of the deficiency. It would be the sole responsibility of the husband who failed to report the income.

If the deficiency relates to the items of both spouses, the separate liability for the deficiency will be allocated between the spouses in the same proportion as the items giving rise to the deficiency are allocated. If the deficiency arises as a result of an item of deduction or credit, the amount of the deficiency allocated to the spouse to whom the item of deduction or credit is allocated would be limited to the amount of income or tax allocated to such spouse that was offset by the deduction or credit. The remainder of the liability would be allocated to the other spouse to reflect the fact that income or tax allocated to that spouse was originally offset by a portion of the disallowed deduction or credit.

For example, a married couple files a joint return with wage income of $100,000 allocable to the wife and $30,000 of self employment income allocable to the husband. On examination, a $20,000 deduction allocated to the husband is disallowed, resulting in a deficiency of $5,600. Under the proposal, the liability is allocated in proportion to the items giving rise to the deficiency. Since the only item giving rise to the deficiency is allocable to the husband, and because he reported sufficient income to offset the item of deduction, the entire deficiency is allocated to the husband and the wife has no liability with regard to the deficiency, regardless of the ability of the IRS to collect the deficiency from the husband.

If the joint return had shown only $15,000 (instead of $30,000) of self employment income for the husband, the income offset limitation rule discussed above would apply. In this case, the disallowed $20,000 deduction entirely offsets the $15,000 of income of the husband, and $5,000 remains. This remaining $5,000 of the disallowed deduction offsets income of the wife. The liability for the deficiency is therefore divided in proportion to the amount of income offset for each spouse. In this example, the husband would be liable for 3/4 of the deficiency ($4,200), and the wife would be liable for the remaining 1/4 ($1,400).

Tax shown on a return, but not paid

The separate liability election would also be applicable in situations where the tax shown on a joint return is not paid with the return. In this case, the amount determined under the separate liability election would equal the electing spouse's liability on a separate return.

The separate liability election could not be used to create a refund, or to direct a refund to a particular spouse.

Effective Date

The proposal would apply to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date, but remaining unpaid as of such date.

2. Reports on collection activity against spouses

Present Law

If a tax deficiency with respect to a joint return is assessed, and the individuals filing the joint return are no longer married or no longer reside in the same household, the IRS must disclose in writing (in response to the written request of one of the individuals) whether the IRS has attempted to collect the deficiency from the other individual, the general nature of the collection activities, and the amount collected, if any.

Description of Proposal

The Treasury Inspector General would be required to certify annually that the IRS has implemented and is following procedures insuring that properly requested disclosures regarding amounts collected from former or estranged spouses are being provided.

Effective Date

The certification would be made annually, beginning in 1999.

3. Suspension of statute of limitations on filing refund claims during periods of disability

Present Law

In general, a taxpayer must file a refund claim within three years of the filing of the return or within two years of the payment of the tax, whichever period expires later (if no return is filed, the two-year limit applies) (sec. 6511(a)). A refund claim that is not filed within these time periods is rejected as untimely.

There is no explicit statutory rule providing for equitable tolling of the statute of limitations. The U.S. Supreme Court has held that Congress did not intend the equitable tolling doctrine to apply to the statutory limitations of section 6511 on the filing of tax refund claims.

Description of Proposal

The proposal would permit equitable tolling of the statute of limitations for refund claims of an individual taxpayer during any period of the individual's life in which he or she is unable to manage his or her financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months. Tolling would not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters.

Effective Date

The proposal would apply to periods of disability before, on, or after the date of enactment but would not apply to any claim for refund or credit which (without regard to the proposed provision) is barred by the statute of limitations as of January 1, 1998.

D. Provisions Relating to Interest and Penalties

1. Elimination of interest differential on overlapping periods of interest on income tax overpayments and underpayments

Present Law

A taxpayer that underpays its taxes is required to pay interest on the underpayment at a rate equal to the Federal short term interest rate plus three percentage points. A special "hot interest" rate equal to the Federal short term interest rate plus five percentage points applies in the case of certain large corporate underpayments.

A taxpayer that overpays its taxes receives interest on the overpayment at a rate equal to the Federal short term interest rate plus two percentage points. In the case of corporate overpayments in excess of $10,000, this is reduced to the Federal short term interest rate plus one-half of a percentage point.

If a taxpayer has an underpayment of tax from one year and an overpayment of tax from a different year that are outstanding at the same time, the IRS will typically offset the overpayment against the underpayment and apply the appropriate interest to the resulting net underpayment or overpayment. However, if either the underpayment or overpayment have been satisfied, the IRS will not typically offset the two amounts, but rather will assess or credit interest on the full underpayment or overpayment at the underpayment or overpayment rate. This has the effect of assessing the underpayment at the higher underpayment rate and crediting the overpayment at the lower overpayment rate. This results in the taxpayer being assessed a net interest charge, even if the amounts of the overpayment and underpayment are the same.

Description of Proposal

The proposal would establish a net interest rate of zero on equivalent amounts of overpayment and underpayment that exist for any period. Each overpayment and underpayment would be considered only once in determining whether equivalent amounts of overpayment and underpayment exist. The special rules that increase the interest rate paid on large corporate underpayments and decrease the interest rate received on corporate underpayments in excess of $10,000 would not prevent the application of the net zero rate. The proposal would apply to income taxes and self-employment taxes.

Effective Date

The proposal would apply to interest for calendar quarters beginning after the date of enactment.

2. Increase in overpayment rate payable to taxpayers other than corporations

Present Law

A taxpayer that underpays its taxes is required to pay interest on the underpayment at a rate equal to the Federal short-term interest rate (AFR) plus three percentage points. A taxpayer that overpays its taxes receives interest on the overpayment at a rate equal to the Federal short-term interest rate (AFR) plus two percentage points.

Description of Proposal

The proposal would provide that the overpayment interest rate will be AFR plus three percentage points, except that for corporations, the rate would remain at AFR plus two percentage points.

Effective Date

The proposal would apply to interest for calendar quarters beginning after the date of enactment.

3. Elimination of penalty on failure to pay during installment agreement

Present Law

Taxpayers who fail to pay their taxes are subject to a penalty of one-half percent per month on the unpaid amount, up to a maximum of 25 percent (sec. 6651(a)).) If the liability is shown on the return, the penalty begins to accrue on the date prescribed for payment of the tax (with regard to extensions (sec. 6651(a)(2)). If the liability should have been shown on the return but was not, the penalty generally begins to accrue after the date that is 21 days from the date of the IRS notice and demand for payment with respect to such liability (sec. 6651(a)(3)). Taxpayers who make installment payments pursuant to an agreement with the IRS (under sec. 6159) are also subject to this penalty (Treas. reg. sec. 301.6159-1(f) and sec. 6601(b)).

Description of Proposal

The proposal would provide that the penalty for failure to pay taxes is not imposed with respect to the tax liability of an individual for any month in which an installment payment agreement with the IRS (under sec. 6159) is in effect, provided that the individual filed the tax return in a timely manner (including extensions).

Effective Date

The proposal would be effective for installment agreement payments made after the date of enactment.

4. Mitigation of failure to deposit penalty

Present Law

Deposits of payroll taxes are allocated to the earliest period for which such a deposit is due. If a taxpayer misses or makes an insufficient deposit, later deposits will first be applied to satisfy the shortfall for the earlier period; the remainder is then applied to satisfy the obligation for the current period. If the depositor is not aware this is taking place, cascading penalties may result as payments that would otherwise be sufficient to satisfy current liabilities are applied to satisfy earlier shortfalls.

Code section 6656(c) authorizes the Secretary to waive the failure to make deposit penalty for inadvertent failures by first-time depositors of employment taxes.

Description of Proposal

The proposal would address the cascading penalty issue by allowing the taxpayer to designate the period to which each deposit is applied. The proposal would also extend the authorization to waive the failure to deposit penalty to the first deposit a taxpayer is required to make after the taxpayer is required to change the frequency of the taxpayer's deposits.

Effective Date

The proposal would apply to deposits made more than 180 days after the date of enactment.

5. Suspend accrual of interest and penalties if IRS fails to contact taxpayer within 1 year

Present Law

In general, interest and penalties accrue during periods for which taxes are unpaid without regard to whether the taxpayer is aware that there is tax due.

Description of Proposal

The proposal would suspend the accrual of penalties and interest after 1 year if the IRS has not sent the taxpayer a notice of deficiency within the year following the date which is the later of (1) the original due date of the return or (2) the date on which the individual taxpayer timely filed the return. The suspension only applies to taxpayers who file a timely tax return. The proposal would apply only to individuals and would not apply in the case of fraud or with respect to criminal penalties. Interest and penalties would resume 21 days after the IRS sends a notice and demand for payment to the taxpayer.

Effective Date

The proposal would be effective for taxable years ending after the date of enactment.

6. Notices of penalties must show computation

Present Law

Present law does not require the IRS to show how penalties are computed on the notice of penalty.

Description of Proposal

Each notice imposing a penalty would be required to include the name of the penalty, the code section requiring the penalty, and a computation of the penalty.

Effective Date

The proposal would apply to notices issued more than 180 days after the date of enactment.

7. Management approval required for certain penalties

Present Law

Under present law, penalties may be imposed on a taxpayer without management approval of the specific penalty imposed.

Description of Proposal

The proposal would require the specific approval of IRS management to assess all non-computer generated penalties unless excepted. The proposal would not apply to failure to file penalties, failure to pay penalties, or to penalties for failure to pay estimated tax.

Effective Date

The proposal would be effective for penalties assessed more than 180 days after date of enactment.

E. Protections for Taxpayers Subject to Audit or Collection

1. Due process in IRS collection actions

Present Law

Levy is the IRS's administrative authority to seize a taxpayer's property to pay the taxpayer's tax liability. The IRS is entitled to seize a taxpayer's property by levy if the Federal tax lien has attached to such property. The Federal tax lien arises automatically where (1) a tax assessment has been made; (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment; and (3) the taxpayer has failed to pay the amount assessed within ten days after the notice and demand.

