TECHNICAL EXPLANATION OF THE TAX REFORM ACT OF 2014, A DISCUSSION DRAFT OF THE CHAIRMAN OF THE HOUSE COMMITTEE ON WAYS AND MEANS TO REFORM THE INTERNAL REVENUE CODE: TITLE VI ─ TAX ADMINISTRATION AND COMPLIANCE

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CONTENTS

Page

INTRODUCTION 1

TITLE VI ─ TAX ADMINISTRATION AND COMPLIANCE 2

A. IRS Investigation-Related Reforms 2
1. Require section 501(c)(4) organizations to provide notice of formation (sec. 6001 of the discussion draft and new sec. 506 of the Code) 2
2. Declaratory judgment procedure for organizations exempt from tax under section 501(c)(4) (sec. 6002 of the discussion draft and sec. 7428 of the Code) 6
3. Modify reporting requirements for contributions to social welfare organizations (sec. 6003 of the discussion draft and sec. 6033 of the Code) 8
4. Mandatory e-filing by exempt organizations (sec. 6004 of the discussion draft and sec. 6033 of the Code) 10
5. Duty to ensure that IRS employees are familiar with and act in accordance with certain taxpayer rights (sec. 6005 of the discussion draft and sec. 7803 of the Code) 12
6. Termination of employment of Internal Revenue Service employees for taking official actions for political purposes (sec. 6006 of the discussion draft) 13
7. Release of information regarding the status of certain investigations (sec. 6007 of the discussion draft and sec. 6103 of the Code) 14
8. Review of Internal Revenue Service examination selection procedures (sec. 6008 of the discussion draft) 16
9. Prohibition of use of personal email for official government business (sec. 6009 of the discussion draft.) 17
10. Moratorium on IRS conferences (sec. 6010 of the discussion draft) 18
11. Applicable standard for determining whether an organization is operated exclusively for the promotion of social welfare (sec. 6011 of the discussion draft) 18

B. Taxpayer Protection and Service Reforms 22
1. Extend Internal Revenue Service authority to require truncated social security numbers on Form W-2 (sec. 6101 of the discussion draft and sec. 6051 of the Code) 22
2. Free electronic filing (sec. 6102 of the discussion draft and sec. 6011 of the Code) 22
3. Pre-populated returns prohibited (sec. 6103 of the discussion draft) 24
4. Simplified filing requirements for individuals over 65 years of age (sec. 6104 of the discussion draft and sec. 6011 of the Code). 25
5. Increase refund and credit threshold for Joint Committee on Taxation review to $5 million for corporate taxpayers (sec. 6105 of the discussion draft and sec. 6405 of the Code) 26

C. Tax Return Due Date Simplification 27
1. New due date for partnership form 1065, S corporation form 1120S and C corporation form 1120 (sec. 6201 of the discussion draft and sec. 6072 of the Code) 28
2. Modification of due dates by regulation (sec. 6202 of the discussion draft) 29
3. Corporations permitted statutory automatic six-month extension of income tax returns (sec. 6203 of the discussion draft and sec. 6081 of the Code) 29
D. Compliance Reforms 31
1. Penalty for failure to file (sec. 6301 of the discussion draft and sec. 6651 of the Code) 31
2. Penalty for failure to file correct information returns and provide payee statements (sec. 6302 of the discussion draft and secs. 6721 and 6722 of the Code) 32
3. Clarification of six-year statute of limitations in case of overstatement of basis (sec. 6303 of the discussion draft and sec. 6501(e) of the Code) 34
4. Reform of rules related to qualified tax collection contracts (sec. 6304 of the discussion draft and sec. 6306 of the Code) 36
5. 100 percent continuous levy authority on payments to Medicare providers and suppliers (sec. 6305 of the discussion draft and sec. 6331 of the Code) 38
6. Treatment of refundable credits for purposes of certain penalties (sec. 6306 of the discussion draft and secs. 6664 and 6676 of the Code) 41

INTRODUCTION

This document[1] provides a technical explanation of Title VI of the Tax Reform Act of 2014, a discussion draft[2] prepared by the Chairman of the House Committee on Ways and Means that proposes to reform the Internal Revenue Code. Title VI of the proposal addresses tax administration and compliance.

1 This document may be cited as follows: Joint Committee on Taxation*, Technical Explanation of the Tax Reform Act of 2014, A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code: Title VI ─ Tax Administration and Compliance* (JCX-17-14), February 26, 2014. This document can also be found on our website at www.jct.gov.

2 Statutory draft version Camp_041.XML.

TITLE VI ─ TAX ADMINISTRATION AND COMPLIANCE

A. IRS Investigation-Related Reforms

1. Require section 501(c)(4) organizations to provide notice of formation (sec. 6001 of the discussion draft and new sec. 506 of the Code)

Present Law

Section 501(c)(4) organizations

Section 501(c)(4) provides tax exemption for civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and no part of the net earnings of which inures to the benefit of any private shareholder or individual. An organization is operated exclusively for the promotion of social welfare if it is engaged primarily in promoting in some way the common good and general welfare of the people of a community.[3] The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office; however, social welfare organizations are permitted to engage in political activity so long as the organization remains engaged primarily in activities that promote social welfare. The lobbying activities of a social welfare organization generally are not limited. An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations that are operated for profit.

Application for tax exemption

Section 501(c)(3) organizations

Section 501(c)(3) organizations (with certain exceptions) are required to seek formal recognition of tax-exempt status by filing an application with the IRS (Form 1023).[4] In response to the application, the IRS issues a determination letter or ruling either recognizing the applicant as tax-exempt or not. Certain organizations are not required to apply for recognition of tax-exempt status in order to qualify as tax-exempt under section 501(c)(3) but may do so. These organizations include churches, certain church-related organizations, organizations (other than private foundations) the gross receipts of which in each taxable year are normally not more than $5,000, and organizations (other than private foundations) subordinate to another tax-exempt organization that are covered by a group exemption letter.

A favorable determination by the IRS on an application for recognition of tax-exempt status will be retroactive to the date that the section 501(c)(3) organization was created if it files

[3] Treas. Reg. sec. 1.501(c)(4)-1(a)(2).

[4] See sec. 508(a). Unless otherwise stated all section references are to the Internal Revenue Service Code of 1986, as amended (the "Code").

a completed Form 1023 within 15 months of the end of the month in which it was formed.[5] If the organization does not file Form 1023 or files a late application, it will not be treated as tax-exempt under section 501(c)(3) for any period prior to the filing of an application for recognition of tax exemption.[6] Contributions to section 501(c)(3) organizations that are subject to the requirement that the organization apply for recognition of tax-exempt status generally are not deductible from income, gift, or estate tax until the organization receives a determination letter from the IRS.[7]

Information required on Form 1023 includes, but is not limited to: (1) a detailed statement of actual and proposed activities; (2) compensation and financial information regarding officers, directors, trustees, employees, and independent contractors; (3) a statement of revenues and expenses for the current year and the three preceding years (or for the years of the organization's existence, if less than four years); (4) a balance sheet for the current year; (5) a description of anticipated receipts and contemplated expenditures; (6) a copy of the articles of incorporation, trust document, or other organizational or enabling document; (7) organization bylaws (if any); and (8) information about previously filed Federal income tax and exempt organization returns, if applicable.

