DESCRIPTION OF H.R. 3056, THE "TAX COLLECTION RESPONSIBILITY ACT OF 2007"

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INTRODUCTION

The House Committee on Ways & Means has scheduled a markup on July 18, 2007. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of H.R. 3056, the "Tax Collection Responsibility Act of 2007."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 3056, the "Tax Collection Responsibility Act of 2007,"* (JCX-49-07), July 17, 2007.

A. Repeal of Private Tax Collection Contract Authority

Present Law

Under present law, the IRS may use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities of any type and to arrange payment of those taxes by the taxpayers.[2]

There are several administrative procedures applicable to the use of private debt collection contracts. First, provisions of the Fair Debt Collection Practices Act apply to the private debt collection company. Second, taxpayer protections that are statutorily applicable to the IRS are also made statutorily applicable to the private sector debt collection companies. In addition, taxpayer protections that are statutorily applicable to IRS employees also are made statutorily applicable to employees of private sector debt collection companies. Third, subcontractors of the private debt collection companies are subject to a number of restrictions regarding their contact with taxpayers.

Present law provides for payments to private debt collection companies to be made from the amount collected pursuant to a private debt collection contract, but not in excess of 25 percent of the amount collected. Present law also permits the IRS to retain 25 percent from the amount collected pursuant to a private debt collection contract for additional enforcement activities.

Description of Proposal

The proposal repeals the authority for the IRS to enter into private debt collection contracts.

Effective Date

The proposal is effective on the date of enactment.

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[2] Sec. 6306.

B. Delayed Implementation of Government Withholding

Present law

For payments made after December 31, 2010, the Code requires withholding at a three-percent rate on certain payments to persons providing property or services made by the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies). The withholding requirement applies regardless of whether the government entity making such payment is the recipient of the property or services. Political subdivisions of States (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services that would otherwise be subject to withholding under this provision are exempt from the withholding requirement.

Payments subject to the three-percent withholding include any payment made in connection with a government voucher or certificate program which functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the withholding requirement. The provision imposes information reporting requirements on payments subject to withholding under the provision.

The three-percent withholding requirement does not apply to any payments made through a Federal, State, or local government public assistance or public welfare program for which eligibility is determined by a needs or income test. The three-percent withholding requirement also does not apply to payments of wages or to any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. The provision does not exclude payments that are potentially subject to backup withholding under section 3406. If, however, payments are actually being withheld under backup withholding, withholding does not apply.

The three-percent withholding requirement also does not apply to the following: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in section 6050M(e)(3)); and payments to a government employee that are not otherwise excludable from the new withholding provision with respect to the employee's services as an employee.

Description of Proposal

The proposal delays the effective date for the three-percent withholding requirement. Under the proposal, the requirement applies to payments made after December 31, 2011.

The proposal directs the Secretary to study issues associated with the three-percent withholding requirement, including (1) the problems, if any, which are anticipated in administering and complying with such requirement, (2) the burdens, if any, that such requirements will place on small businesses (taking into account such mechanisms as may be necessary to administer such requirements), and (3) the application of such requirements to small expenditures for services and goods by governments.

The Secretary is to submit his report to the House Committee on Ways and Means and the Senate Committee on Finance no later than six months after the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

C. Application of Statute of Limitations Rules to Persons Claiming U.S. Virgin Islands Residency

Present Law

Return filing rules for Virgin Islands residents

An individual who is a bona fide resident of the U.S. Virgin Islands ("USVI") during the entire taxable year or who files a joint return for the taxable year with a person who is a bona fide USVI resident during that entire year must file an income tax return for the taxable year with the USVI.[3]

For an individual (1) who is a bona fide resident of the USVI during the entire taxable year, (2) who, on the income tax return filed with the USVI, reports income from all sources and identifies the source of each item shown on the return, and (3) who fully pays the tax liability resulting from the income shown on the return, for purposes of calculating income tax liability to the United States, gross income does not include any amount included in gross income on the USVI return, and allocable deductions and credits are not taken into account.[4] Accordingly, an individual who is a bona fide USVI resident generally may satisfy the individual's U.S. return-filing and income tax payment obligations by filing an income tax return with the USVI and paying income tax to the USVI.