The IRS may collect taxes by levy upon a taxpayer's property or rights to property (including accrued salary and wages) if the taxpayer neglects or refuses to pay the tax within 10 days after notice and demand that the tax be paid. Notice of the IRS's intent to collect taxes by levy must be given no less than 30 days (90 days in the case of a life insurance contract) before the day of the levy. The notice of levy must describe the property that will be the subject of the levy, the procedures that will be used, the administrative appeals available to the taxpayer and the procedures relating to such appeals, the alternatives available to the taxpayer that could prevent levy, and the procedures for redemption of property and release of liens.

The effect of a levy on salary or wages payable to or received by a taxpayer is continuous from the date the levy is first made until it is released.

If the IRS district director finds that the collection of any tax is in jeopardy, collection by levy may be made without regard to either notice period. A similar rule applies in the case of termination assessments.

Description of Proposal

The proposal would establish formal procedures designed to insure due process where the IRS seeks to collect taxes by levy (including by seizure). The due process procedures apply after the Federal tax lien attaches and notice of the Federal tax lien or the notice of the intent to levy has been given to the taxpayer.

As under present law, notice of the intent to levy must be given at least 30 days (90 days in the case of a life insurance contract) before property can be seized or salary and wages garnished. During the 30-day (90-day) notice period, the taxpayer may demand a hearing to take place before an appeals officer who has had no prior involvement in the taxpayer's case. If the taxpayer demands a hearing, the proposed collection action may not proceed until the hearing has concluded and the appeals officer has issued his or her determination.

During the hearing, the IRS would be required to verify that all statutory, regulatory, and administrative requirements for the proposed collection action have been met. IRS verifications would be expected to include (but not be limited to) showings that:

(1) the revenue officer recommending the collection action has verified the taxpayer's liability;

(2) the estimated expenses of levy and sale will not exceed the value of the property to be seized;

(3) a consent or writ of entry has been obtained if the property to be seized is on private property;

(4) the revenue officer has determined that there is sufficient equity in the property to be seized to yield net proceeds from sale to apply to the unpaid tax liabilities; and

(5) with respect to the seizure of the assets of a going business, the revenue officer recommending the collection action has thoroughly considered the facts of the case, including the availability of alternative collection methods, before recommending the collection action.

The taxpayer (or affected third party) would be allowed to raise any relevant issue at the hearing. Issues eligible to be raised are expected to include (but not be limited to):

(1) challenges to the underlying liability as to existence or amount;

(2) appropriate spousal defenses;

(3) challenges to the appropriateness of collection actions; and

(4) collection alternatives, which could include the posting of a bond, substitution of other assets, an installment agreement or an offer-in-compromise.

The determination of the appeals officer is expected to address whether the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the taxpayer that the collection action be no more intrusive than necessary. It is expected that a proposed collection action will not be approved solely because the IRS shows that it has followed appropriate procedures.

The taxpayer may contest the determination of the appellate officer in Tax Court by filing a petition within 30 days of the date of the determination. The taxpayer's contest may be based on IRS abuse of discretion and also may raise procedural issues, as under present law. The IRS may not take any collection action pursuant to the determination during such 30 day period or while the taxpayer's contest is pending in Tax Court.

IRS Appeals would retain jurisdiction over its determinations. An order could be entered requiring the IRS collection division to adhere to the original determination. In addition, the taxpayer would be allowed to return to IRS Appeals to seek a modification of the original determination based on any change of circumstances.

In the case of a continuous levy, the due process procedures would apply to the original imposition of the levy. Except in jeopardy and termination cases, continuous levy would not be allowed to begin without notice and an opportunity for a hearing. A determination allowing the continuous levy to proceed entered at the conclusion of a hearing would be subject to post-determination adjustment on application by the taxpayer. Thus, taxpayers would have the right to have IRS Appeals review any continuous levy and take any changes in circumstances into account.

This proposal does not apply in the case of jeopardy and termination assessments. Jeopardy and termination assessments would subject to post-seizure review as part of the Appeals determination hearing as well as through any existing judicial procedure. A jeopardy or termination assessments must be approved by the IRS District Counsel responsible for the case. Failure to obtain District Counsel approval would render the jeopardy or termination assessment void.

Effective Date

The proposed due process procedures would apply to collection actions initiated more than six months after the date of enactment.

2. Privilege of confidentiality extended to taxpayer's dealings with non-attorneys authorized to practice before IRS

Present Law

A common law privilege of confidentiality exists for communications between an attorney and client with respect to the legal advice the attorney gives the client.

The privilege of confidentiality applies only where the attorney is advising the client on legal matters. It does not apply in situations where the attorney is acting in other capacities. The privilege of confidentiality also does not apply where an attorney that is licensed to practice another profession is performing such other profession. Further, the privilege of confidentiality does not apply where an attorney is engaged in a non-legal matter, such as the preparation of an income tax return.

The attorney-client privilege is limited to communications between taxpayers and attorneys. No equivalent privilege is provided for communications between taxpayers and other professionals authorized to practice before the Internal Revenue Service, such as accountants or enrolled agents.

Description of Proposal

The proposal would extend the present law attorney-client privilege of confidentiality to tax advice that is furnished to a client-taxpayer (or potential client-taxpayer) by any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to regulation under section 330 of title 31, United States Code. Tax advice means advice that is within the scope of authority for such individual's practice in respect to matters under Title 26 (The Internal Revenue Code).

The privilege of confidentiality extended by the proposal could be asserted in any noncriminal tax proceeding before the Internal Revenue Service and in noncriminal tax proceedings in the Federal Courts with regard to noncriminal tax matters.

The proposal would allow taxpayers to consult with other qualified tax advisors in the same manner they currently may consult with tax advisors that are licensed to practice law. The proposal would not modify the attorney-client privilege of confidentiality, other than to extend it to other authorized practitioners.

Effective Date

The proposal would be effective on the date of enactment.

3. Expansion of authority to issue taxpayer assistance orders

Present Law

Taxpayers can request that the Taxpayer Advocate in the Internal Revenue Service ("IRS") issue a taxpayer assistance order ("TAO") if they are suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered (sec. 7811). A TAO may require the IRS to release property of the taxpayer that has been levied upon, or to cease any action, take any action as permitted by law, or refrain from taking any action with respect to the taxpayer.

Description of Proposal

The proposal would provide that, in addition to current law requirements, the Taxpayer Advocate would issue a TAO for "significant hardship" if one of the following four factors exists: (1) there is an immediate threat of adverse action; (2) there has been a delay of more than 30 days in resolving the taxpayer's account problems; (3) the taxpayer will have to pay significant costs if relief is not granted; or (4) the taxpayer will suffer irreparable injury, or a long-term adverse impact, if relief is not granted.

In addition, the proposal would provide that, in cases in which the IRS failed to follow applicable published guidance (including procedures set forth in the Internal Revenue Manual), the Taxpayer Advocate would construe the matter in a manner most favorable to the taxpayer.

Effective Date

The proposal would be effective on the date of enactment.

4. Limitation on financial status audit techniques

Present Law

The Secretary is authorized and required to make the inquiries and determinations necessary to insure the assessment of Federal income taxes. For this purpose, any reasonable method may be used to determine the amount of Federal income tax owed. The courts have upheld the use of financial status and economic reality examination techniques to determine the existence of unreported income in appropriate circumstances.

Description of Proposal

The proposal would prohibit the IRS from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS has a reasonable indication that there is a likelihood of unreported income.

Effective Date

The proposal would be effective on the date of enactment.

5. Limitation on authority to require production of computer source code

Present Law

The Secretary of the Treasury is authorized to examine any books, papers, records, or other data that may be relevant or material to an inquiry into the correctness of any Federal tax return. The Secretary may issue and serve summonses necessary to obtain such data, including summonses on certain third-party record keepers. There are no specific statutory restrictions on the ability of the Secretary to demand the production of computer records, programs, code or similar materials.

Description of Proposal

The proposal would generally prohibit the Secretary from issuing a summons in a Federal tax matter for any portion of computer source code. Exceptions to the general rule would be provided for inquiries into any criminal offense connected with the administration or enforcement of the internal revenue laws and for computer software source code that was developed by the taxpayer or a related person for internal use by the taxpayer or related person. In addition, the Secretary would be allowed to summons computer source code if the Secretary (1) is unable to otherwise reasonably ascertain the correctness of an item on a return from the taxpayer's books and records, or the computer software program and associated data; (2) identifies with reasonable specificity the portion of the computer source code to be used to verify the correctness of the item; and (3) determines that the need for the source code outweighs the risks of disclosure of the computer source code. It is expected that the Secretary will make a good faith, bona fide effort to ascertain the correctness of an item prior to seeking computer source code. The portion of the computer source code to be used would be considered identified with reasonable specificity where, for example, the Secretary requests the portion of the code that is used to determine a particular item on the return, that otherwise relates to an item on the return, that implements an accounting or other method.

The requirements that the Secretary be unable to otherwise reasonably ascertain the correctness of an item on a return from the taxpayer's books and records, or the computer software program and associated data and that the Secretary have identified with reasonable specificity the portion of the computer source code requested would be deemed to be satisfied where (1) the Secretary makes a good faith determination that it is not feasible to determine the correctness of the return item in question without access to the computer software program and associated data, (2) the Secretary makes a formal request for such program and data of both the taxpayer and the owner of the program after reaching such determination, and (3) the Secretary has not received such program and data within 180 days of making the formal request.

The proposal also establishes a number of protections against the disclosure and improper use of trade secrets and confidential information incident to the examination by the Secretary of any summoned computer software program or source code. Summoned software or source code could be examined only in connection with the examination of the taxpayer's return with regard to which it was summoned. Summoned software or source code must be maintained in a secure area. Summoned source code may not be removed from the owner's place of business without the owner's consent unless such removal is pursuant to a court order. If the owner does not consent to the removal of source code from its place of business, the owner must make available the necessary equipment to review the source code. Summoned software or source code could not be decompiled or disassembled, and it may only be copied as necessary to perform the specific examination. The owner of the software must be informed of any copies that are made, such copies must be numbered, and at the conclusion of the examination and any related court proceedings, all such copies must be accounted for and returned to the owner, permanently deleted, or destroyed. The Secretary must provide the owner of summoned software or source code with the names of any individuals who will have access to such software or source code and, in the case of individuals that are not employees of the U.S. Government, a written agreement that such individual will not participate in the development of software that is intended for a similar purpose as the summoned software for a period of two years.