A favorable determination letter issued by the IRS will state that the application for recognition of tax exemption and supporting documents establish that the organization submitting the application meets the requirements of section 501(c)(3) and will classify (as either an adverse or definitive ruling) the organization as either a public charity or a private foundation.

Organizations that are classified as public charities (or as private operating foundations) and not as private nonoperating foundations may cease to satisfy the conditions that entitled the organization to such status. The IRS makes an initial determination of public charity or private foundation status (either a definitive ruling, or an advance ruling generally effective for five years and then reviewed again by the IRS) that is subsequently monitored by the IRS through annual return filings. The IRS periodically announces in the Internal Revenue Bulletin a list of organizations that have failed to establish, or have been unable to maintain, their status as public charities or as private operating foundations, and that become private nonoperating foundations.

If the IRS denies an organization's application for recognition of exemption under section 501(c)(3), the organization may seek a declaratory judgment regarding its tax status.[8] Prior to

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[5] Pursuant to Treas. Reg. sec. 301.9100-2(a)(2)(iv), organizations are allowed an automatic 12-month extension as long as the application for recognition of tax exemption is filed within the extended, *i.e.*, 27-month, period. The IRS also may grant an extension beyond the 27-month period if the organization is able to establish that it acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. Treas. Reg. secs. 301.9100-1 and 301.9100-3.

[6] Treas. Reg. sec. 1.508-1(a)(1).

[7] Sec. 508(d)(2)(B). Contributions made prior to receipt of a favorable determination letter may be deductible prior to the organization's receipt of such favorable determination letter if the organization has timely filed its application to be recognized as tax-exempt. Treas. Reg. secs. 1.508-1(a) and 1.508-2(b)(1)(i)(b).

[8] Sec. 7428.

utilizing the declaratory judgment procedure, the organization must have exhausted all administrative remedies available to it within the IRS.

Other section 501(c) organizations

Most section 501(c) organizations – including organizations described within sections 501(c)(4) (social welfare organizations, etc.), 501(c)(5) (labor organizations, etc.), or 501(c)(6) (business leagues, etc.) – are not required to provide notice to the Secretary that they are requesting recognition of exempt status. Rather, organizations are exempt under these provisions if they satisfy the requirements applicable to such organizations. However, in order to obtain certain benefits such as public recognition of tax-exempt status, exemption from certain State taxes, and nonprofit mailing privileges, such organizations voluntarily may request a formal recognition of exempt status by filing a Form 1024.

If such an organization voluntarily requests a determination letter by filing Form 1024 within 27 months of the end of the month in which it was formed, its determination of exempt status, once provided, generally will be effective as of the organization's date of formation.[9] If, however, the organization files Form 1024 after the 27-month deadline has passed, its exempt status will be formally recognized only as of the date the organization filed Form 1024.

The declaratory judgment process available to organizations seeking exemption under section 501(c)(3) is not available to organizations seeking exemption under other subsections of the Code, including sections 501(c)(4), 501(c)(5), and 501(c)(6).

Revocation (and suspension) of exempt status

An organization that has received a favorable tax-exemption determination from the IRS generally may continue to rely on the determination as long as "there are no substantial changes in the organization's character, purposes, or methods of operation."[10] A ruling or determination letter concluding that an organization is exempt from tax may, however, be revoked or modified: (1) by notice from the IRS to the organization to which the ruling or determination letter was originally issued; (2) by enactment of legislation or ratification of a tax treaty; (3) by a decision of the United States Supreme Court; (4) by issuance of temporary or final Regulations by the Treasury Department; (5) by issuance of a revenue ruling, a revenue procedure, or other statement in the Internal Revenue Bulletin; or (6) automatically, in the event the organization fails to file a required annual return or notice for three consecutive years.[11] A revocation or modification of a determination letter or ruling may be retroactive if, for example, there has been

[9] Rev. Proc. 2013-9, 2013-2 I.R.B. 255. Prior to the issuance of Revenue Procedure 2013-9 in early 2013, an organization that filed an application for exemption on Form 2014 generally could obtain a determination that it was exempt as of its date of formation, regardless of when it filed Form 1024.

[10] Treas. Reg. sec. 1.501(a)-1(a)(2).

[11] Rev. Proc. 2013-9, 2013-2 I.R.B. 255.

a change in the applicable law, the organization omitted or misstated a material fact, or the organization has operated in a manner materially different from that originally represented.[12]

The IRS generally issues a letter revoking recognition of an organization's tax-exempt status only after: (1) conducting an examination of the organization; (2) issuing a letter to the organization proposing revocation; and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of a section 501(c)(3) organization, the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization no longer is entitled to exemption.

Upon revocation of tax-exemption or change in the classification of an organization (*e.g.*, from public charity to private foundation status), the IRS publishes an announcement of such revocation or change in the Internal Revenue Bulletin. Contributions made to organizations by donors who are unaware of the revocation or change in status ordinarily will be deductible if made on or before the date of publication of the announcement.

The IRS may suspend the tax-exempt status of an organization for any period during which an organization is designated or identified by U.S. authorities as a terrorist organization or supporter of terrorism.[13] Such an organization also is ineligible to apply for tax exemption. The period of suspension runs from the date the organization is first designated or identified to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive Order under which the designation or identification was made. During the period of suspension, no deduction is allowed for any contribution to a terrorist organization.

Description of Proposal

Under the proposal, an organization described in section 501(c)(4) must provide to the Secretary notice of its formation and intent to operate as such an organization, in such manner as the Secretary may prescribe. The notice, together with a reasonable user fee in an amount to be established by the Secretary, must be provided no later than 60 days following the organization's establishment and must include the following information: (1) the name, address, and taxpayer identification number of the organization; (2) the date on which, and the State under the laws of which, the organization was organized; and (3) a statement of the purpose of the organization. The Secretary may extend the 60-day deadline for reasonable cause. Within 60 days of receipt of a notice of an organization's formation and intent to operate as an organization described in section 501(c)(4), the Secretary shall issue to the organization an acknowledgment of the notice. The notice and receipt are subject to the disclosure requirements of section 6104.

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[12] *Ibid*.

[13] Sec. 501(p) (enacted by Pub. L. No. 108-121, sec. 108(a), effective for designations made before, on, or after November 11, 2003).

The proposal amends section 6652(c) (which provides for penalties in the event of certain failures to file an exempt organization return or disclosure) to impose penalties for failure to file the notice required under the proposal. An organization that fails to file a notice within 60 days of its formation (or, if an extension is granted for reasonable cause, by the deadline established by the Secretary) is subject to a penalty equal to $20 for each day during which the failure occurs, up to a maximum of $5,000. In the event such a penalty is imposed, the Secretary may make a written demand on the organization specifying a date by which the notice must be provided. If any person fails to comply with such a demand on or before the date specified in the demand, a penalty of $20 is imposed for each day the failure continues, up to a maximum of $5,000.