Statute of limitations

The IRS generally must assess tax within three years after the due date for the return to which the assessment relates.[5]

In certain circumstances, the three-year statute of limitations does not apply, and the IRS may assess tax at any time. These circumstances include the filing of a false or fraudulent return with the intent to evade tax; a willful attempt to defeat or evade tax; and the failure to file a return.

Statute of limitations for USVI residents

In guidance published in 1999, the IRS concluded that when a U.S. citizen who was a bona fide resident of the USVI timely filed a USVI income tax return but failed to report on that return a U.S.-source dividend, the three-year statute of limitations period began to run with the filing of the USVI return and the IRS was precluded from assessing tax after expiration of the three-year period.[6] In 2006 guidance, the IRS concluded that when a U.S. citizen who timely

[3] Sec. 932(c)(1), (2).

[4] Sec. 932(c)(4).

[5] Sec. 6501(a), (b)(1).

[6] Field Service Advice Memorandum 199906031 (Feb. 12, 1999).

files a USVI income tax return fails to satisfy a requirement of section 932(c)(4) (because, for example, the individual is not a bona fide USVI resident or does not report all income on the USVI return), the three-year statute of limitations period does not begin to run until the individual also files a return with the IRS.[7]

In 2007 guidance, the IRS provided rules for the application of the three-year statute of limitations period and the section 932(c) return filing requirements to a U.S. citizen or resident who claims status as a bona fide USVI resident.[8] As a result of this guidance, for taxable years ending on or after December 31, 2006, the three-year statute of limitations period for every U.S. citizen or resident claiming to be a bona fide USVI resident generally begins when the individual files an income tax return with the USVI.

The rules in the 2007 guidance for an individual who claims bona fide USVI residence for a taxable year ending before December 31, 2006 differ based on whether the individual is a "covered person" or a non-covered person. A covered person is a U.S. citizen or resident alien who takes the position that he or she is a bona fide USVI resident, files a USVI income tax return, and has less than $75,000 gross income for the taxable year. A covered person generally may claim application of the three-year statute of limitations period for a taxable year ending before December 31, 2006 based on that person's filing of a USVI income tax return for that year. A non-covered person may start the running of the three-year limitations period for a taxable year ending before December 31, 2006 by filing an income tax return for that year with the IRS and reporting on that return no gross income and no taxable income. The three-year limitations period starts with the filing of the return with the IRS.

Description of Proposal

The proposal provides generally that an income tax return filed with the USVI by an individual claiming to be a bona fide USVI resident during the entire taxable year (or to be a person filing a joint return for the taxable year with an individual who is a bona fide USVI resident during the entire year) will be treated for purposes of subtitle F of the Code (Procedure and Administration) in the same manner as if the return were an income tax return filed with the United States for that year. Consequently, under the proposal the filing of a USVI income tax return by any individual claiming status as a bona fide USVI resident generally starts the three-year limitations period. This rule does not, however, apply if the return filed with the USVI is false or fraudulent with the intent to avoid tax or otherwise is a willful attempt in any manner to defeat or evade tax.

Effective Date

The proposal applies to taxable years beginning after 1986.

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[7] Chief Counsel Advice Memorandum 200624002 (June 16, 2006).

[8] Notice 2007-19, 2007-11 I.R.B. 689 (Mar. 12, 2007); Notice 2007-31, 2007-16 I.R.B. 971 (Apr. 16, 2007).

D. Revision of Tax Rules on Expatriation of Individuals

<u>Present Law</u>

<u>In general</u>

<u>Income tax</u>

U.S. citizens and residents generally are subject to U.S income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign source income. Nonresident aliens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. trade or business.

Certain special rules (sections 671-679) apply to certain trust interests deemed to be owned by the grantor or other person (a "grantor trust"). In that case, the deemed owner must include in income the items of income and deduction (and credits against tax) of the portion of such trust deemed to be owned by such person.

Except to the extent a trust is a grantor trust, a transfer of property by a U.S. person to a foreign estate or trust is treated (under section 684) by the transferor as if the property had been sold to such estate or trust. The same rule applies if a domestic trust becomes a foreign trust.

<u>Estate tax</u>

The estates of U.S. citizens and residents are subject to estate tax on all property, wherever located. The estates of nonresident aliens generally are subject to estate tax on U.S.-situated property (e.g., real estate and tangible property located within the United States and stock in a U.S. corporation).