The Secretary's determination may be contested in any proceeding to enforce the summons, by any person to whom the summons is addressed. In any such proceeding, the court may issue any order that is necessary to prevent the disclosure of confidential information, including the enforcement of the protections established by this proposal.

Effective Date

The proposal would be effective for summons issued after the date of enactment. In addition, 90 days after the date of enactment, the protections against the disclosure and improper use of trade secrets and confidential information added by the proposal (except for the requirement that the Secretary provide a written agreement from non-U.S. government employees) would apply to summons of software and source code issued before the date of enactment.

6. Extensions of statute of limitations by agreement

Present Law

The statute of limitations within which the IRS may assess additional taxes is generally three years from the date a return is filed (sec. 6501). The statute of limitations within which a tax may be collected is 10 years after assessment (sec. 6502). Prior to the expiration of the statute of limitations, both the taxpayer and the IRS may agree in writing to extend the statute.

Description of Proposal

The proposal would eliminate the provision of present law that allows the statute of limitations on collections to be extended by agreement between the taxpayer and the IRS.

The proposal would also require that, on each occasion on which the taxpayer is requested by the IRS to extend the statute of limitations on assessment, the IRS must notify the taxpayer of the taxpayer's right to refuse to extend the statute of limitations or to limit the extension to particular issues.

The Treasury Inspector General would be required to collect information on extensions of the statute of limitations and annually report to the tax writing committees.

Effective Date

The proposal would apply to requests to extend the statute of limitations made after the date of enactment and to all extensions of the statute of limitations on collection that are open 180 days after the date of enactment.

7. Notice of deficiency to specify deadlines for filing Tax Court petition

Present Law

Taxpayers must file a petition with the Tax Court within 90 days after the deficiency notice is mailed (150 days if the person is outside the United States) (sec. 6213). If the petition is not filed within that time period, the Tax Court does not have jurisdiction to consider the petition.

Description of Proposal

The proposal would require the IRS to include on each deficiency notice the date determined by the IRS as the last day on which the taxpayer may file a petition with the Tax Court. The proposal would provide that a petition filed with the Tax Court by this date would be treated as timely filed.

Effective Date

The proposal would apply to notices mailed after December 31, 1998.

8. Refund or credit of overpayments before final determination

Present Law

Generally, the IRS may not take action to collect a deficiency during the period a taxpayer may petition the Tax Court, or if the taxpayer petitions the Tax Court, until the decision of the Tax Court becomes final. Actions to collect a deficiency attempted during this period may be enjoined, but there is no authority for ordering the refund of any amount collected by the IRS during the prohibited period.

If a taxpayer contests a deficiency in the Tax Court, no credit or refund of income tax for the contested taxable year generally may be made, except in accordance with a decision of the Tax Court that has become final. Where the Tax Court determines that an overpayment has been made and a refund is due the taxpayer, and a party appeals a portion of the decision of the Tax Court, no provision exists for the refund of any portion of any overpayment that is not contested in the appeal.

Description of Proposal

The proposal would provide that a proper court (including the Tax Court) may order a refund of any amount that was collected within the period during which the Secretary is prohibited from collecting the deficiency by levy or other proceeding.

The proposal would also allow the refund of that portion of any overpayment determined by the Tax Court to the extent the overpayment is not contested on appeal.

Effective Date

The proposal would be effective on the date of enactment.

9. Threat of audit prohibited to coerce Tip Reporting Alternative Commitment Agreements

Present Law

Restaurants may enter into Tip Reporting Alternative Commitment (TRAC) agreements. A restaurant entering into a TRAC agreement is obligated to educate its employees on their tip reporting obligations, to institute formal tip reporting procedures, to fulfill all filing and record keeping requirements, and to pay and deposit taxes. In return, the IRS agrees to base the restaurant's liability for employment taxes solely on reported tips and any unreported tips discovered during an IRS audit of an employee.

Description of Proposal

The proposal would require the IRS to instruct its employees that they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer to enter into a TRAC agreement.

Effective Date

The proposal would be effective on the date of enactment.

10. Codify existing IRS procedures relating to appeal of examinations and collections and increase independence of appeals function

Present Law

IRS Appeals operates through regional Appeals offices which are independent of the local District Director and Regional Commissioner's offices. The regional Directors of Appeals report to the National Director of Appeals of the IRS, who reports directly to the Commissioner and Deputy Commissioner. In general, IRS Appeals offices have jurisdiction over both pre-assessment and post-assessment cases. The taxpayer generally has an opportunity to seek

Appeals jurisdiction after failing to reach agreement with the Examination function and before filing a petition in Tax Court, after filing a petition in Tax Court (but before litigation), after assessment of certain penalties, after a claim for refund has been rejected by the District Director's office, and after a proposed rejection of an offer-in-compromise in a collection case (Treas. Reg. sec. 601.106(a)(1)).

In certain cases under Coordinated Examination Program procedures, the taxpayer has an opportunity to seek early Appeals jurisdiction over some issues while an examination is still pending on other issues (Rev. Proc. 96-9, 1996-1 C.B. 575). The early referral procedures also apply to employment tax issues on a limited basis (Announcement 97-52).

A mediation or alternative dispute resolution (ADR) process is also available in certain cases. ADR is used at the end of the administrative process as a final attempt to resolve a dispute before litigation. ADR is currently only available for cases with more than $10 million in dispute. ADR processes are also available in bankruptcy cases and cases involving a competent authority determination.

In April 1996, the IRS implemented a Collections Appeals Program within the Appeals function, which allows taxpayers to appeal lien, levy, or seizure actions proposed by the IRS. In January 1997, appeals for installment agreements proposed for termination were added to the program.

Description of Proposal

The proposal would codify existing IRS procedures with respect to early referrals to Appeals and the Collections Appeals Process. The proposal would also codify the ADR procedures and eliminate the dollar threshold. The proposal would direct the IRS to establish an independent Appeals function and to prohibit ex parte communications between IRS employees and Appeals officers with respect to any particular taxpayer's case that is pending in Appeals.

Effective Date

The proposal would be effective as of the date of enactment.

11. Appeals videoconferencing alternative for rural areas

Present Law

The IRS has the capability to do videoconferencing. The IRS does not have any program to provide for Appeals conferences by videoconferencing techniques.

Description of Proposal

The IRS would be advised to consider videoconferencing of Appeals conferences for taxpayers seeking appeals in rural or remote areas.

Effective Date

The proposal would be effective on the date of enactment.

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

Present Law

Third parties may be contacted by the IRS in connection with the examination of a taxpayer or the collection of the tax liability of the taxpayer. The IRS has the right to summon third-party recordkeepers under Code section 7609. In general, the taxpayer must be notified of the service of summons on a third party within three days of the date of service (sec. 7609(a)). The IRS also has the right to seize property of the taxpayer that is held in the hands of third parties (sec. 6331(a). Except in jeopardy situations, the Internal Revenue Manual provides that IRS will personally contact the taxpayer and inform the taxpayer that seizure of the asset is planned.

Description of Proposal

The proposal would require the IRS to notify the taxpayer before contacting third parties regarding examination or collection activities with respect to the taxpayer.

Effective Date

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

F. Disclosures to Taxpayers

1. Explanation of joint and several liability

Present Law

In general, spouses who file a joint tax return are each fully responsible for the accuracy of the tax return and for the full liability. Spouses who wish to avoid such joint and several liability may file as married persons filing separately. Special rules apply in the case of innocent spouses pursuant to section 6013(e).

Description of Proposal

The proposal would require that, no later than 180 days after the date of enactment, the IRS must establish procedures clearly to alert married taxpayers of their joint and several liability on all appropriate tax publications and instructions. It is anticipated that the IRS will make an appropriate cross-reference to these statements near the signature line on appropriate tax forms.

Effective Date

The proposal would require that the procedures be established as soon as practicable, but no later than 180 days after the date of enactment.

2. Explanation of taxpayers' rights in interviews with the IRS

Present Law

Prior to or at initial in-person audit interviews, the IRS must explain to taxpayers the audit process and taxpayers' rights under that process (sec. 7521). In addition, prior to or at initial in-person collection interviews, the IRS must explain the collection process and taxpayers' rights under that process. If a taxpayer clearly states during an interview with the IRS that the taxpayer wishes to consult with the taxpayer's representative, the interview must be suspended to afford the taxpayer a reasonable opportunity to consult with the representative.

Description of Proposal

The proposal would require that the IRS rewrite Publication 1 ("Your Rights as a Taxpayer") to more clearly inform taxpayers of their rights (1) to be represented by a representative and (2) if the taxpayer is so represented, that the interview may not proceed without the presence of the representative unless the taxpayer consents.

In addition, the proposal would require the Treasury Inspector General to report annually as to whether IRS employees are directly contacting taxpayers who have indicated that they prefer their representatives be contacted.

Effective Date

The addition to Publication 1 must be made not later than 180 days after the date of enactment. The annual reports would begin in 1999.

3. Disclosure of criteria for examination selection

Present Law

The IRS examines Federal tax returns to determine the correct liability of taxpayers. The IRS selects returns to be audited in a number of ways, such as through a computerized classification system (the discriminant function ("DIF") system).

Description of Proposal

The proposal would require that IRS add to Publication 1 ("Your Rights as a Taxpayer") a statement which sets forth in simple and nontechnical terms the criteria and procedures for selecting taxpayers for examination. The statement must not include any information the disclosure of which would be detrimental to law enforcement. The statement must specify the general procedures used by the IRS, including whether taxpayers are selected for examination on the basis of information in the media or from informants.

Effective Date

The addition to Publication 1 must be made not later than 180 days after the date of enactment.

4. Explanations of appeals and collection process

Present Law

There is no statutory requirement that specific notices be given to taxpayers along with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals.

Description of Proposal

The proposal would require that, no later than 180 days after the date of enactment, a description of the entire process from examination through collections, including the assistance available to taxpayers from the Taxpayer Advocate at various points in the process, be provided with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals.

Effective Date

The proposal would require that the explanation be included as soon as practicable, but no later than 180 days after the date of enactment.