With its first annual information return (Form 990, Form 990-EZ, or Form 990-N) filed after providing the notice described above, a section 501(c)(4) organization must provide such information as the Secretary may require, and in the form prescribed by the Secretary, to support its qualification as an organization described in section 501(c)(4). The Secretary is not required to issue a determination letter following the organization's filing of the expanded first annual information return.

A section 501(c)(4) organization that desires additional certainty regarding its qualification as an organization described in section 501(c)(4) may file a request for a determination, together with the required user fee, with the Secretary. Such a request is in addition to, not in lieu of, filing the required notice described above. It is intended that such a request for a determination be submitted on a new form (separate from Form 1024, which may continue to be used by certain other organizations) that clearly states that filing such a request is optional. The request for a determination is treated as an application subject to public inspection and disclosure under sections 6104(a) and (d).

Effective Date

The proposal generally is effective for organizations organized after December 31, 2014.

Organizations organized prior to January 1, 2015, that have not filed an application for exemption (Form 1024) or annual information return on or before the date of enactment must provide the notice required under the provision within 180 days of the date of enactment.

2. Declaratory judgment procedure for organizations exempt from tax under section 501(c)(4) (sec. 6002 of the discussion draft and sec. 7428 of the Code)

Present Law

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it must file an application for recognition of exemption with the IRS and receive a favorable determination of its status.[14] For most section 501(c)(3) organizations, eligibility to receive tax-deductible contributions similarly is dependent upon its receipt of a

[14] Sec. 508(a).

favorable determination from the IRS. In general, a section 501(c)(3) organization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases where an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS generally may revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

Present law authorizes an organization to seek a declaratory judgment regarding its tax-exempt status as a remedy if the IRS denies its application for recognition of exemption under section 501(c)(3), fails to act on such an application, or informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status.[15] The right to seek a declaratory judgment arises in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3).[16] A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization. Section 7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.[17]

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS.[18] For the first 270 days after a request for a determination is made and before the IRS informs the organization of its decision, an organization is deemed not to have exhausted its administrative remedies. If no determination is made during the 270-day period, the organization may initiate an action for declaratory judgment after the period has elapsed. If, however, the IRS makes an adverse determination during the 270-day period, an organization may immediately seek declaratory relief. The 270-day period does not begin with respect to applications for recognition of tax-exempt status until the date a substantially completed application is submitted.

Under present law, a non-charity (*i.e.*, an organization not described in section 501(c)(3)) may not seek a declaratory judgment with respect to an IRS determination regarding its tax-exempt status. In general, such an organization must petition the U.S. Tax Court for relief following the issuance of a notice of deficiency or pay any tax owed and file a refund action in Federal district court or the U.S. Court of Federal Claims.

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[15] Sec. 7428.

[16] Sec. 7428(a)(1).

[17] Sec. 7428(a)(2).

[18] Sec. 7428(b)(2).

Description of Proposal

The proposal extends the section 7428 declaratory judgment procedure to the initial determination or continuing classification of an organization as tax-exempt under section 501(a) as an organization described in section 501(c)(4) (*i.e.*, social welfare and certain other organizations).

Effective Date

The proposal is effective for pleadings filed after the date of enactment.

3. Modify reporting requirements for contributions to social welfare organizations (sec. 6003 of the discussion draft and sec. 6033 of the Code)

Present Law

In general, organizations exempt from taxation under section 501(a) – including social welfare and other organizations exempt under section 501(c)(4) – are required to file an annual return (Form 990 series), stating specifically the items of gross income, receipts, disbursements, and such other information as the Secretary may prescribe.[19] An organization that is required to file an information return, but that has gross receipts of less than $200,000 during its taxable year, and total assets of less than $500,000 at the end of its taxable year, may file Form 990-EZ. Section 501(c)(3) private foundations are required to file Form 990-PF rather than Form 990. An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a tax-exemption determination.

On the applicable annual information return, organizations are required to report their gross income, information on their finances, functional expenses, compensation, activities, and other information required by the IRS in order to review the organization's activities and operations during the previous taxable year and to review whether the organization continues to meet the statutory requirements for exemption. Examples of the information required by Form 990 include: (1) a statement of program accomplishments; (2) a description of the relationship of the organization's activities to the accomplishment of the organization's exempt purposes; (3) a description of payments to individuals, including compensation to officers and directors, highly paid employees and contractors, grants, and certain insider transactions and loans; and (4) disclosure of certain activities, such as expenses of conferences and conventions, political expenditures, compliance with public inspection requirements, and lobbying activities.

Form 990-PF requires, among other things, reporting of: the foundation's gross income for the year; expenses attributable to such income; disbursements for exempt purposes; total contributions and gifts received and the names of all substantial contributors; names, addresses, and compensation of officers and directors; an itemized statement of securities and other assets held at the close of the year; an itemized statement of all grants made or approved; and

[19] Sec. 6033(a).

information about whether the organization has complied with the restrictions applicable to private foundations (secs. 4941 through 4945).

An organization that files Form 990, Form 990-EZ, or Form 990-PF and receives during the year $5,000 or more (in money or property) from any one contributor generally must report such contributions on Schedule B ("Schedule of Contributors").[20] The Schedule B is open to public inspection for an organization that files Form 990-PF (private foundations) or a section 527 political organization that files Form 990 or Form 990-EZ. For all other Form 990 and Form 990-EZ filers, the names and addresses of contributors are not required to be made available for public inspection. All other information, including the amount of contributions, the description of noncash contributions, and any other information, is required to be made available for public inspection unless it clearly identifies the contributor. As a matter of practice, the IRS does not include schedule B on the CD sets or any other form of media made available to the public. Instead, on a case-by-case basis, when an individual makes a request for a specific organization's Schedule B, the IRS reviews and redacts the schedule in an effort to avoid divulging information that would identify any contributor.

The requirement that an exempt organization file an annual information return (Form 990 or Form 990-EZ) does not apply to certain exempt organizations, including organizations (other than private foundations) the gross receipts of which in each taxable year normally are not more than $50,000. Pursuant to the Pension Protection Act of 2006, organizations that are excused from filing an information return by reason of normally having gross receipts below such amount must furnish to the Secretary an annual notice (Form 990-N), in electronic form, containing certain basic information about the organization.[21]

Other organizations exempt from the annual information return requirement include: churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; certain State institutions whose income is excluded from gross income under section 115; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; and certain other organizations, including some that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.[22]

Description of Proposal

The proposal limits the contributor information that must be reported by an organization described in section 501(c)(4) on its annual information return. In the case of such an organization, information relating to a contribution or gift may only be required to be submitted

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[20] Certain section 501(c)(3) organizations that meet a 33-1/2 percent public support test of the regulations under sections 509(a)(1) and 170(b)(1)(A)(vi) generally must report contributions totaling $5,000 or more from a single contributor only to the extent such contributions exceed two percent of the organization's total contributions. Additional special reporting rules apply to organizations described in sections 501(c)(7), (8), or (10).

[21] Sec. 6033(i).