<u>Gift tax</u>

U.S. citizens and residents generally are subject to gift tax on transfers by gift of any property, wherever situated. Nonresident aliens generally are subject to gift tax on transfers by gift of U.S.-situated property (e.g., real estate and tangible property located within the United States), but excluding intangibles, such as stock, regardless of where they are located.

<u>Income tax rules with respect to expatriates</u>

For the 10 taxable years after an individual relinquishes his or her U.S. citizenship or terminates his or her U.S. long-term residency, unless certain conditions are met, the individual is subject to an alternative method of income taxation than that generally applicable to nonresident aliens (the "alternative tax regime"). Generally, the individual is subject to income

tax for the 10-year period at the rates applicable to U.S. citizens, but only on U.S.-source income.[9]

A "long-term resident" is a noncitizen who is a lawful permanent resident of the United States for at least eight taxable years during the period of 15 taxable years ending with the taxable year during which the individual either ceases to be a lawful permanent resident of the United States or commences to be treated as a resident of a foreign country under a tax treaty between such foreign country and the United States (and does not waive such benefits).

A former citizen or former long-term resident is subject to the alternative tax regime for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or former long-term resident: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004) and his or her net worth is less than $2 million, or alternatively satisfies limited, objective exceptions for certain dual citizens and minors who have had no substantial contacts with the United States; and (2) certifies under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years and provides such evidence of compliance as the Secretary may require.

Anti-abuse rules are provided to prevent the circumvention of the alternative tax regime.

Estate tax rules with respect to expatriates

Special estate tax rules apply to individuals who die during a taxable year in which he or she is subject to the alternative tax regime. Under these special rules, certain closely-held foreign stock owned by the former citizen or former long-term resident is includible in his or her gross estate to the extent that the foreign corporation owns U.S.-situated assets. The special rules apply if, at the time of death: (1) the former citizen or former long-term resident directly or indirectly owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation; and (2) directly or indirectly, is considered to own more than 50 percent of (a) the total combined voting power of all classes of stock entitled to vote in the foreign corporation, or (b) the total value of the stock of such corporation. If this stock ownership test is met, then the gross estate of the former citizen or former long-term resident includes that proportion of the fair market value of the foreign stock owned by the individual at the time of death, which the fair market value of any assets owned by such foreign corporation and situated in the United States (at the time of death) bears to the total fair market value of all assets owned by such foreign corporation (at the time of death).

Gift tax rules with respect to expatriates

Special gift tax rules apply to individuals who make gifts during a taxable year in which he or she is subject to the alternative tax regime. The individual is subject to gift tax on gifts of U.S.-situated intangibles made during the 10 years following citizenship relinquishment or

[9] For this purpose, however, U.S.-source income has a broader scope than it does typically in the Code.

residency termination. In addition, gifts of stock of certain closely-held foreign corporations by a former citizen or former long-term resident are subject to gift tax, if the gift is made during the time that such person is subject to the alternative tax regime. The operative rules with respect to these gifts of closely-held foreign stock are the same as described above relating to the estate tax, except that the relevant testing and valuation date is the date of gift rather than the date of death.

Termination of U.S. citizenship or long-term resident status for U.S. Federal income tax purposes

An individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes, including for purposes of section 7701(b)(10), until the individual: (1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively; and (2) provides a statement to the Secretary of the Treasury in accordance with section 6039G.

Sanction for individuals subject to the individual tax regime who return to the United States for extended periods

The alternative tax regime does not apply to any individual for any taxable year during the 10-year period following citizenship relinquishment or residency termination if such individual is present in the United States for more than 30 days in the calendar year ending in such taxable year. Such individual is treated as a U.S. citizen or resident for such taxable year and, therefore, is taxed on his or her worldwide income.

Similarly, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any calendar year ending during the 10-year period following citizenship relinquishment or residency termination, and the individual dies during that year, he or she is treated as a U.S. resident, and the individual's worldwide estate is subject to U.S. estate tax. Likewise, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, the individual is subject to U.S. gift tax on any transfer of his or her worldwide assets by gift during that taxable year.

For purposes of these rules, an individual is treated as present in the United States on any day if such individual is physically present in the United States at any time during that day. The present-law exceptions from being treated as present in the United States for residency purposes[10] generally do not apply for this purpose. However, for individuals with certain ties to countries other than the United States[11] and individuals with minimal prior physical presence in

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[10] Secs. 7701(b)(3)(D), 7701(b)(5) and 7701(b)(7)(B)-(D).

