Joint Committee on Taxation
April 4, 2000
JCX-43-00

DESCRIPTION OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE PROVISIONS OF THE "TAXPAYER BILL OF RIGHTS 2000"

The House Committee on Ways and Means has scheduled a markup of the provisions of the "Taxpayer Bill of Rights 2000"[1] on April 5, 2000. This document,[2] prepared by the staff of the Joint Committee on Taxation, contains a description of an amendment in the nature of a substitute to the "Taxpayer Bill of Rights 2000."

The amendment in the nature of a substitute contains the provisions of the "Taxpayer Bill of Rights 2000" with the following modifications and additional provisions.

I. MODIFICATIONS TO PROVISIONS

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

The proposal would be modified to provide that the exclusion from income of underpayment interest would not apply if the Secretary determines that the taxpayer's principal purpose in filing a claim for refund or amended return is to take advantage of the exclusion.

For example, a taxpayer prepares his return taking the basic standard deduction although he is aware that he is entitled to choose to take significant itemized deductions. Before the expiration of the statute of limitations, the taxpayer files an amended return claiming these itemized deductions and requesting a refund with interest. Unless the taxpayer can establish another purpose for the delay in claiming the itemized deductions, the Secretary may determine that the principal purpose of waiting to claim the deductions on an amended return was to earn interest that would be excluded from income. In that case, the interest on the underpayment could not be excluded from income.

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[1] A description of the provisions of the "Taxpayer Bill of Rights 2000" may be found in Joint Committee on Taxation, *Description of the "Taxpayer Bill of Rights 2000"* (JCX-42-00), April 3, 2000.

[2] This document may be cited as follows: Joint Committee on Taxation, *Description of an Amendment in the Nature of a Substitute to the Provisions of the "Taxpayer Bill of Rights 2000"* (JCX-43-00), April 4, 2000.

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

B. Penalty for Failure to Pay Tax

The amendment in the nature of a substitute deletes the provision relating to the repeal of the penalty for failure to pay tax and imposition of a late payment service charge (section 103), and inserts the following provision in its place:

Partial Repeal and Reduction in the Penalty for Failure to Pay Tax (sec. 103 of the bill)

Present Law

Taxpayers who fail to pay their taxes are generally subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent.[3] If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return. If a return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of $100 or 100 percent of the amount required to be shown on the return. For any month in which an installment payment agreement with the IRS is in effect, the rate of the penalty is half the usual rate (0.25 percent instead of 0.5 percent), provided that the taxpayer filed the tax return in a timely manner (including extensions).[4] The rate of the penalty is twice the usual rate (1.0 percent instead of 0.5 percent) for months beginning after the IRS notifies the taxpayer that the IRS will levy upon the assets of the taxpayer.[5]

Description of Proposal

The proposal would partially repeal and reduce the penalty for failure to pay tax. The first element of the proposal would repeal the penalty for failure to pay tax for taxpayers with respect to whom an installment payment agreement with the IRS is in effect, provided that the taxpayer filed the tax return in a timely manner (including extensions). Thus, for any month in which an installment payment agreement with the IRS is in effect, the rate of the penalty is zero (instead of 0.25 percent), provided that the taxpayer filed the tax return in a timely manner (including extensions).

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

[4] Sec. 6651(h). This provision was added by sec. 3303 of the IRS Reform Act, effective for purposes of determining additions to the tax for months beginning after December 31, 1999.

[5] Sec. 6651(d). This provision was added by sec. 1502 of the Tax Reform Act of 1986.

The second element of the proposal would reduce by half the failure to pay tax penalty for all other taxpayers (generally, those who have not entered into an installment payment agreement with the IRS). Thus, in general, the rate of the penalty would be 0.25 percent per month instead of 0.5 percent per month. The special rate for months beginning after the IRS notifies the taxpayer that the IRS will levy upon the assets of the taxpayer would also be reduced by half (0.5 percent instead of 1.0 percent).

The third element of the proposal would provide that taxpayers who enter into installment agreements would not be required to pay the present-law $43 fee for installment agreements[6] while automated withdrawals of installment payments are made directly from their bank account.

Effective Date

The repeal of the penalty for failure to pay tax for taxpayers with respect to whom an installment payment agreement with the IRS is in effect, provided that the taxpayer filed the tax return in a timely manner (including extensions), would be effective for purposes of determining additions to tax for months beginning after December 31, 2000.

The reduction by half of the failure to pay tax penalty for all other taxpayers also would be effective for purposes of determining additions to tax for months beginning after December 31, 2000.

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

II. ADDITIONAL PROVISIONS

A. Modification of interest netting rules for individuals (sec. 106 of the bill)

Present Law

A special net interest rate of zero applies to the extent that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer.[7] If both the underpayment and overpayment are unsatisfied, the interest rate applied to both will be zero. If either the underpayment or overpayment has previously been satisfied, the interest rate applicable to the unsatisfied amount will be equal to the interest rate applicable to the satisfied amount to the extent that interest was allowable or payable on both the underpayment and the overpayment for the same period.

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

[7] This provision was enacted in sec. 3301 of the IRS Reform Act.

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

For example, on July 1, 2003, a deficiency of $1,000 is determined with respect to an individual taxpayer's 2000 Federal income tax return, which the taxpayer pays within 21 days. In the meantime, the taxpayer has filed returns for 2001 and 2002, showing a refund due to overwithholding each year of $1,000. The IRS issues the appropriate refund checks on May 15, within 45 days of the due date of the returns. Thus, interest is not allowable to the taxpayer with respect to either 2001 or 2002.[8] In this case, the taxpayer owes interest on the $1,000 year 2000 underpayment from the original due date of the return (April 15, 2001) until July 1, 2003.[9] Although, there are offsetting periods of overpayment (April 16, 2002 to May 15, 2002 and April 16, 2003 to May 15, 2003), there is no offsetting period for which interest is allowable on an overpayment.

Description of Proposal

In the case of an individual taxpayer, the interest netting rules would be applied without regard to the 45-day period in which the Secretary may refund an overpayment of tax without the payment of interest under section 6611(e). The proposal does not modify the period for which interest is payable or allowable. In the example above, a net interest rate of zero would be applied to $1,000 of the taxpayer's year 2000 underpayment for the periods between the due date of the 2002 and 2003 returns and the dates of the refunds. Thus, the taxpayer in the example would owe interest at the underpayment rate for the periods from April 16, 2001 to April 16, 2002; May 16, 2002 to April 16, 2003; and from May 16, 2003 to July 1, 2003. For the periods April 16, 2002 to May 15, 2002 and April 16, 2003 to May 15, 2003, a zero net interest rate will apply.

Effective Date

The proposal would be effective for interest accrued after December 31, 2000.

[8] Sec. 6611(e)(1) provides that no interest will be allowable if any overpayment of tax is refunded within 45 days after the return is filed.

[9] Under the example, the underpayment is satisfied within 21 days of the determination on July 1, 2003, and therefore the taxpayer does not owe interest after that date (sec. 6601(e)(3)).

B. Information Regarding Statute of Limitations (sec. 308 of the bill)

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).[10] A refund claim that is not filed within these time periods is rejected as untimely.

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

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

Description of Proposal

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

Effective Date

The revisions to Publication 1 would be required to be made as soon as practicable, but not later than 180 days after the date of enactment. The revisions to the Form 1040 instructional packages would be required to be made for instructions for taxable years beginning after December 31, 1999.

[10] Sec. 6511(a).