[22] Sec. 6033(a)(2)(A); Treas. Reg. secs. 1.6033-2(a)(2)(i) and (g)(1).

on the organization's annual information return to the extent the contribution or gift is in excess of $5,000 and is made by an officer or director of the organization (or a person having powers or responsibilities similar to those of an officer or director) or by a covered employee. For this purpose, covered employee means a person who was (1) one of the five highest compensated employees of the organization for the taxable year, or (2) was a covered employee of the organization (or any predecessor organization) for any preceding taxable year beginning after December 31, 2013.

Effective Date

The proposal is effective for returns for taxable years beginning after December 31, 2013.

4. Mandatory e-filing by exempt organizations (sec. 6004 of the discussion draft and sec. 6033 of the Code)

Present Law

In general

The Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998")[23] states a Congressional policy to promote the paperless filing of Federal tax returns. Section 2001(a) of RRA 1998 set a goal for the IRS to have at least 80 percent of all Federal tax and information returns filed electronically by 2007.[24] Section 2001(b) of RRA 1998 requires the IRS to establish a 10-year strategic plan to eliminate barriers to electronic filing.

Present law requires the Secretary to issue regulations regarding electronic filing and specifies certain limitations on the rules that may be included in such regulations.[25] The statute requires that Federal income tax returns prepared by specified tax return preparers be filed electronically,[26] and that all partnerships with more than 100 partners be required to file electronically. For taxpayers other than partnerships, the statute prohibits any requirement that persons who file fewer than 250 returns during a calendar year file electronically. With respect to individuals, estates, and trusts, the Secretary may permit, but generally cannot require, electronic filing of income tax returns. In crafting any of these required regulations, the Secretary must take into account the ability of taxpayers to comply at reasonable cost.

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[23] Pub. L. No. 105-206.

[24] The Electronic Tax Administration Advisory Committee, the body charged with oversight of IRS progress in reaching that goal reported that e-filing by individuals exceeded 80 percent in the 2013 filing season, but projected an overall rate of 72.8 percent based on all Federal returns. See Electronic Tax Administration Advisory Committee, *Annual Report to Congress*, June 2013, IRS Pub. 3415, page 6.

[25] Sec. 6011(e).

[26] Section 6011(e)(3)(B) defines a "specified tax return preparer" as any return preparer who reasonably expects to file more than 10 individual income tax returns during a calendar year.

The regulations require corporations that have assets of $10 million or more and file at least 250 returns during a calendar year to file electronically their Form 1120/1120S income tax returns and Form 990 information returns for tax years ending on or after December 31, 2006. In determining whether the 250 return threshold is met, income tax, information, excise tax, and employment tax returns filed within one calendar year are counted.

Tax-exempt organizations

Most tax-exempt organizations are required to file annual information returns in the Form 990 series. Since 2007, the smallest organizations − generally, those with gross receipts of less than $50,000 − may provide an abbreviated notice on Form 990-N, sometimes referred to as an "e-postcard." Which form to file depends on the annual receipts, value of assets, and types of activities of the exempt entity. The Forms 990, 990-EZ, and 990-PF are released to the public on DVDs.

In general, only the largest and smallest tax-exempt organizations are required to electronically file their annual information returns. First, as indicated above, tax-exempt corporations that have assets of $10 million or more and that file at least 250 returns during a calendar year must electronically file their Form 990 information returns. Private foundations and charitable trusts, regardless of asset size, that file at least 250 returns during a calendar year are required to file electronically their Form 990-PF information returns.[27] Finally, organizations that file Form 990-N (the e-postcard) also must electronically file.[28]

Description of Proposal

The proposal extends the requirement to e-file to all tax-exempt organizations required to file statements or returns in the Form 990 series. The proposal also requires that the IRS make the information provided on the forms available to the public in a machine-readable format as soon as practicable. It is intended that the information be provided to the public in a format that permits one to extract and perform computations on the data but not alter or manipulate the statements or returns from which the data is to be extracted.

Effective Date

The proposal generally is effective for taxable years beginning after date of enactment. Transition relief is provided for certain organizations. First, for certain small organizations or other organizations for which the Secretary determines that application of the e-filing requirement would constitute an undue hardship in the absence of additional transitional time, the requirement to file electronically must be implemented not later than taxable years beginning two years following the date of enactment. For this purpose, small organization means any

[27] Taxpayers can request waivers of the electronic filing requirement if they cannot meet that requirement due to technological constraints, or if compliance with the requirement would result in undue financial burden on the taxpayer.

[28] See Form 990-N, "Electronic Notice for Tax-exempt Organizations not Required to File a Form 990 or 990-EZ."

organization: (1) the gross receipts of which for the taxable year are less than $200,000; and (2) the aggregate gross assets of which at the end of the taxable year are less than $500,000. In addition, the proposal grants IRS the discretion to delay the effective date not later than taxable years beginning two years after the date of enactment for the filing of form 990-T (reports of unrelated business taxable income or the payment of proxy tax under section 6033(e)).

5. Duty to ensure that IRS employees are familiar with and act in accordance with certain taxpayer rights (sec. 6005 of the discussion draft and sec. 7803 of the Code)

Present Law

The Code provides that the Commissioner has such duties and powers as prescribed by the Secretary. Unless otherwise specified by the Secretary, such duties and powers 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). If the Secretary determines not to delegate such specified duties to the Commissioner, such determination will not take effect until 30 days after the Secretary notifies the House Committees on Ways and Means, Government Reform and Oversight, and Appropriations, and the Senate Committees on Finance, Governmental Affairs, and Appropriations. The Commissioner is to consult with the Oversight 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 is authorized to employ such persons as the Commissioner deems proper for the administration and enforcement of the internal revenue laws and is required to issue all necessary directions, instructions, orders, and rules applicable to such persons. Unless otherwise provided by the Secretary, the Commissioner will determine and designate the posts of duty.

Description of Proposal

The proposal adds to the Commissioner's duties the requirement to ensure that employees of the IRS are familiar with and act in accord with taxpayer rights as afforded by other provisions of the Internal Revenue Code, including (i) the right to be informed, (ii) the right to be assisted, (iii) the right to be heard, (iv) the right to pay not more than the correct amount of tax, (v) the right to appeal, (vi) the right to certainty, (vii) the right to privacy, (viii) the right to confidentiality, (ix) the right to representation, and (x) the right to a fair and just tax system.

Effective Date

The proposal is effective on the date of enactment.