[11] An individual has such a relationship to a foreign country if (1) the individual becomes a citizen or resident of the country in which the individual was born, such individual's spouse was born, or either of the individual's parents was born, and (2) the individual becomes fully liable for income tax in such country.

the United States,[12] a day of physical presence in the United States is disregarded if the individual is performing services in the United States on such day for an unrelated employer (within the meaning of sections 267 and 707(b)), who meets the requirements the Secretary of the Treasury may prescribe in regulations. No more than 30 days may be disregarded during any calendar year under this rule.

Annual return

Former citizens and former long-term residents are required to file an annual return for each year following citizenship relinquishment or residency termination in which they are subject to the alternative tax regime. The annual return is required even if no U.S. Federal income tax is due. The annual return requires certain information, including information on the permanent home of the individual, the individual's country of residence, the number of days the individual was present in the United States for the year, and detailed information about the individual's income and assets that are subject to the alternative tax regime. This requirement includes information relating to foreign stock potentially subject to the special estate and gift tax rules.

If the individual fails to file the statement in a timely manner or fails correctly to include all the required information, the individual is required to pay a penalty of $10,000. The $10,000 penalty does not apply if it is shown that the failure is due to reasonable cause and not to willful neglect.

Description of Proposal

In general

In general, the proposal subjects certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residence to tax. Such individuals are subject to tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before the expatriation or residency termination ("mark-to-market tax"). Gain from the deemed sale is taken into account at that time without regard to other Code provisions. Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000. The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2007. Any gains or losses subsequently realized are to be adjusted for gains and losses taken into account under the deemed sale rules, without regard to the $600,000 exemption.

[12] An individual has a minimal prior physical presence in the United States if the individual was physically present for no more than 30 days during each year in the ten-year period ending on the date of loss of United States citizenship or termination of residency. However, for purposes of this test, an individual is not treated as being present in the United States on a day if the individual remained in the United States because of a medical condition that arose while the individual was in the United States. Sec. 7701(b)(3)(D)(ii).

The deemed sale rule of the proposal applies to most types of property interests held by the individual on the date of relinquishment of citizenship or termination of residency, with certain exceptions. U.S. real property interests (which remain subject to U.S. tax in the hands of nonresident noncitizens), with the exception of stock of certain former U.S. real property holding corporations, are exempted from the proposal. In addition, deferred compensations items, interests in nongrantor trusts, and specified tax deferred accounts are excepted from the deemed sale rule but are subject to special rules described below.

Individuals covered

The mark-to-market tax applies to any U.S. citizen who relinquishes citizenship and any long-term resident who terminates U.S. residency, if such individual (1) has an average annual net income tax liability for the five preceding years ending before the date of the loss of U.S. citizenship or residency termination that exceeds $124,000 (as adjusted for inflation after 2004 -- $136,000 in 2007);[13] (2) has a net worth of $2 million or more on such date; or (3) fails to certify under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years or fails to submit such evidence of compliance as the Secretary may require ("covered expatriate").

Exceptions to an individual's classification as a covered expatriate due to (1) or (2) above (but not (3)) are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual has been a resident of the United States for not more than 10 taxable years during the 15-year taxable year period ending with the taxable year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18½, provided that the individual was a resident of the United States for no more than 10 taxable years before such relinquishment.

The definition of "long-term resident" under the proposal is the same as that under present law. As under present law, an individual is considered to terminate long-term residency when the individual ceases to be a lawful permanent resident (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have been abandoned), including being treated as a resident of another country under a tax treaty and not waiving the benefits of the treaty. In the case of a long-term resident, the date that such long term residency is terminated is the "expatriation date." In the case of a citizen, the date that the individual relinquishes citizenship is the "expatriation date."

For purposes of the mark-to-market tax, an individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary

[13] Rev. Proc. 2006-53, sec. 3.29, 2006-48 I.R.B. 996.

relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization.

In addition, the proposal provides that, for all tax purposes, including for purposes of section 877 (i.e., not limited to the mark-to-market tax), a U.S. citizen continues to be treated as a U.S. citizen for tax purposes until that individual's citizenship is treated as relinquished under the rules of the immediately preceding paragraph. However, under Treasury regulations, relinquishment may occur earlier with respect to an individual who became at birth a citizen of the United States and of another country.