5. Require IRS to explain reason for denial for refund

Present Law

The Examination Division of the IRS examines claims for refund submitted by taxpayers. The Internal Revenue Manual requires examination or other audit action on refund claims within 30 days after receipt of the claims. The refund claim is preliminarily examined to determine if it should be disallowed because it (1) was untimely filed; (2) was based solely on alleged unconstitutionality of the Revenue Acts; (3) was already waived by the taxpayer as consideration for a settlement; (4) covers a taxable year and issues which were the subject of a final closing agreement or an offer in compromise; or (5) relates to a return closed on the basis of a final order of the Tax Court. In those cases, the taxpayer will receive a form from the IRS stating that the claim for refund cannot be considered. Other cases will be examined as quickly as possible and the disposition of the case, including the reasons for the disallowance or partial disallowance of the refund claim, must be stated in the portion of the revenue agent's report that is sent to the taxpayer.

Description of Proposal

The proposal would require the IRS to send the taxpayer an explanation of the reason for the disallowance of the refund claim.

Effective Date

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

G. Low-Income Taxpayer Clinics

Present Law

There are no provisions in present law providing for assistance to clinics that assist low-income taxpayers.

Description of Proposal

The Secretary would be authorized to provide up to $3,000,000 per year in matching grants to certain low-income taxpayer clinics. No clinic could receive more than $100,000 per year.

Eligible clinics would be those that charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or provide tax information to individuals for whom English is a second language.

A "clinic" would include (1) a clinical program at an accredited law school, an accredited business school, or an accredited accounting school, in which students represent low-income taxpayers, or (2) an organization exempt from tax under Code section 501(c) which either represents low-income taxpayers or provides referral to qualified representatives.

Effective Date

The proposal would be effective on the date of enactment.

H. Other Taxpayer Rights Provisions

1. Cataloging complaints

Present Law

The IRS is required to make an annual report to the Congress, beginning in 1997, on all categories of instances involving allegations of misconduct by IRS employees, arising either from internally identified cases or from taxpayer or third-party initiated complaints. The report must identify the nature of the misconduct or complaint, the number of instances received by category, and the disposition of the complaints.

Description of Proposal

The proposal would require that, in collecting data for this report, records of taxpayer complaints of misconduct by IRS employees shall be maintained on an individual employee basis. These individual records are not to be listed in the report.

Effective Date

The requirement would be effective on the date of enactment.

2. Archive of records of the IRS

Present Law

The IRS is obligated to transfer agency records to the National Archives and Records Administration ("NARA") for retention or disposal. The IRS is also obligated to protect confidential taxpayer records from disclosure. These two obligations have created conflict between NARA and the IRS.

Description of Proposal

The proposal would provide an exception to the disclosure rules to require IRS to disclose IRS records to officers or employees of NARA, upon written request from the U.S. Archivist, for purposes of the appraisal of such records for destruction or retention. The present-law prohibitions on and penalties for disclosure of tax information would generally apply to NARA.

Effective Date

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

3. Payment of taxes

Present Law

The Code provides that it is lawful for the Secretary to accept checks or money orders as payment for taxes, to the extent and under the conditions provided in regulations prescribed by the Secretary (sec. 6311). Those regulations state that checks or money orders should be made payable to the Internal Revenue Service.

Description of Proposal

The proposal would require the Secretary or his delegate to establish such rules, regulations, and procedures as are necessary to allow payment of taxes by check or money order to be made payable to the United States Treasury.

Effective Date

The proposal would be effective on the date of enactment.

4. Clarification of authority of Secretary relating to the making of elections

Present Law

Except as otherwise provided, elections provided by the Code are to be made in such manner as the Secretary shall by regulations or forms prescribe.

Description of Proposal

The proposal would clarify that, except as otherwise provided, the Secretary may prescribe the manner of making of any election by any reasonable means.

Effective Date

The proposal would be effective as of the date of enactment.

I. Studies

1. Study of penalty administration

Present Law

The last major revision of the overall penalty structure in the Internal Revenue Code was the "Improved Penalty Administration and Compliance Tax Act," enacted as part of the Omnibus Budget Reconciliation Act of 1989.

Description of Proposal

The proposal would require the Joint Committee on Taxation and the Treasury to each conduct a separate study reviewing the administration and implementation of the penalty reform provisions of the Omnibus Budget Reconciliation Act of 1989, and making any legislative and administrative recommendations it deems appropriate to simplify penalty administration and reduce taxpayer burden.

Effective Date

The report must be provided not later than nine months after the date of enactment.

2. Study of confidentiality of tax return information

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the IRS to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Description of Proposal

The proposal would require the Joint Committee on Taxation and Treasury to each conduct a separate study on provisions regarding taxpayer confidentiality. The studies are to examine present-law protections of taxpayer privacy, the need for third parties to use tax return information, the ability to achieve greater levels of voluntary compliance by allowing the public to know who is legally required to file tax returns but does not do so, and the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code with those elsewhere in the United States Code (such as the Freedom of Information Act).

Effective Date

The findings of the studies, along with any recommendations, are required to be reported to the Congress no later than one year after the date of enactment.

J. Limits on Seizure Authority

1. IRS to implement approval process for liens, levies, or seizures

Present Law

Supervisory approval of liens, levies or seizures is only required under certain circumstances. For example, a levy on a taxpayer's principal residence is only permitted upon the written approval of the District Director or Assistant District Director.

Description of Proposal

The proposal would require the IRS to develop and implement a review process under which, where appropriate, any lien, levy, or seizure would be reviewed by a supervisor before issuance. The review process could, if appropriate, encompass certification that the revenue officer has reviewed the taxpayer's information, verified that a balance is due, and affirmed that a lien, levy or seizure is appropriate given the taxpayer's circumstances, considering the amount due and the value of the asset. Failure to follow such procedures could result in disciplinary action against the supervisor and revenue officer.

In addition, the Treasury Inspector General would be required to collect information on the review process and annually report to the tax writing committees.

Effective Date

The proposal would be effective for collection actions commenced after date of enactment.

2. Prohibit sales of seized property at less than minimum bid

Present Law

Section 6335(e) requires that a minimum bid price be established for seized property offered for sale. To conserve the taxpayer's equity, the minimum bid price should normally be computed at 80 percent or more of the forced sale value of the property less encumbrances having priority over the Federal tax lien. If the group manager concurs, the minimum sales price may be set at less than 80 percent. The taxpayer is to receive notice of the minimum bid price within 10 days of the sale. The taxpayer has the opportunity to challenge the minimum bid price. The minimum bid price cannot be more than the tax liability plus the expenses of sale. Accordingly, if the minimum bid price is set at the tax liability plus the expenses of sale, the taxpayer's concurrence is not required. IRM 56(13)5.1(4). Section 6335 does not contemplate a sale of the seized property at less than the minimum bid price. Rather, if no person offers the minimum bid price, the IRS may buy the property at the minimum bid price or the property may be released to the owner. Code section 7433 provides civil damages for certain unauthorized collection actions.

Description of Proposal

The proposal would prohibit the IRS from selling seized property for less than the minimum bid price. The proposal would provide that the sale of property for less than the minimum bid price would constitute an unauthorized collection action, which would permit an affected person to sue for civil damages for certain unauthorized collection actions pursuant to section 7433.

Effective Date

The proposal would be effective for sales occurring after the date of enactment.

3. IRS to provide accounting and receipt to taxpayer for property seized and sold

Present Law

The IRS is authorized to seize and sell a taxpayer's property to satisfy an unpaid tax liability (sec. 6331(b)). The IRS is required to give written notice to the taxpayer before seizure of the property (sec. 6331(d)). The IRS must also give written notice to the taxpayer at least 10 days before the sale of the seized property.

The IRS is required to keep records of all sales of real property (sec. 6340). The records must set forth all proceeds and expenses of the sale. The IRS is required to apply the proceeds first against the expenses of the sale, then against a specific tax liability on the seized property, if any, and finally against any unpaid tax liability of the taxpayer (sec. 6342(a)). Any surplus proceeds are credited to the taxpayer or persons legally entitled to the proceeds.

Description of Proposal

The proposal would require the IRS to provide a written accounting of all sales of seized property, whether real or personal, to the taxpayer. The accounting must include a receipt for the amount credited to the taxpayer's account.

Effective Date

The proposal would be effective for seizures occurring after the date of enactment.

4. Uniform asset disposal mechanism

Present Law

The IRS must sell property seized by levy either by public auction or by public sale under sealed bids (sec. 6335(e)(2)(A)). These are often conducted by the revenue officer charged with collecting the tax liability.

Description of Proposal

The proposal would require the IRS to implement a uniform asset disposal mechanism for sales of seized property. The disposal mechanism should be designed to remove any participation in the sale of seized assets by revenue officers. The proposal would authorize the consideration of outsourcing of the disposal mechanism.

Effective Date

The proposal would require a uniform asset disposal system to be implemented within two years from the date of enactment.

5. Increase exempt amounts for personal effects and tools

Present Law

The Code authorizes the IRS to levy on all non-exempt property of the taxpayer. Property exempt from levy is described in section 6334. Section 6334(a)(2) exempts from levy up to $2,500 in value of fuel, provisions, furniture, and personal effects in the taxpayer's household. Section 6334(a)(3) exempts from levy up to $1,250 in value of books and tools necessary for the trade, business or profession of the taxpayer.

Description of Proposal

The proposal would increase the value of personal effects exempt from levy to $10,000 and the value of books and tools exempt from levy to $5,000. These amounts would be indexed for inflation.

Effective Date

The proposal would be effective for collection actions taken after the date of enactment.

6. Require IRS to immediately release levy upon agreement that amount is not collectible

Present Law

Some have contended that the IRS does not release a wage levy immediately upon receipt of proof that the taxpayer is unable to pay the tax, but instead, the IRS levies on one period's wage payment before releasing the levy.

Description of Proposal

The IRS would be required to immediately release a wage levy upon agreement with the taxpayer that the tax is not collectible.

Effective Date

The proposal would be effective for levies imposed after date of enactment.

7. Codify IRS administrative procedures for seizure of taxpayer's property

Present Law

The IRS provides guidelines for revenue officers engaged in the collection of unpaid tax liabilities. The Internal Revenue Manual (IRM) 56(12)5.1 provides general guidelines for seizure actions: (1) the revenue officer must first verify the taxpayer's liability; (2) no levy may be made if the estimated expenses of levy and sale will exceed the fair market value of the property to be sized (sec. 6331(f)); (3) no levy may be made on the date of an appearance in response to an administrative summons, unless jeopardy exists (sec. 6331(g)); (4) if the property to be seized is located on private premises, consent or a writ of entry is required (G.M. Leasing Corp. v. United States, 429 U.S. 338 (1977); IRS Policy Statement P-5-38); (5) the taxpayer should have an opportunity to read the levy form; (6) the revenue officer must attach a sufficient number of warning notices on the property to clearly identify the property to be seized; (7) the revenue officer must inventory the property to be seized; and (8) a revenue officer may not use force in the seizure of property.