6. Termination of employment of Internal Revenue Service employees for taking official actions for political purposes (sec. 6006 of the discussion draft)

Present Law

The IRS Restructuring and Reform Act of 1998 (the "Act")[29] requires 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) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets; (2) providing a false statement under oath material to a matter involving a taxpayer; (3) with respect to a taxpayer, taxpayer representative, or other IRS employee, the violation of any right under the U.S. Constitution, or any civil right established under titles VI or VII of the Civil Rights Act of 1964, title IX of the Educational Amendments of 1972, the Age Discrimination in Employment Act of 1967, the Age Discrimination Act of 1975, sections 501 or 504 of the Rehabilitation Act of 1973 and title I of the Americans with Disabilities Act of 1990; (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or a taxpayer representative; (5) assault or battery on a taxpayer or other IRS employee, but only if there is a criminal conviction or a final judgment by a court in a civil case, with respect to the assault or battery; (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; (7) willful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry; (8) willful failure to file any tax return required under the Code on or before the due date (including extensions) unless failure is due to reasonable cause; (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause; and (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

The Act provides non-delegable authority to the Commissioner to determine that mitigating factors exist, that, in the Commissioner's sole discretion, mitigate against terminating the employee. The Act also provides that the Commissioner, in his sole discretion, may establish a procedure to determine whether an individual should be referred for such a determination by the Commissioner. The Treasury Inspector General ("IG") is required to track employee terminations and terminations that would have occurred had the Commissioner not determined that there were mitigation factors and include such information in the IG's annual report.

Description of Proposal

The proposal expands the scope of the violation concerning an IRS employee threatening to audit a taxpayer for the purpose of extracting personal gain or benefit. The proposal requires the IRS to terminate an employee for performing, delaying, or failing to perform (or threatening to perform, delay, or fail to perform) any official action (including any audit) with respect to a taxpayer for purpose of extracting personal gain or benefit or for a political purpose.

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[29] Pub. L. No. 105-206, sec. 1203(b), July 22, 1998.

Effective Date

The proposal is effective on the date of enactment.

7. Release of information regarding the status of certain investigations (sec. 6007 of the discussion draft and sec. 6103 of the Code)

Present Law

Section 6103: Rules and penalties associated with the disclosure of confidential returns and return information

Generally, tax returns and return information ("tax information") are confidential and may not be disclosed unless authorized in the Code. [30] Return information includes data received, collected or prepared by the Secretary with respect to the determination of the existence or possible existence of liability of any person under the Code for any tax, penalty, interest, fine, forfeiture, or other imposition or offense. Criminal penalties apply for the unauthorized inspection or disclosure of tax information. Willful unauthorized disclosure is a felony under section 7213 and the willful unauthorized inspection of tax information is a misdemeanor under section 7213A. Taxpayers may also pursue a civil cause of action for disclosures and inspections not authorized by section 6103.[31]

Section 6103 provides exceptions to the general rule of confidentiality, detailing permissible disclosures. Among those exceptions are disclosures to specified persons with a "material interest" in the return or return information. The Secretary may withhold return information which the Secretary determines will seriously impair tax administration.[32]

Under section 6103(c), the IRS may disclose a taxpayer's return or return information to such person or persons as the taxpayer may designate in a request for or consent to such disclosure. There are no restrictions placed on the recipient of tax information received pursuant to the consent of the taxpayer, and the safeguard and recordkeeping procedures, as well as penalties for unauthorized disclosure or inspection do not apply to persons receiving tax information pursuant to a taxpayer's consent.

Section 7214: Other offenses by officers and employees of the United States

Section 7214 concerns offenses by officers and employees of the United States. It provides, upon conviction, for the dismissal from office, a $10,000 fine and/or five years imprisonment of any officer or employee:

(1) who is guilty of any extortion or willful oppression under color of law; or

[30] Sec. 6103(a).

[31] Sec. 7431.

[32] Sec. 6103(e)(7).

(2) who knowingly demands other or greater sums than are authorized by law, or receives any fee, compensation, or reward, except as by law prescribed, for the performance of any duty; or

(3) who with intent to defeat the application of any provision of this title fails to perform any of the duties of his office or employment; or

(4) who conspires or colludes with any other person to defraud the United States; or

(5) who knowingly makes opportunity for any person to defraud the United States; or

(6) who does or omits to do any act with intent to enable any other person to defraud the United States; or

(7) who makes or signs any fraudulent entry in any book, or makes or signs any fraudulent certificate, return, or statement; or

(8) who, having knowledge or information of the violation of any revenue law by any person, or of fraud committed by any person against the United States under any revenue law, fails to report, in writing, such knowledge or information to the Secretary; or

(9) who demands, or accepts, or attempts to collect, directly or indirectly as payment or gift, or otherwise, any sum of money or other thing of value for the compromise, adjustment, or settlement of any charge or complaint for any violation or alleged violation of law, except as expressly authorized by law so to do.

In the discretion of the court, up to one-half of the amount of fine for a section 7214 violation may be awarded for the use of the informer. In addition, the court is to render judgment against said officer or employee for the amount of damages sustained in favor of the party injured.

Section 7214 also provides that any internal revenue officer or employee interested, directly or indirectly, in the manufacture of tobacco, snuff, cigarettes, or in the production, rectification or redistillation of distilled spirits is to be dismissed from office and each such officer or employee so interested in any such manufacture or production, rectification, or redistillation of fermented liquors is to be fined not more than $5,000.

Description of Proposal

In the case of an investigation involving the return or return information of an individual alleging a violation of sections 7213, 7213A or 7214, the Secretary may disclose to the complainant (or such person's designee) whether an investigation, based on the person's provision of information indicating a violation of sections 7213, 7213A or 7214 of the Code, has been intiated, is open or is closed. The Secretary may disclose whether the investigation substantiated a violation of sections 7213, 7213A or 7214 of the Code, and whether action has been taken with respect to the individual who committed the substantiated violation. The proposal does not permit the Secretary to describe what action was taken with respect to the individual, other than whether any referral has been made for criminal prosecution.

Effective Date

The proposal is effective on the date of enactment.

8. Review of Internal Revenue Service examination selection procedures (sec. 6008 of the discussion draft)

Present Law

In general, the IRS independently determines how enforcement cases are selected and processed.

Description of Proposal

The proposal requires the Comptroller General of the United States to study each IRS operating division to assess the process used for determining how enforcement cases are selected and processed. The study is required to include a review of: (i) the standards each operating division has established for enforcement case selection and case work (and handling of referrals and complaints), and whether such standards meet the objectives of impartiality, objectivity, and tax law compliance and reduce taxpayer burden (herein, the "IRS objectives"); (ii) the extent to which any cases are initiated by referrals or complaints from inside or outside of the operating division; (iii) the IRS controls for assuring that its standards for enforcement cases in each operating division are sufficient for achieving the IRS objectives; (iv) the IRS controls for assuring that is standards are adhered to by all division personnel and the effectiveness of such controls; and (v) whether the existing standards and controls provide reasonable assurance that each division's enforcement processes meet the IRS objectives.

The proposal requires the Comptroller General to submit to Congress and the Secretary of the Treasury a report on the study results and his recommendations within one year after the date of enactment.

The proposal also requires the Comptroller General to conduct follow-up studies and provide reports on each operating division every four years reviewing whether any previous recommendations have been implemented and are working as intended.

Effective Date

The proposal is effective on the date of enactment.