The proposal repeals the present-law rules that provide that an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes until the individual gives certain notice of an expatriating act or termination of residency.

Deferral of payment of mark-to-market tax

Under the proposal, an individual is permitted to elect to defer payment of the mark-to-market tax imposed on the deemed sale of property. Interest is charged for the period the tax is deferred at the rate normally applicable to individual underpayments. The election is irrevocable and is made on a property-by-property basis. Under the election, the deferred tax attributable to a particular property is due when the return is due for the taxable year in which the property is disposed (or, if the property is disposed of in a transaction in which gain is not recognized in whole or in part, at such other time as the Secretary of the Treasury may prescribe). The deferred tax attributable to a particular property is an amount that bears the same ratio to the total mark-to-market tax as the gain taken into account with respect to such property bears to the total gain taken into account under these rules. The deferral of the mark-to-market tax may not be extended beyond the due date of the return for the taxable year which includes the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to provide a bond to the Secretary. The bond must be conditioned upon payment of the amount of tax due, plus interest thereon, and must be in accordance with such requirements relating to terms, conditions, form of the bond, and sureties, as may be specified by regulations. The bond must be approved by the Secretary. Other security mechanisms, including letters of credit, are permitted provided that the individual establishes to the satisfaction of the Secretary that the security is adequate. In the event that the security provided with respect to a particular property subsequently becomes inadequate and the individual fails to correct the situation, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the assessment or collection of the tax.

Deferred compensation items

The proposal contains special rules for interests in a "deferred compensation item." For purposes of the proposal, a "deferred compensation item" means any interest in a plan or arrangement described in section 219(g)(5), any interest in a foreign pension plan or similar retirement arrangement or program, any item of deferred compensation, and any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83.

The plans and arrangements described in section 219(g)(5) are (i) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a); (ii) an annuity plan described in section 403(a); (iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)); (iv) an annuity contract described in section 403(b); (v) a simplified employee pension (within the meaning of section 408(k)); (vi) a simplified retirement account (within the meaning of section 408(p)); and (vii) a trust described in section 501(c)(18).

If a deferred compensation item is an eligible deferred compensation item, the payor must deduct and withhold from any "taxable payment" to a covered expatriate a tax equal to 30 percent of such taxable payment. This withholding requirement is in lieu of any withholding requirement under present law. A taxable payment is subject to withholding to the extent it would be included in gross income of the covered expatriate if such person were a U.S. citizen or resident. A taxable payment includes an item that would be included in gross income pursuant to section 83 (even if no payment is actually made at that time). In the case of property or a right to property that has not been taken into account under section 83, payment occurs at the time section 83 requires income recognition with respect to the property.

If a deferred compensation item is not an eligible deferred compensation item, an amount equal to the present value of the covered expatriate's accrued benefit is treated as having been received on the day before the expatriation date. In addition, these deemed distributions are not subject to additional tax. For this purpose, additional tax means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), and 530(d)(4). Appropriate adjustments shall be made to subsequent distributions to take into account this treatment.

An "eligible deferred compensation item" means any deferred compensation item with respect to which (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of withholding and who meet the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, and (ii) the covered expatriate notifies the payor of his status as a covered expatriate and irrevocably waives any claim of withholding reduction under any treaty with the United States.

Interests in trusts

Grantor trusts

In the case of the portion of any trust for which the covered expatriate is treated as the owner under the grantor trust provisions of the Code (sections 671-679), as determined

immediately before the expatriation date, the assets held by that portion of the trust are subject to the deemed sale rules of the proposal, i.e., they are subject to mark-to-market tax. If a trust that is a grantor trust immediately before that date subsequently becomes a nongrantor trust, such trust remains a grantor trust for purposes of the proposal.

Nongrantor trusts

Special rules apply to interests in nongrantor trusts. In the case of the portion of any trust which the covered expatriate is not treated as the owner under the grantor trust provisions of the Code (sections 671-679), as determined immediately before the expatriation date, the mark-to-market tax does not apply. Instead, in the case of any direct or indirect distribution from the trust to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the portion of the distribution which would be includible in the gross income of the covered expatriate if the expatriate were subject to U.S. income tax. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States.