Prior to the levy action, the revenue officer must determine that there is sufficient equity in the property to be seized to yield net proceeds from the sale to apply to unpaid tax liabilities. If it is determined after seizure that the taxpayer's equity is insufficient to yield net proceeds from sale to apply to the unpaid tax, the revenue officer will immediately release the seized property. See IRM 56(12)2.1.

IRS Policy Statement P-5-34 states that the facts of a case and alternative collection methods must be thoroughly considered before deciding to seize the assets of a going business. IRS Policy Statement P-5-16 advises reasonable forbearance on collection activity when the taxpayer's business has been affected by a major disaster such as flood, hurricane, drought, fire, etc., and whose ability to pay has been impaired by such disaster.

Description of Proposal

The proposal would codify the IRS administrative procedures which require the IRS to investigate the status of property prior to levy. The Treasury Inspector General would be required to review IRS compliance with seizure procedures and report annually to Congress.

Effective Date

The provision would be effective as of date of enactment.

8. Suspend collection by levy during refund suit

Present Law

The IRS is prohibited from making a tax assessment (and thus prohibited from collecting payment) with respect to a tax liability while it is being contested in Tax Court. However, under present law, the IRS is permitted to assess and collect tax liabilities during the pendency of a refund suit relating to such tax liabilities, under the circumstances described below.

Generally, full payment of the tax at issue is a prerequisite to a refund suit. However, if the tax is divisible (such as employment taxes or the trust fund penalty under Code section 6672), the taxpayer need only pay the tax for the applicable period before filing a refund claim. Most divisible taxes are not within the Tax Court's jurisdiction; accordingly, the taxpayer has no pre-payment forum for contesting such taxes. In the case of divisible taxes, it is possible that the taxpayer could be properly under the refund jurisdiction of the District Court or the U.S. Court of Federal Claims and still be subject to collection by levy with respect to the entire amount of the tax at issue. The IRS's policy is generally to exercise forbearance with respect to collection while the refund suit is pending, so long as the interests of the Government are adequately protected (e.g., by the filing of a notice of Federal tax lien) and collection is not in jeopardy. Any refunds due the taxpayer may be credited to the unpaid portion of the liability pending the outcome of the suit.

Description of Proposal

The proposal would require the IRS to withhold collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation. This would only apply when refund suits can be brought without the full payment of the tax, i.e., in the case of divisible taxes. Collection by levy would be withheld unless jeopardy exists or the taxpayer waives the suspension of collection in writing (because collection will stop the running of interest and penalties on the tax liability). This proposal would not affect the IRS's ability to collect other assessments that are not the subject of the refund suit, to offset refunds, or to file a notice of Federal tax lien. The statute of limitations on collection would be stayed for the period during which the IRS is prohibited from collecting by levy.

Effective Date

The proposal would be effective for refund suits brought with respect to tax years beginning after December 31, 1998.

9. Require district counsel review of jeopardy and termination assessments and jeopardy levies

Present Law

In general, a 30 day waiting period is imposed after assessment of all types of taxes. In certain circumstances, the waiting period puts the collection of taxes at risk. The Code provides special procedures that allow the IRS to make jeopardy assessments or termination assessments in certain extraordinary circumstances, such as if the taxpayer is leaving or removing property from the United States (sec. 6851), or if assessment or collection would be jeopardized by delay (secs. 6861 and 6862). In jeopardy or termination situations, a levy may be made without the 30 days' notice of intent to levy that is ordinarily required by section 6331(d)(2). Jeopardy assessments apply when the tax year is over. Termination assessments apply to the current taxable year or the immediately preceding taxable year if the filing date has not yet passed. A termination assessment serves to terminate the taxable year for the purpose of computing the tax to be assessed and collected under the termination assessment procedure. Under both the jeopardy and termination assessment procedures, the IRS can assess the tax and immediately begin collection if any one of the following situations exists: (1) the taxpayer is or appears to be planning to depart the United States or to go into hiding; (2) the taxpayer is or appears to be planning to place property beyond the reach of the IRS by removing it from the country, hiding it, dissipating it, or by transferring it to other persons; or (3) the taxpayer's financial solvency is or appears to be imperiled. Because the same criteria apply to jeopardy and termination assessments, jeopardy and termination assessments are often entered at the same time against the same taxpayer.

The Code and regulations do not presently require District Counsel to review jeopardy assessments, termination assessments, or jeopardy levies, although the Internal Revenue Manual does require District Counsel review before such actions and it is current practice to make such a review. The IRS bears the burden of proof with respect to the reasonableness of a jeopardy or termination assessment or a jeopardy levy (sec. 7429(g)).

Description of Proposal

The proposal would require IRS District Counsel review and approval before the IRS could make a jeopardy assessment, a termination assessment, or a jeopardy levy. If District

Counsel's approval was not obtained, the taxpayer would be entitled to obtain abatement of the assessment or release of the levy, and, if the IRS failed to offer such relief, to appeal first to IRS Appeals under the new due process procedure for IRS collections (described in E. 1 above) and then to the U.S. District Court.

Effective Date

The proposal would be effective with respect to taxes assessed after the date of enactment.

10. Codify certain fair debt collection practices

Present Law

The Fair Debt Collection Practices Act provides a number of rules relating to debt collection practices. Among these are restrictions on communication with the consumer, such as a general prohibition on telephone calls outside the hours of 8:00 a.m. to 9:00 p.m. local time, and prohibitions on harassing or abusing the consumer. In general, these provisions do not apply to the Federal Government. These provisions relating to communication with the consumer and prohibiting harassing or abusing the consumer have been applied to the IRS through the appropriations process.

Description of Proposal

The proposal would make the restrictions relating to communication with the taxpayer/debtor and the prohibitions on harassing or abusing the debtor applicable to the IRS by incorporating these provisions into the Internal Revenue Code.

Effective Date

The proposal would be effective on the date of enactment.

11. Ensure availability of installment agreements

Present Law

Section 6159 of the Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed. An installment agreement does not reduce the amount of taxes, interest, or penalties owed. However, it does provide for a longer period during which payments may be made during which other IRS enforcement actions (such as levies or seizures) are held in abeyance. Many taxpayers can request an installment agreement by filing form 9465. This form is relatively simple and does not require the submission of detailed financial statements. The IRS in most instances readily approves these requests if the amounts involved are not large (in general, below $10,000) and if the taxpayer has filed tax returns on time in the past. Some taxpayers are required to submit background information to the IRS substantiating their application. If the request for an installment agreement is approved by the IRS, a user fee of $43 is charged. This user fee is in addition to the tax, interest, and penalties that are owed.

Description of Proposal

The proposal would require the Secretary to enter an installment agreement, at the taxpayer's option, if:

(1) the liability is $10,000, or less;

(2) within the previous 5 years, the taxpayer has not failed to file or to pay, nor entered an installment agreement under this provision;

(3) if requested by the Secretary, the taxpayer submits financial statements that demonstrate an inability to pay the tax due in full;

(4) the installment agreement provides for full payment of the liability within 3 years; and

(5) the taxpayer agrees to continue to comply with the tax laws and the terms of the agreement for the period (up to 3 years) that the agreement is in place.

Effective Date

The proposal would be effective on the date of enactment.

12. Increase superpriority dollar limits

Present Law

The Federal tax lien attaches to all property and rights in property of the taxpayer, if the taxpayer fails to pay the assessed tax liability after notice and demand (sec. 6321). However, the Federal tax lien is not valid as to certain "superpriority" interests as defined in section 6323(b).

Two of these interests are limited by a specific dollar amount. Under section 6323(b)(4), purchasers of personal property at a casual sale are presently protected against a Federal tax lien attached to such property to the extent the sale is for less than $250. Section 6323(b)(7) provides protection to mechanic's lienors with respect to the repairs or improvements made to owner-occupied personal residences, but only to the extent that the contract for repair or improvement is for not more than $1,000.

In addition, a superpriority is granted under section 6323(b)(10) to banks and building and loan associations which make passbook loans to their customers, provided that those institutions retain the passbooks in their possession until the loan is completely paid off.

Description of Proposal

The proposal would increase the dollar limit in section 6323(b)(4) for purchasers at a casual sale from $250 to $1,000, and it would increase the dollar limit in section 6323(b)(7) from $1,000 to $5,000 for mechanics lienors providing home improvement work for owner-occupied personal residences. The proposal would index these amounts for inflation. The proposal also would clarify section 6323(b)(10) to reflect present banking practices, where a passbook-type loan may be made even though an actual passbook is not used.

Effective Date

The proposal would be effective on the date of enactment.

13. Permit personal delivery of section 6672(b) notices

Present Law

Any person who is required to collect, truthfully account for, and pay over any tax imposed by the Internal Revenue Code who willfully fails to do so is liable for a penalty equal to the amount of the tax (Code sec. 6672(a)). Before the IRS may assess any such "100 percent penalty," it must mail a written preliminary notice informing the person of the proposed penalty to that person's last known address. The mailing of such notice must precede any notice and demand for payment of the penalty by at least 60 days. The statute of limitations shall not expire before the date 90 days after the date in which the notice was mailed. These restrictions do not apply if the Secretary finds the collection of the penalty is in jeopardy.

Description of Proposal

The proposal would permit in person delivery, as an alternative to delivery by mail, of a preliminary notice that the IRS intends to assess a 100 percent penalty. (In some cases, personal delivery may better assure that the recipient actually receives notice.)

Effective Date

The proposal would be effective on the date of enactment.

14. Allow taxpayers to quash third-party summonses

Present Law

When the IRS issues a summons to a "third-party record keeper" relating to the business transactions or affairs of a taxpayer, Code section 7609 requires that notice of the summons be given to the taxpayer within three days by certified or registered mail. The taxpayer is thereafter given up to 23 days to begin a court proceeding to quash the summons. If the taxpayer does so, third-party record keepers are prohibited from complying with the summons until the court rules on the taxpayer's petition or motion to quash, but the statute of limitations for assessment and collection with respect to the taxpayer is stayed during the pendency of such a proceeding. Third-party record keepers are generally persons who hold financial information about the taxpayer, such as banks, brokers, attorneys, and accountants.