9. Prohibition of use of personal email for official government business (sec. 6009 of the discussion draft.)

Present and Prior Law

Federal executive agencies are required to maintain and preserve Federal records,[33] whether in paper or electronic form, and protect against unauthorized removal of such records. Record retention and disposal policies must conform to the requirements of the record management procedures, as implemented by the Archivist of the United States.[34] Email accounts are specifically included within the scope of records subject to the record retention policies.[35] Each agency is required to provide instruction and guidance to persons conducting business on behalf of the agency, including employees, officers and contractors, and use of personal email accounts for agency business is to be discouraged.[36]

The government-wide records management requirements are in addition to the obligations to protect the sensitive information for which the IRS is responsible. Tax information is sensitive and confidential.[37] The Code imposes civil and criminal penalties to protect it from unauthorized use, inspection or disclosure.[38] As a condition of receiving tax data, outside agencies must establish to the satisfaction of the IRS that they have adequate programs and security protocols in place to protect the data received.[39] Personal email computer storage systems are not inspected by the IRS for security.

Given the sensitive and confidential nature of the information handled by the IRS and the need to be accountable for all agency records, the IRS has in place policies restricting the use of email accounts.[40] Transmission of Federal tax information is only permitted outside the IRS in limited circumstances. In 2012, the IRS published a revised section of its manual in which it

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[33] 44 U.S.C. sec. 3101. See section 3301 for a definition of Federal records that generally includes all documentary materials that agencies receive or create in the conduct of official business and that may have evidentiary value with respect to official business, regardless of the physical form of the materials.

[34] See generally Title 44, at chapter 29 (records management by the Archivist of the United States and the General Services Administration), chapter 31 (records management of Federal agencies) and chapter 33 (disposal of records).

[35] 36 CFR sec. 1236.22(a).

[36] A quarterly bulletin published by the National Archives and Records Administration provides guidance to executive agencies. See generally NARA Bulletin 2013-03, available at http://www.archives.gov/records-mgmt/bulletins/2013/2013-03.html.

[37] Sec. 6103(a).

[38] See secs. 7213 (criminal unauthorized disclosure), 7213A (criminal unauthorized inspection) and 7431 (civil remedy for uanauthorized inspection or disclosure).

[39] Sec. 6103(p)(4).

[40] I.R.M. paragraphs 1.10.3 *et seq*., and 11.3.1.

updated its rules on e-records generally, and banned use of non-IRS/Treasury email for any governmental or official purpose.[41]

Description of Proposal

Under the proposal, employees of the IRS are not permitted to use a personal email account for any official government business.

Effective Date

The proposal is effective on date of enactment.

10. Moratorium on IRS conferences (sec. 6010 of the discussion draft)

Present Law

The IRS has general authority to organize conferences to further its statutory functions.

Description of Proposal

The proposal prevents the IRS from holding any conference until the Treasury Inspector General for Tax Administration ("IG") submits a report to Congress certifying that the IRS has implemented all of the recommendations set out in such IG's report titled "Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California," and describing such implementation.

Effective Date

The proposal is effective on the date of enactment.

11. Applicable standard for determining whether an organization is operated exclusively for the promotion of social welfare (sec. 6011 of the discussion draft)

Present Law

Section 501(c)(4) organizations, in general

Section 501(c)(4) provides a tax exemption for civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.[42] Treasury regulations provide that an organization is operated exclusively for the promotion of social welfare if it is engaged primarily in promoting in some way the common good and general

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[41] I.R.M. paragraph 10.8.1.4.6.3.1, "Privately Owned E-Mail Accounts." (May 3, 2012).

[42] Sec. 501(c)(4).

welfare of the people of a community.[43] An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations that are operated for profit.[44]

Political campaign activities of section 501(c)(4) organizations

Treasury regulations further provide that the promotion of social welfare does not include "direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office" (herein, "political campaign intervention").[45] However, social welfare organizations are permitted to engage in political campaign intervention so long as the organization is primarily engaged in activities that promote social welfare.[46]

Whether an activity constitutes political campaign intervention (and thus does not promote social welfare) depends on all the facts and circumstances of the particular case.[47] The rules concerning political campaign intervention apply only to activities involving candidates for elective public office; the rules do not apply to activities involving officials who are selected or appointed, such as executive branch officials and judges.

Similar rules apply for determining whether other types of section 501(c) organizations have engaged in political campaign intervention, including charities (section 501(c)(3)), labor and horticultural organizations (section 501(c)(5)), and business leagues (section 501(c)(6)). However, while section 501(c)(4), (5), and (6) organizations may engage in some political campaign intervention without jeopardizing exempt status, section 501(c)(3) organizations are prohibited from engaging in any political campaign intervention.[48]

The lobbying and advocacy activities of a section 501(c)(4) organization generally are not limited, provided the activities are in furtherance of the organization's exempt purpose.

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[43] Treas. Reg. secs. 1.501(c)(4)-1(a)(1) and (2)(i).

[44] Treas. Reg. sec. 1.501(c)(4)-1(a)(2)(i).

[45] Treas. Reg. sec. 1.501(c)(4)-1(a)(2)(ii).

[46] See Rev. Rul. 81-95, 1981-1 C.B. 332.

[47] See, *e.g*., Rev. Rul. 2007-41, 2007 -25 I.R.B. 1421 (June 18, 2007) (analyzing 21 different factual scenarios involving section 501(c)(3) charitable organizations for political campaign intervention); Rev. Rul. 81-95, 1981-1 C.B. 332 (referencing section 501(c)(3) standards in determining whether activities of a section 501(c)(4) organization constitute political campaign intervention).

[48] Sec. 501(c)(3).

Proposed regulations relating to the political campaign activities of section 501(c)(4) organizations

On November 29, 2013, the Department of the Treasury and the IRS published proposed regulations regarding the political campaign activities of section 501(c)(4) organizations.[49] The proposed regulations seek to replace the present-law facts-and-circumstances test used in determining whether a section 501(c)(4) organization has engaged in political campaign intervention with an enumerated list of activities that constitute political campaign activities (and which therefore do not promote social welfare).[50]

The proposed regulations replace the political campaign intervention reference in the existing section 501(c)(4) regulations (*i.e.*, "direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office") with a new defined term, "candidate-related political activity."[51] Candidate-related political activity means: (1) communications that express a view on, whether for or against, the selection, nomination, election, or appointment of one or more clearly identified candidates (often referred to as express advocacy communications); (2) certain public communications (as defined) within 30 days of a primary election or 60 days of a general election that refer to one or more clearly identified candidates, or in the case of a general election one or more political parties; (3) communications the expenditures for which are reported to the Federal Election Commission; (4) contributions (including gifts, grants, subscriptions, loans, advances, or deposits) of money or anything of value to or the solicitation of contributions on behalf of a candidate, a section 527 political organization, or a section 501(c) organization that engages in candidate-related political activity; (5) conduct of a voter registration drive or "get-out-the-vote" drive; (6) distribution of any material prepared by or on behalf of a candidate or by a section 527 political organization; (7) preparation or distribution of a voter guide that refers to one or more clearly identified candidates, or in the case of a general election to one or more political parties; and (8) hosting or conducting a forum for candidates within 30 days of a primary election or 60 days of a general election.[52]

For purposes of defining candidate-related political activity, the proposed regulations define the term "candidate" to mean "an individual who publicly offers himself, or is proposed by another, for selection, nomination, election, or appointment to any federal, state, or local public office or office in a political organization, or to be a Presidential or Vice-Presidential elector, whether or not such individual is ultimately selected, nominated, elected, or appointed,"

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[49] Notice of Proposed Rulemaking, *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* REG-134417-13, 78 Fed. Reg. 71535 (November 29, 2013); incorporating Prop. Treas. Reg. secs. 1.501(c)(4)-1(a)(2)(ii), (a)(2)(iii), and (c).