In addition, if the nongrantor trust distributes appreciated property to a covered expatriate, the trust recognizes gain as if the property were sold to the expatriated at its fair market value.

If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust for which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the proposal as a distribution to such covered expatriate to the extent of the portion of the trust for which the covered expatriate is treated as the owner.

Specified tax deferred accounts

In the case of any interest in a specified tax deferred account held by a covered expatriate on the day before the expatriation date, the expatriate is treated as receiving a distribution of his entire interest in the account on that date. Appropriate adjustments are made for subsequent distributions to take into account this treatment. As with deferred compensation items, these deemed distributions are not subject to additional tax.

The term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts.

Special rules

Notwithstanding any other provision of the Code, any period for acquiring property which results in the reduction of gain recognized with respect to property disposed of by the taxpayer terminates on the day before the expatriation day. This rule applies to certain

incomplete transactions such as deferred like-kind exchanges and involuntary conversions. In addition, notwithstanding any other provision of the Code, any extension of time for payment of tax ceases to apply on the day before relinquishment of citizenship or termination of residency, and the unpaid portion of such tax becomes due and payable at the time and in the manner prescribed by the Secretary.

For purposes of determining the tax imposed under the deemed sale rule, property that was held by an individual on the date that such individual first became a resident of the United States (within the meaning of section 7701(b)) is treated as having a basis on such date of not less than the fair market value of such property on such date. An individual may make an irrevocable election not to have this rule apply.

In the case of a domestic trust that becomes a foreign trust due to the expatriation of an individual, the general income tax rules pertaining to transfers by U.S. persons to foreign trusts (i.e., section 684) apply before the rules of the proposal.

Regulatory authority

The proposal authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the of the income tax rules of the proposal.

Treatment of gifts and bequests from a former citizen or former long-term resident

Under the proposal, a special transfer tax applies to certain "covered gifts or bequests" received by a U.S. citizen or resident. A covered gift or bequest is any property acquired (i) by gift directly or indirectly from an individual who was a covered expatriate at the time of such acquisition, or (ii) directly or indirectly by reason of the death of an individual who was a covered expatriate. A covered gift or bequest, however, does not include (i) any property shown as a taxable gift on a timely filed gift tax return by the covered expatriate, and (ii) any property included in the gross estate of the covered expatriate for estate tax purposes and shown on a timely filed estate tax return of the estate of the covered expatriate.

The tax is calculated as the product of (i) the highest marginal rate of tax specified in the table in relating to estate tax (i.e., section 2001(c)) or, if greater, the highest marginal rate of tax specified in the table relating to gift tax (i.e., section 2502(a)), both as in effect on the date of receipt of the covered gift or bequest; and (ii) the value of the covered gift or bequest.

The tax is imposed upon the recipient of the covered gift or bequest and is imposed on a calendar-year basis. The tax applies only to the extent that the covered gifts and bequests received by the tax payer exceed $10,000 during the calendar year. The tax on covered gifts and bequests is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest.

Special rules apply to the tax on covered gifts or bequests made to domestic or foreign trusts. In the case of a covered gift or bequest made to a domestic trust, the tax applies as if the trust were a U.S. citizen and the trust is required to pay the tax. In the case of a covered gift or bequest made to a foreign trust, the tax applies to any distribution, whether from income or corpus, made from such trust to a recipient that is a U.S. citizen or resident, in the same manner

as if such distribution were a covered gift or bequest. Such a recipient is entitled to a deduction for income tax purposes for such tax to the extent the tax is imposed on the portion of such distribution included in the gross income of the recipient. For purposes of these rules, a foreign trust may elect to be treated as a domestic trust. The election may not be revoked without the Secretary's consent.

Coordination with present-law alternative tax regime

Under the proposal, the present-law expatriation income tax rules under section 877 generally continue to apply to a covered expatriate whose expatriation or residency termination occurs on or after the date of enactment.

Information reporting

Certain information reporting requirements under the law presently applicable to former citizens and former long-term residents (sec. 6039G) also apply for purposes of the proposal.

Effective Date

The proposal generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment. However, the portion of the proposal relating to covered gifts and bequests is effective for gifts and bequests received from former citizens or former long-term residents (or their estates) on or after the date of enactment, regardless of when the transferor expatriated.