Description of Proposal

The proposal would generally expand the current "third-party record keeper" procedures to apply to summonses issued to persons other than the taxpayer. Thus, the taxpayer whose liability is being investigated would receive notice of the summons and would be entitled to bring an action in the appropriate U.S. District Court to quash the summons. As under the current third-party record keeper provision, the statute of limitations on assessment and collection would be stayed pending the litigation, and certain kinds of summonses specified under current law would not be subject to these requirements.

Effective Date

The proposal would be effective for summonses served after the date of enactment.

15. Permit service of summonses by mail

Present Law

Code section 7603 requires that a summons shall be served "by an attested copy delivered in hand to the person to whom it is directed or left at his last and usual place of abode." By contrast, if a third-party recordkeeper summons is served, section 7609 permits the IRS to give the taxpayer notice of the summons via certified or registered mail. Moreover, Rule 4 of the Federal Rules of Civil Procedure permits service of process by mail even in summons enforcement proceedings.

Description of Proposal

The proposal would permit the IRS the option of serving any summons either in person or by mail.

Effective Date

The proposal would be effective for summonses served after the date of enactment.

16. Provide new remedy for third parties who claim that the IRS has filed an erroneous lien

Present Law

Prior to 1995, the provisions governing jurisdiction over refund suits had generally been interpreted to apply only if an action was brought by the taxpayer against whom tax was assessed. Remedies for third parties from whom tax was collected (rather than assessed) were found in other provisions of the Internal Revenue Code. The Supreme Court held in Williams v. United States, 115 S.Ct. 1611 (1995), however, that a third party who paid another person's tax under protest to remove a lien on the third party's property could bring a refund suit, because she had no other adequate administrative or judicial remedy. In Williams, the IRS had filed a nominee lien against property that was owned by the taxpayer's former spouse and that was under a contract for sale. In order to complete the sale, the former spouse paid the amount of the lien under protest, and then sued in district court to recover the amount paid. The Supreme Court held that parties who are forced to pay another's tax under duress could bring a refund suit, because no other judicial remedy was adequate.

Description of Proposal

The proposal would create an administrative procedure similar to the wrongful levy remedy for third parties in section 7426. Under this procedure, a record owner of property against which a Federal tax lien had been filed could obtain a certificate of discharge of property from the lien as a matter of right. The third party would be required to apply to the Secretary of the Treasury for such a certificate and either to deposit cash or to furnish a bond sufficient to protect the lien interest of the United States. Although the Secretary would determine the amount of the bond necessary to protect the Government's lien interest, the Secretary would have no discretion to refuse to issue a certificate of discharge if this procedure was followed, thus curing the defect in this remedy that the Supreme Court found in Williams. A certificate of discharge of property from a lien issued pursuant to the procedure would enable the record owner to sell the property free and clear of the Federal tax lien in all circumstances. The proposal also would authorize the refund of all or part of the amount deposited, plus interest at the same rate that would be made on an overpayment of tax by the taxpayer, or the release of all or part of the bond, if the Secretary otherwise satisfies the tax liability or determines that the United States does not have a lien interest or has a lesser lien interest than the amount initially determined.

The proposal would also establish a judicial cause of action for third parties challenging a lien that is similar to the wrongful levy remedy in section 7426. The period within which such an action must be commenced would be 120 days to ensure an early resolution of the parties' interests. Upon conclusion of the litigation, the IRS would be authorized to apply the deposit or bond to the assessed liability and to refund to the third party any amount in excess of the liability, plus interest, or to release the bond. Actions to quiet title under 28 U.S.C. §2410 would still be available to persons who did not seek the expedited review permitted under the new statutory procedure.

Effective Date

The proposal would be effective on the date of enactment.

17. Waiver of early withdrawal tax for IRS levies on employer-sponsored retirement plans or IRAs

Present Law

Under present law, a distribution of benefits from any employer-sponsored retirement plan or an individual retirement arrangement ("IRA") generally is includible in gross income in the year it is paid or distributed, except to the extent the amount distributed represents the employee's after-tax contributions or investment in the contract (i.e., basis). Special rules apply to certain lump-sum distributions from qualified retirement plans, distributions rolled over to an IRA, and lump-sum distributions of employer securities.

Distributions from qualified plans and IRAs prior to attainment of age 59-1/2 that are includible in income generally are subject to a 10-percent early withdrawal tax, unless an exception to the tax applies. An exception to the tax applies if the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of adjusted gross income ("AGI"), or is used to purchase health insurance of an unemployed individual. Certain additional exceptions to the tax apply separately to withdrawals from IRAs and qualified plans. Distributions from IRAs for education expenses and for up to $10,000 of first-time homebuyer expenses are not subject to the 10-percent early withdrawal tax. A distribution from a qualified plan made by an employee after separation from service after attainment of age 55 is not subject to the 10-percent early withdrawal tax.

Under present law, the IRS is authorized to levy on all non-exempt property of the taxpayer. Benefits under employer-sponsored retirement plans (including section 403(b) and 457 plans) and IRAs are not exempt from levy by the IRS.

Under present law, distributions from employer-sponsored retirement plans or IRAs made on account of an IRS levy are includible in the gross income of the individual, except to the extent the amount distributed represents after-tax contributions. In addition, the amount includible in income is subject to the 10-percent early withdrawal tax, unless an exception described above applies.

Description of Proposal

The proposal would provide an exception from the 10-percent early withdrawal tax for amounts withdrawn from any employer-sponsored retirement plan or an IRA that are subject to a levy by the IRS.

Effective Date

The proposal would be effective for withdrawals subject to an IRS levy after the date of enactment.

18. Prohibit seizure of residences in small deficiency cases

Present Law

Subject to certain procedural rules and limitations, the Secretary may seize the property of the taxpayer who neglects or refuses to pay any tax within 10 days after notice and demand. The IRS may not levy on the personal residence of the taxpayer unless the District Director (or the assistant District Director) personally approves in writing or in cases of jeopardy.

Description of Proposal

The proposal would prohibit the IRS from seizing real property that is used as a residence (by the taxpayer or another person) to satisfy an unpaid liability of $5,000 or less, including penalties and interest.

Effective Date

The proposal would be effective on the date of enactment.

K. Offers-in-Compromise

1. Rights of taxpayers entering into offers-in-compromise

Present Law

Section 7122 of the Code permits the IRS to compromise a taxpayer's tax liability. An offer-in-compromise is a proposal by the taxpayer to settle unpaid tax accounts for less than the full amount of the assessed balance due. An offer-in-compromise may be submitted for all types of taxes, as well as interest and penalties, arising under the Internal Revenue Code.

There are two bases on which an offer can be made: doubt as to liability for the amount owed and doubt as to ability to pay the amount owed.

A compromise agreement based on doubt as to ability to pay requires the taxpayer to file returns and pay taxes for five years from the date the IRS accepts the offer. Failure to do so permits the IRS to begin immediate collection actions for the original amount of the liability.

Description of Proposal

The proposal would require the IRS to develop and publish schedules of national and local allowances that will provide taxpayers entering into an offer-in-compromise with adequate means to provide for basic living expenses. The IRS would also be required to consider the facts and circumstances of a particular taxpayer's case in determining whether the national and local schedules are adequate for that particular taxpayer. If the facts indicate that use of scheduled allowances would be inadequate under the circumstances, the taxpayer would not be limited by the national or local allowances. The proposal also would allow a compliant spouse to apply to reinstate an agreement that would otherwise be revoked due to the nonfiling or nonpayment of the other spouse, providing all payments required under the compromise agreement are current. Finally, the proposal would require the IRS to publish guidance on the rights and obligations of taxpayers and the IRS relating to offers in compromise.

Effective Date

The proposal would be effective on the date of enactment.

2. Prohibit IRS rejection of low income taxpayer's offer-in-compromise based on amount of offer

Present Law

The Internal Revenue Manual[22] provides guidelines for revenue officers to determine whether an offer-in-compromise is adequate. An offer is adequate if it reasonably reflects collection potential. Although the revenue officer is instructed to consider the taxpayer's assets and future and present income, the IRM advises that rejection of an offer solely based on narrow asset and income evaluations should be avoided.

Description of Proposal

The proposal would prohibit the IRS from rejecting an offer-in-compromise from a low income taxpayer solely on the basis of the amount of the offer.

Effective Date

The proposal would be effective for offers-in-compromise submitted after the date of enactment.

3. Prohibit the IRS from rejecting an offer-in-compromise solely based on a dispute as to liability because the taxpayer's file cannot be located by the IRS

Present Law

Section 7122 of the Code permits the IRS to compromise a taxpayer's tax liability. An offer-in-compromise is a proposal to settle unpaid tax accounts for less than the full amount of the assessed balance due.

There are two bases on which an offer can be made by the taxpayer: doubt as to liability for the amount owed and doubt as to ability to pay the amount owed.

Description of Proposal

The proposal would provide that, in the case of an offer-in-compromise submitted solely on the basis of doubt as to liability, the IRS may not reject the offer merely because the IRS cannot locate the taxpayer's file.

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[22] IRM 57(10)(10).1

Effective Date

The provision would be effective for offers in compromise submitted after the date of enactment.

4. Prohibit the IRS from requiring a financial statement for offer-in-compromise based solely on doubt as to liability

Present Law

The instructions to Form 656 ("Offer in Compromise") note that financial information is only required to be supplied when submitting an offer based on doubt as to collectibility. Some have observed that the IRS may not be following this instruction.

Description of Proposal

The proposal would prohibit the IRS from requesting a financial statement if the taxpayer makes an offer-in-compromise based solely on doubt as to liability.

Effective Date

The proposal would be effective on the date of enactment.

5. Suspend collection by levy while offer-in-compromise is pending

Present Law

Pursuant to the Internal Revenue Manual, collection normally is withheld during the period an offer-in-compromise is pending, unless it is determined that the offer is a delaying tactic and collection is in jeopardy.