[50] Notice of Proposed Rulemaking, *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* REG-134417-13, 78 Fed. Reg. 71535 (November 29, 2013), p. 71536.

[51] Prop. Treas. Reg. secs. 1.501(c)(4)-1(a)(2)(ii) and (iii).

[52] Prop. Treas. Reg. sec. 1.501(c)(4)-1(a)(2)(iii)(A).

including officeholders who are the subject of a recall election;[53] this includes certain judicial and executive branch appointments.

The proposed regulations apply only to section 501(c)(4) organizations.[54] Other section 501(c) organization (including section 501(c)(3) charitable organizations, section 501(c)(5) labor and horticultural organizations, and section 501(c)(6) business leagues) will continue to use present-law rules concerning political campaign intervention.

The proposed regulations are not immediately effective. They are proposed to be effective on the date they are published in the Federal Register as final regulations.[55]

Description of Proposal

The proposal provides that the standards and definitions as in effect on January 1, 2010, which are used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4), shall apply for determining the tax-exempt status of organizations under section 501(c)(4).

The proposal also provides that neither the Secretary nor any delegate of the Secretary may issue, revise, or finalize any regulation (including the November 29, 2013 proposed regulations described above), revenue ruling, or other guidance that is not limited to a particular taxpayer relating to the standards or definitions used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4).

The proposal applies with respect to any organization claiming tax-exempt status as an organization described in section 501(c)(4) that was created on, before, or after the date of enactment.

The proposal sunsets such that it does not apply after the one-year period beginning on the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

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[53] Prop. Treas. Reg. sec. 1.501(c)(4)-1(a)(2)(iii)(B)(1).

[54] Notice of Proposed Rulemaking, *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* REG-134417-13, 78 Fed. Reg. 71535 (November 29, 2013), p. 71537.

[55] Prop. Treas. Reg. sec. 1.501(c)(4)-1(c). In the notice of proposed rulemaking, the IRS seeks comments on a number of issues, including: (1) whether the existing regulation that provides that an organization is operated exclusively for social welfare if it is engaged primarily in promoting in some way the common good and general welfare of the people of a community should be modified; and (2) whether the rules included in the proposed regulations should be extended to other section 501(c) organizations or to section 527 political organizations. Notice of Proposed Rulemaking, *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* REG-134417-13, 78 Fed. Reg. 71535 (November 29, 2013), p. 71537.

B. Taxpayer Protection and Service Reforms

1. Extend Internal Revenue Service authority to require truncated social security numbers on Form W-2 (sec. 6101 of the discussion draft and sec. 6051 of the Code)

Present Law

Section 6051(a) of the Code generally requires that an employer provide a written statement to each employee on or before January 31st of the succeeding year showing the remuneration paid to that employee during the calendar year and other information including the employee's social security number ("SSN"). The Form W-2, Wage and Tax Statement, is used to provide this information to employees and contains the taxpayer's SSN, wages paid, taxes withheld, and other information.

Other statements provided to taxpayers, such as Forms 1099, generally issued to any individual or unincorporated business paid in excess of $600 per calendar year for services rendered, are subject to rules under section 6109 dealing with identifying numbers. Section 6109 requires that the filer provide the taxpayer's "identifying number" which is an individual's SSN except as otherwise specified in regulations. Accordingly, for some statements, the Treasury Department has the authority to require or permit filers to use a number other than a taxpayer's SSN.

Description of Proposal

The proposal provides the Treasury Department authority to require employers to include an "identifying number" for each employee, rather than an employee's SSN, on Form W-2. This change will permit the Treasury Department to promulgate regulations requiring or permitting a truncated SSN on Form W-2, as is currently provided under section 6109.

Effective Date

The proposal is effective on the date of enactment.

2. Free electronic filing (sec. 6102 of the discussion draft and sec. 6011 of the Code)

Present Law

The Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998")[56] states a Congressional policy to promote the paperless filing of Federal tax returns. Section 2001(a) of RRA 1998 set a goal for the IRS to have at least 80 percent of all Federal tax and information returns filed electronically by 2007.[57] Section 2001(b) of RRA 1998 requires the IRS to establish a 10-year strategic plan to eliminate barriers to electronic filing.

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[56] Pub. L. No. 105-206.

[57] The Electronic Tax Administration Advisory Committee, the body charged with oversight of IRS progress in reaching that goal reported that e-filing by individuals exceeded 80 percent in the 2013 filing season, but

In October 2002, to help meet the 80 percent e-file target, the IRS partnered with the Free File Alliance, a group of tax preparation software manufactures, to create the Free File program which provides taxpayers with access to free online tax preparation and e-filing services. Taxpayers with adjusted gross income of $57,000 or less, regardless of filing status, are generally eligible to use the Free File program but participating software companies may establish other eligibility requirements and limit usage of their programs based on geographic location, military service, or other criteria.

Present law requires the Secretary to issue regulations regarding electronic filing and specifies certain limitations on the rules that may be included in such regulations.[58] The statute requires that Federal income tax returns prepared by specified tax return preparers be filed electronically,[59] and that all partnerships with more than 100 partners be required to file electronically. For taxpayers other than partnerships, the statute prohibits any requirement that persons who file fewer than 250 returns during a calendar year file electronically. With respect to individuals, estates, and trusts, the Secretary may permit, but generally cannot require, electronic filing of income tax returns. In crafting any of these required regulations, the Secretary must take into account the ability of taxpayers to comply at reasonable cost.

The regulations require corporations that have assets of $10 million or more and file at least 250 returns during a calendar year to file electronically their Form 1120/1120S income tax returns and Form 990 information returns for tax years ending on or after December 31, 2006. In determining whether the 250 return threshold is met, income tax, information, excise tax, and employment tax returns filed within one calendar year are counted.

Description of Proposal

The proposal requires the Secretary of the Treasury, in cooperation with the private sector, to maintain a program that provides free individual income tax preparation and electronic filing services to low-income taxpayers and elderly taxpayers. The proposal requires the Secretary to provide guidance detailing (i) the qualifications, selection process, and contract term for businesses participating in the program, (ii) a process for periodic review of businesses participating in the program, (iii) procedures for terminating business participation in the program for failure to comply with any program requirements, and (iv) such other procedures as the Secretary determines are necessary and appropriate to carry out the purposes of the program. The proposal provides that the IRS' current Free File program satisfies the requirements for a free filing program.

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projected an overall rate of 72.8 percent based on all Federal returns. See Electronic Tax Administration Advisory Committee, *Annual Report to Congress*, June 2013, IRS Pub. 3415, p. 6.

[58] Sec. 6011(e).

[59] Section 6011(e)(3)(B) defines a "specified tax return preparer" as any return preparer who reasonably expects to file more than 10 individual income tax returns during a calendar year.