E. Repeal of Provision Regarding Suspension of Interest and Penalties Where Internal Revenue Service Fails to Contact Taxpayer

Present Law

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was aware that there was tax due. Prior to amendment by the Small Business and Work Opportunity Tax Act of 2007, the accrual of certain penalties and interest is suspended starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period.[14] If a tax return is filed before the due date, for purposes of interest suspension it is considered to have been filed on the due date. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self assessed the tax. The suspension only applies to taxpayers who file a timely tax return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. Generally, the suspension of interest also does not apply to interest accruing with respect to underpayments resulting from listed transactions or undisclosed reportable transactions.

For IRS notices issued after October 25, 2007, the Small Business and Work Opportunity Tax Act of 2007 provides that the accrual of penalties and interest is suspended starting 36 months after the filing of the tax return.[15] Because the general statute of limitations on assessment of tax is 36 months after the filing of a tax return, the effect of the provision in the Small Business and Work Opportunity Tax Act of 2007 is that interest suspension only applies to tax liabilities eligible for suspension which may be assessed more than three years after the filing of a tax return.

Description of Proposal

The proposal repeals the suspension of interest and certain penalties provision. The Small Business and Work Opportunity Tax Act of 2007 provides that the accrual of penalties and interest is suspended starting 36 months after the filing of a tax return. Thus, the effect of the proposal is to eliminate interest suspension for liabilities which may be assessed more than three years after the filing of a tax return.

Effective Date

The proposal is effective for IRS notices issued after the date that is six months after the date of enactment of the Small Business and Work Opportunity Act of 2007.

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[14] Sec. 6404(g).

[15] Pub. L. No. 110-28, sec. 8242 (2007).

F. Increase in Information Return Penalties

Present Law

Present law imposes information reporting requirements on participants in certain transactions. Under section 6721, any person required to file a correct information return who fails to do so on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed. If a person files a correct information return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $15 per return (the "first-tier penalty"), with a maximum penalty of $75,000 per calendar year. If a person files a correct information return after the date that is after 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is $30 per return (the "second-tier penalty"), with a maximum penalty of $150,000 per calendar year. If a correct information return is not filed on or before August 1, of any year, the amount of the penalty is $50 per return (the "third-tier penalty"), with a maximum penalty of $250,000 per calendar year.

Special lower maximum levels for this penalty apply to small businesses. Small businesses are defined as firms having average annual gross receipts for the most recent three taxable years that do not exceed $5 million. The maximum penalties for small businesses are: $25,000 (instead of $75,000) if the failures are corrected on or before 30 days after the prescribed filing date; $50,000 (instead of $150,000) if the failures are corrected on or before August 1; and $100,000 (instead of $250,000) if the failures are not corrected on or before August 1.

Section 6722 also imposes penalties for failing to furnish correct payee statements to taxpayers. In addition, section 6723 imposes a penalty for failing to comply with other information reporting requirements. Under both section 6722 and section 6723, the penalty amount is $50 for each failure, up to a maximum of $100,000.

Description of Proposal

The proposal increases the penalties for failing to file correct information returns, failing to furnish correct payee statements, and for failing to comply with other information reporting requirements. Specifically, the proposal increases the failure to file correct information returns as follows: the first-tier penalty would be increased from $15 to $25, with a maximum penalty of $200,000 per calendar year; the second-tier penalty would be increased from $30 to $60, with a maximum penalty of $400,000 per calendar year; and the third-tier penalty would be increased from $50 to $100, with a maximum penalty of $600,000 per calendar year. The maximum penalties for small businesses would be: $75,000 if the failures are corrected on or before 30 days after the prescribed filing date; $150,000 if the failures are corrected on or before August 1; and $250,000 if the failures are not corrected on or before August 1.

The proposal increases both the penalty for failing to furnish correct payee statements to taxpayers and the penalty for failing to comply with other information reporting requirements penalties to $100 for each such failure, up to a maximum of $600,000 in a calendar year.

Effective Date

The proposal is effective with respect to information returns required to be filed on or after January 1, 2008.

G. Modifications to Corporate Estimated Tax Payments

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

Under present law, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 114.50 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Description of Proposal

The proposal increases the percentage from 114.50 percent to 114.75 percent.

Effective Date

The proposal is effective on the date of enactment.