Description of Proposal

The proposal would prohibit the IRS from collecting a tax liability by levy (1) during any period that a taxpayer's offer-in-compromise for that liability is being processed, (2) during the 30 days following rejection of an offer, and (3) during any period in which an appeal of the rejection of an offer is being considered. Return of an offer-of-compromise as unprocessable would be considered a rejection for this purpose. Taxpayers whose offers are either rejected or returned as unprocessable and who made good faith revisions of their offers and resubmitted them within 30 days of the rejection or return would be eligible for a continuous period of relief from collection by levy. This prohibition on collection by levy would not apply if the IRS determines that collection is in jeopardy or that the offer was submitted solely to delay collection. The proposal would provide that the statute of limitations on collection would be tolled for the period during which collection by levy is barred.

Effective Date

The proposal would be effective with respect to taxes assessed on or after 60 days after the date of enactment.

6. Rejected offers-in-compromise and requests for installment agreements to be reviewed

Present Law

After an offer-in-compromise is rejected, the taxpayer has the opportunity to appeal the rejection in IRS Appeals.

Description of Proposal

The proposal would require that the IRS must implement procedures for it to review all proposed IRS rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer.

Effective Date

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

7. Liberal acceptance policy for offers-in-compromise

Present Law

No provision.

Description of Proposal

The proposal would provide that the IRS should implement liberal acceptance procedures for offers-in-compromise to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.

Effective Date

The proposal would be effective on the date of enactment

L. Additional Items

1. Basis for evaluation of IRS employees

Present Law

The IRS is prohibited from using records of tax enforcement results to evaluate IRS employees directly involved in collection activities and the employees' immediate supervisors.

Description of Proposal

The proposal would prohibit using records of tax enforcement results to evaluate or to provide bonuses to any IRS employee. The proposal would also require the Treasury Inspector General to report to the Senate Finance and House Ways and Means Committees annually on whether the law is being followed.

Effective Date

The proposal would be effective on the date of enactment.

2. IRS employee contacts

Present Law

The IRS sends many different notices to taxpayers. Some (but not all) of these notices contain a name and telephone number of an IRS employee who the taxpayer may call if the taxpayer has any questions.

Description of Proposal

The proposal would require that all IRS notices and correspondence contain a name and telephone number of an IRS employee who the taxpayer may call. In addition, to the extent practicable and where it is advantageous to the taxpayer, the IRS should assign one employee to handle a matter with respect to a taxpayer until that matter is resolved.

Effective Date

The proposal would be effective 60 days after the date of enactment.

3. Use of pseudonyms by IRS employees

Present Law

The Federal Service Impasses Panel has ruled that if an employee believes that use of the employee's last name only will identify the employee due to the unique nature of the employee's last name, and/or nature of the office locale, then the employee may "register" a pseudonym with the employee's supervisor.

Description of Proposal

The proposal would require that an employee provide adequate justification, such as protecting personal safety, for the use of a pseudonym as part of the request and that management must approve the request to use a pseudonym before it may be used.

Effective Date

The proposal would be effective on the date of enactment.

4. Conferences of right in the National Office of IRS

Present Law

In any matter involving the submission of a substantive legal matter involving a specific taxpayer to the National Office of the IRS, the taxpayer is entitled to at least one conference (the "conference of right") at which it can explain its position.

Description of Proposal

The proposal would give a taxpayer the right to limit participation in its conference of right to IRS national office personnel.

Effective Date

The proposal would be effective on the date of enactment.

5. Illegal tax protestor designations

Present Law

The IRS designates individuals who meet certain criteria as "illegal tax protestors" in the IRS Master File.

Description of Proposal

The proposal would prohibit the use by the IRS of the "illegal tax protestor" designation. The IRS would, however, be permitted to designate that appropriate taxpayers are nonfilers; IRS must also remove the nonfiler designation once the taxpayer has filed tax returns for two consecutive years and paid all taxes shown on those returns. The Treasury Inspector General would be required to report to Congress annually regarding IRS compliance with the proposal.

Effective Date

The proposal would be effective on the date of enactment.

6. Allow tax-writing committees to obtain confidential information from IRS whistle blowers

Present Law

Tax return information generally may not be disclosed, except as specifically provided by statute. The Secretary of the Treasury may furnish tax return information to the Committee on Finance, the Committee on Ways and Means and the Joint Committee on Taxation upon a written request from the chairmen of such committees. If the information can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer, the information may by furnished to the committee only while sitting in closed executive session unless such taxpayer otherwise consents in writing to such disclosure.

Description of Proposal

The proposal would allow any employee of the IRS to disclose tax return information directly to the Chairman of the Committee on Finance, the Chairman of the Committee on Ways and Means or the Chief of Staff of the Joint Committee on Taxation provided: (1) such disclosure is for the purpose of disclosing an incident of employee or taxpayer abuse and (2) the chairman of the committee to which the information will be disclosed gives prior approval for the disclosure in writing.

Effective Date

The proposal would be effective on the date of enactment.

IV. CONGRESSIONAL ACCOUNTABILITY FOR THE IRS

A. Funding for Century Date Change

Present Law

No specific provision.

Description of Proposal

Operations of the IRS computer systems are critical to the running of the Federal tax system. Accordingly, the proposal would provide that it is the sense of the Senate that the IRS should place resolving the century date change computing problems as a high priority.

Effective Date

The proposal would be effective on the date of enactment.

B. Tax Law Complexity Analysis

Present Law

Present law does not require a formal complexity analysis with respect to changes to the tax laws.

Description of Proposal

The IRS would be required to report to the tax writing committees annually regarding sources of complexity in the Federal tax laws. Factors the IRS may take into account include: frequently asked questions by taxpayers; common errors made by taxpayers in filling out returns; areas of the law that frequently result in disagreements between taxpayers and the IRS; major areas in which there is no or incomplete published guidance or in which the law is uncertain; areas in which revenue agents make frequent errors in interpreting or applying the law; impact of recent legislation on complexity; information regarding forms, including a listing of IRS forms, the time it takes for taxpayers to complete and review forms, the number of taxpayers who use each form, and how the time required changed as a result of recently enacted legislation; and recommendations for reducing complexity.

Effective Date

The proposal would be effective on the date of enactment.

V. REVENUE OFFSETS

A. Employer Deduction for Vacation and Severance Pay

Present Law

For deduction purposes, any method or arrangement that has the effect of a plan deferring the receipt of compensation or other benefits for employees is treated as a deferred compensation plan (sec. 404(b)). In general, contributions under a deferred compensation plan (other than certain pension, profit-sharing and similar plans) are deductible in the taxable year in which an amount attributable to the contribution is includible in income of the employee. However, vacation pay which is treated as deferred compensation is deductible for the taxable year of the employer in which the vacation pay is paid to the employee (sec. 404(a)(5)).

Temporary Treasury regulations provide that a plan, method, or arrangement defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed. A plan, method or arrangement is presumed to defer the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the 3rd calendar month after the end of the employer's taxable year in which the related services are rendered (the "2-1/2 month" period). A plan, method or arrangement is not considered to defer the receipt of compensation or benefits for more than a brief period of time after the end of the employer's taxable year to the extent that compensation or benefits are received by the employee on or before the end of the applicable 2-1/2 month period. (Temp. Treas. Reg. sec. 1.404(b)-1T A-2).

The Tax Court recently addressed the issue of when vacation pay and severance pay are considered deferred compensation in Schmidt Baking Co., Inc., 107 T.C. 271 (1996). In Schmidt Baking, the taxpayer was an accrual basis taxpayer with a fiscal year that ended December 28, 1991. The taxpayer funded its accrued vacation and severance pay liabilities for 1991 by purchasing an irrevocable letter of credit on March 13, 1992. The parties stipulated that the letter of credit represented a transfer of substantially vested interest in property to employees for purposes of section 83, and that the fair market value of such interest was includible in the employees' gross incomes for 1992 as a result of the transfer.[23] The Tax Court held that the purchase of the letter of credit, and the resulting income inclusion, constituted payment of the vacation and severance pay within the 2-1/2 month period. Thus, the vacation and severance pay were treated as received by the employees within the 2-1/2 month period and were not treated as deferred compensation. The vacation pay and severance pay were deductible by the taxpayer for its 1991 fiscal year pursuant to its normal accrual method of accounting.

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[23] While the rules of section 83 may govern the income inclusion, section 404 governs the deduction if the amount involved is deferred compensation.

Description of Proposal

Under the proposal, for purposes of determining whether an item of compensation is deferred compensation (under Code sec. 404), the compensation would not be considered to be paid or received until actually received by the employee. In addition, an item of deferred compensation would not be considered paid to an employee until actually received by the employee. The proposal is intended to overrule the result in Schmidt Baking. For example, with respect to the determination of whether vacation pay is deferred compensation, the fact that the value of the vacation pay is includible in the income of employees within the applicable 2-1/2 month period would not be relevant. Rather, the vacation pay must have been actually received by employees within the 2-1/2 month period in order for the compensation not to be treated as deferred compensation.

It is intended that similar arrangements, in addition to the letter of credit approach used in Schmidt Baking, would not constitute actual receipt by the employee, even if there is an income inclusion. Thus, for example, actual receipt would not include the furnishing of a note or letter or other evidence of indebtedness of the taxpayer, whether or not the evidence is guaranteed by any other instrument or by any third party. As a further example, actual receipt would not include a promise of the taxpayer to provide service or property in the future (whether or not the promise is evidenced by a contract or other written agreement). In addition, actual receipt would not include an amount transferred as a loan, refundable deposit, or contingent payment. Amounts set aside in a trust for employees would not be considered to be actually received by the employee.

The proposal would not change the rule under which deferred compensation (other than vacation pay and deferred compensation under qualified plans) is deductible in the year includible in the gross income of employees participating in the plan if separate accounts are maintained for each employee.

While Schmidt Baking involved only vacation pay and severance pay, there is concern that this type of arrangement may be tried to circumvent other provisions of the Code where payment is required in order for a deduction to occur. Thus, it is intended that the Secretary will prevent the use of similar arrangements. No inference is intended that the result in Schmidt Baking is present law beyond its immediate facts or that the use of similar arrangements is permitted under present law.

The proposal would not affect the determination of whether an item is includible in income. Thus, for example, using the mechanism in Schmidt Baking for vacation pay would still result in income inclusion to the employees, but the employer would not be entitled to a deduction for the vacation pay until actually paid to and received by the employees.

Effective Date

The proposal would be effective for taxable years ending after the date of enactment. Any change in method of accounting required by the bill is treated as initiated by the taxpayer with the consent of the Secretary of the Treasury. Any adjustment required by section 481 as a result of the change will be taken into account in the year of the change.

B. Modify Foreign Tax Credit Carryover Rules

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate foreign tax credit limitations are applied to specific categories of income.

The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and forward five years. The amount carried over may be used as a credit in a carryover year to the extent the taxpayer otherwise has excess foreign tax credit limitation for such year. The separate foreign tax credit limitations apply for purposes of the carryover rules.

Description of Proposal

The proposal would reduce the carryback period for excess foreign tax credits from two years to one year. The proposal also would extend the excess foreign tax credit carryforward period from five years to seven years.

Effective Date

The proposal would apply to foreign tax credits arising in taxable years beginning after the date of enactment.

C. Clarify and Expand Mathematical Error Procedures

Present Law

Taxpayer identification numbers ("TIN"s)

The IRS may deny a personal exemption for a taxpayer, the taxpayer's spouse or the taxpayer's dependents if the taxpayer fails to provide a correct TIN for each person for whom the taxpayer claims an exemption. This TIN requirement also indirectly effects other tax benefits currently conditioned on a taxpayer being able to claim a personal exemption for a dependent (e.g., head-of-household filing status and the dependent care credit). Other tax benefits, including the adoption credit, the child tax credit, the Hope Scholarship credit and Lifetime Learning credit, and the earned income credit also have TIN requirements. For most individuals, their TIN is their Social Security Number ("SSN"). The mathematical and clerical error procedure currently applies to the omission of a correct TIN for purposes of personal exemptions and all of the credits listed above except for the adoption credit.

Mathematical or clerical errors

The IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he or she believes the assessment was made in error.

Description of Proposal

The proposal would provide in the application of the mathematical and clerical error procedure that a correct TIN is a TIN that was assigned by the Social Security Administration (or in certain limited cases, the IRS) to the individual identified on the return. For this purpose the IRS would be authorized to determine that the individual identified on the tax return corresponds in every aspect (including, name, age, date of birth, and SSN) to the individual to whom the TIN is issued. The IRS would be authorized to use the mathematical and clerical error procedure to deny eligibility for the dependent care tax credit, the child tax credit, and the earned income credit even though a correct TIN has been supplied if the IRS determines that the statutory age restrictions for eligibility for any of the respective credits is not satisfied (e.g., the TIN issued for the child claimed as the basis of the child tax credit identifies the child as over the age of 17 at the end of the taxable year).

Effective Date

The proposal would be effective for taxable years ending after the date of enactment.

D. Freeze Grandfathered Status of Stapled REITs

Present Law

A real estate investment trust ("REIT") is an entity that receives most of its income from passive real estate related investments, and the portion of whose income that is distributed to the investors each year generally is taxed to the investors without being subject to tax at the REIT level. A REIT must satisfy a number of tests on a year-by-year basis including the source-of-income tests, which require at least 95 percent of its gross income generally must be derived from rents, dividends, interest and certain other passive sources (the "95-percent test"). In addition, at least 75 percent of its income generally must be from real estate sources, including rents from real property and interest on mortgages secured by real property (the "75-percent test").

In a stapled REIT structure, both the shares of a REIT and a C corporation are subject to a provision that they may not be sold separately. Thus, the REIT and the C corporation have identical ownership at all times. In the Deficit Reduction Act of 1984 (the "1984 Act"), Congress provided that, in applying the tests for REIT status, all stapled entities are treated as one entity. Although the 1984 Act generally was effective upon enactment, it included a grandfather rule that provided that the new provision did not apply to a REIT that was a part of a group of stapled entities if the group of entities was stapled on June 30, 1983, and included a REIT on that date.

Description of Proposal

General rule

The proposal would limit the tax benefits of the existing stapled REITs that qualify under the 1984 Act's grandfather rules. Under the proposal, the REIT and all stapled entities would be treated as a single entity for purposes of determining REIT status with respect to real property interests held by the REIT, a stapled entity, or a subsidiary or partnership in which a 10-percent or greater interest is owned by a stapled entity (the "REIT group"), unless the real property interest is a grandfathered property. Thus, the activities and gross income of a REIT group with respect to non-grandfathered real property interests held by any member of the REIT group would be treated as activities and income of the REIT for purposes of the provisions of the REIT rules that depend on the REIT's gross income (i.e., the 95-percent test and the 75-percent test). If a REIT or stapled entity owns, directly or indirectly, a 10-percent-or-greater interest in a subsidiary or partnership that holds a real property interest, the above rules would apply with respect to a proportionate part of the subsidiary's or partnership's property, activities and gross income. The bill would not apply to a stapled REIT's ownership of a corporate subsidiary, although a stapled REIT would be subject to the normal restrictions on a REIT's ownership of stock in a corporation. Similar rules attributing the proportionate part of the subsidiary's or partnership's real estate interests and gross income would apply when a REIT or stapled entity acquires a 10-percent-or-greater interest (or in the case of a previously-owned entity, acquires an additional interest) after March 26, 1998, with exceptions for interests acquired pursuant to agreements or announcements described below.

Grandfathered properties

Under the proposal, grandfathered properties generally are those properties that had been acquired by a member of the REIT group on or before March 26, 1998. In addition, grandfathered properties include properties acquired by a member of the REIT group after March 26, 1998, pursuant to a written agreement which was binding on March 26, 1998, and all times thereafter. Grandfathered properties also include certain properties, the acquisition of which were described in a public announcement or in a filing with the Securities and Exchange Commission on or before March 26, 1998. While a property does not lose its status as a grandfathered property by reason of a repair to, an improvement of, or a lease of, a grandfathered property, a property loses its status as a grandfathered property to the extent that there is an expansion that either (1) is beyond the boundaries of the land of the otherwise grandfathered property or (2) is an improvement of an otherwise grandfathered property that is placed in service after December 31, 1999, which changes the use of the property and whose cost is greater than 200 percent of (a) the undepreciated cost of the property (prior to the improvement) or (b) in the case of property acquired where there is a substituted basis, the fair market value of the property on the date that the property was acquired by the stapled entity or the REIT.

If a stapled REIT is not stapled as of March 26, 1998, or if it fails to qualify as a REIT as of such date or any time thereafter, no properties of any member of the REIT group would be treated as grandfathered properties, and thus the general provisions of the proposal described above would apply to all properties held by the group.

Mortgage rules

Special rules would apply where the REIT or a stapled entity acquires a mortgage interest after March 26, 1998, where a member of the REIT group performs services with respect to the property secured by the mortgage. In such cases, all interest on the mortgage and all gross income received by a member of the REIT group from the activity would be treated as income of the REIT that does not qualify as a type of income that counts toward the 75-percent and 95-percent tests. An exception would be provided for mortgages the interest on which does not exceed an arm's-length rate and which would be treated as interest for purposes of the REIT rules (e.g., the 75-percent and 95-percent tests, above). The exception for existing mortgages would cease to apply if the mortgage is refinanced and the principal amount is increased in such refinancing.

Other rules

The Secretary of the Treasury would be given authority to prescribe such guidance as may be necessary or appropriate to carry out the purposes of the provision, including guidance to prevent the double counting of income and to prevent transactions that would avoid the purposes of the provision.

Effective Date

The proposal would be effective for taxable years ending after March 26, 1998.

Joint Committee on Taxation
March 27, 1998

ERRATA FOR JCX-17-98

DESCRIPTION OF SENATE FINANCE COMMITTEE CHAIRMAN'S MARK RELATING TO REFORM AND RESTRUCTURING OF THE INTERNAL REVENUE SERVICE

Effective date of Item V.B. Modify Foreign Tax Credit Carryover Rules should be revised to read as follows:

The proposal would apply to foreign tax credits arising in taxable years ending after the date of enactment.

Insert at the end of the document the following new item (and add heading to the Contents):

E. Make Certain Trade Receivables Ineligible for Mark-to-Market Treatment

Present Law

In general, dealers in securities are required to use a mark-to-market method of accounting for securities (sec. 475). Exceptions to the mark-to-market rule are provided for securities held for investment, certain debt instruments and obligations to acquire debt instruments and certain securities that hedge securities. A dealer in securities is a taxpayer who regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business, or who regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in certain types of securities with customers in the ordinary course of a trade or business. A security includes (1) a share of stock, (2) an interest in a widely held or publicly traded partnership or trust, (3) an evidence of indebtedness, (4) an interest rate, currency, or equity notional principal contract, (5) an evidence of an interest in, or derivative financial instrument in, any of the foregoing securities, or any currency, including any option, forward contract, short position, or similar financial instrument in such a security or currency, or (6) a position that is an identified hedge with respect to any of the foregoing securities.

Treasury regulations provide that if a taxpayer would be a dealer in securities only because of its purchases and sales of debt instruments that, at the time of purchase or sale, are customer paper with respect to either the taxpayer or a corporation that is a member of the same consolidated group, the taxpayer will not normally be treated as a dealer in securities. However, the regulations allow such a taxpayer to elect out of this exception to dealer status.[1] For this purpose, a debt instrument is customer paper with respect to a person if: (1) the person's principal activity is selling nonfinancial goods or providing nonfinancial services; (2) the debt instrument was issued by the purchaser of the goods or services at the time of the purchase of those goods and services in order to finance the purchase; and (3) at all times since the debt instrument was issued, it has been held either by the person selling those goods or services or by a corporation that is a member of the same consolidated group as that person.

Description of Proposal

The proposal would provide that certain trade receivables would not be eligible for mark-to-market treatment, whether the taxpayer is a securities dealer required to use mark-to-market treatment or elects such treatment under the Treasury regulation. The trade receivables that would be excluded would include non-interest bearing receivables, and account, note and trade receivables unrelated to an active business of a securities dealer. The proposal would grant the Treasury regulatory authority to carry out the purposes of the proposal. The proposal would not affect the non-accrual experience method of accounting for service providers.

Effective Date

The proposal generally would be effective for taxable years ending after the date of enactment. Adjustments required under section 481 as a result of the change in method of accounting would be required to be taken into account ratably over the four-year period beginning in the first taxable year for which the proposal is in effect.

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[1] Treas. reg. sec. 1.475(c)-1(b), issued December 23, 1996; the "customer paper election."