Effective Date

The proposal is effective on the date of enactment.

3. Pre-populated returns prohibited (sec. 6103 of the discussion draft)

Present Law

The Secretary does not generally compute taxes owed by taxpayers or prepare tax returns for taxpayers, except in two limited circumstances discussed below. The Secretary does not generally have the burden of proof to demonstrate that a third party information return is correct except in the limited circumstance discussed below.

In general, income taxes are due and payable at the time and place fixed for filing returns, even if the time for filing the return is extended.[60] Individual taxpayers electing under the Code to have their taxes computed by the Secretary are not required to pay until thirty days after the IRS notifies them of the amount due and demands payment.[61] This option is limited to persons with gross income of less than $10,000, derived entirely from services as an employee, dividends, and interest, whose income from sources other than wages (as defined for withholding purposes) does not exceed $100, and who do not itemize their deductions. This option also is not available to any individual who may be claimed as a depended on another taxpayer's return who is ineligible to claim a person exemption on his own return.

The Code permits the Secretary to prepare and receive a return that is signed by the taxpayer in circumstances where the taxpayer fails to make a return but consents to disclose information necessary for its preparation.[62] When the Secretary prepares the return and the taxpayer signs it, that return is the taxpayer's return. In addition, if any taxpayer fails to make a required return or makes, willfully or otherwise, a false or fraudulent return, the Secretary is authorized to make a return from his or her own knowledge and from such information as can be obtained through testimony or otherwise.[63] Any return made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes. The execution of this return will not start the running of the period of limitations on assessment and collection without assessment.[64]

The Code provides that if a taxpayer, in a court proceeding, asserts a reasonable dispute with respect to any item shown on an information return on which a proposed deficiency is based, and has fully cooperated with the Secretary with respect to the production of witnesses,

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[60] Sec. 6151(a).

[61] Sec. 6151(b)(1).

[62] Sec. 6020(a).

[63] Sec. 6020(b).

[64] Sec. 6501(b)(3).

documents, and other information, then the Secretary shall have the burden of producing reasonable and probative evidence regarding the accuracy of the information return in dispute.[65] For example, if the taxpayer disputes the income reported by a third party on its information return, and has fully cooperated with the Secretary as described, the burden to prove that the information return is correct then shifts to the Secretary. The taxpayer is not required to establish the correct amount due, but only the facts on the basis of which the court can redetermine the deficiency.

Description of Proposal

The proposal prohibits the Secretary of the Treasury from providing to any person a proposed final return or statement for use by such person to satisfy a filing or reporting requirement under the Code except to the extent provided in sections 6014, 6020, or 6201(d).

Effective Date

The proposal is effective on the date of enactment.

4. Simplified filing requirements for individuals over 65 years of age (sec. 6104 of the discussion draft and sec. 6011 of the Code)

Present Law

Persons required to make returns of income are generally required to file returns in the form prescribed by the Secretary in regulations.[66] Income tax returns are required from each individual whose taxable year gross income equals or exceeds the exemption amount, with certain exceptions.[67] The income tax returns are due on April 15 of the year following the taxable year, for taxpayers using a calendar year.

The standard form available for individuals subject to income tax are in the series of form known as Form 1040, and include two simplified versions, the Form 1040A and the Form 1040EZ. In recent filing seasons, the majority of returns filed by individuals were filed electronically.[68]

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[65] Sec. 6201(d).

[66] Sec. 6011.

[67] See section 6012(a)(1)(A), which enumerates several conditions under which individuals with gross income in excess of the exemption amount in section 151(d) are nevertheless excused from the filing requirements.

[68] The Internal Revenue Service Restructuring and Reform Act of 1998 (“RRA 1998”)[68] states a Congressional policy to promote the paperless filing of Federal tax returns, and set a goal for the IRS to have at least 80 percent of all Federal tax and information returns filed electronically by 2007. See sec. 2001(a) of RRA 1998. The Electronic Tax Administration Advisory Committee, the body charged with oversight of IRS progress in reaching that goal reported that e-filing by individuals exceeded 80 percent in the 2013 filing season, but projected an overall rate of 72.8 percent based on all Federal returns. See Electronic Tax Administration Advisory Committee, *Annual Report to Congress*, June 2013, IRS Pub. 3415, p. 6.

Description of Proposal

The proposal requires that the IRS publish a simplified income tax return form designated a Form 1040SR, for use by persons who are age 65 or older by the close of the taxable year. The form is to be as similar as possible to the Form 1040EZ. The use of Form 1040SR is not to be restricted based on the amount of taxable income to be shown on the return, or the fact that the income to be reported for the taxable year includes social security benefits, distributions from qualified retirement plans, annuities or other such deferred payment arrangements, interest and dividends, or capital gains and losses taken into account in determining adjusted net capital gain.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2014.

5. Increase refund and credit threshold for Joint Committee on Taxation review to $5 million for corporate taxpayers (sec. 6105 of the discussion draft and sec. 6405 of the Code)

Present and Prior Law

No refund or credit in excess of a specified dollar threshold of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation.[69] A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues. The specified dollar threshold for review is $2,000,000.

Description of Proposal

The proposal increases the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from $2,000,000 to $5,000,000 in the case of an entity taxable as a corporation under subchapter C. The staff of the Joint Committee on Taxation continues to be authorized to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues.

Effective Date

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

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[69] Sec. 6405.

C. Tax Return Due Date Simplification

Present Law

Persons required to file income tax returns[70] must file such returns in the manner prescribed by the Secretary, in compliance with due dates established in the Code, if any, or by regulations. The Code includes a general rule that requires income tax returns to be filed on or before the 15th day of the fourth month following the end of the taxable year, but certain exceptions are provided both in the Code and in regulations.

A partnership generally is required to file a Federal income tax return on or before the 15th day of the fourth month after the end of the partnership taxable year.[71] For a partnership with a taxable year that is a calendar year, for example, the partnership return due date (and the date by which Schedules K-1 must be furnished to partners) is April 15. However, a partnership is allowed an automatic five-month extension of time to file the partnership return and the Schedule K-1s (to September 15 in the foregoing example) by submitting an application on Form 7004 in accordance with the rules prescribed by the Treasury regulations.[72]

A C corporation or an S corporation generally is required to file a Federal income tax return on or before the 15th day of the third month following the close of the corporation's taxable year. For a corporation with a taxable year that is a calendar year, for example, the corporate return due date is March 15.[73] However, a corporation is allowed an automatic six-month extension of time to file the corporate return (to September 15 in the foregoing example) by submitting an application on Form 7004 in accordance with the rules prescribed by the Treasury regulations.[74]

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[70] Section 6012 provides general rules identifying who must file an income tax return, while other Code provisions referenced herein specifically address filing requirements of partnerships, corporations, and other entities.

[71] Secs. 6031, 6072.

[72] Sec. 6081. Treas. Reg. sec. 1.6081-2. See Department of the Treasury, Internal Revenue Service, *2011 Instructions for Form 1065, U.S. Return of Partnership Income*, p. 3. Unlike other partnerships, an electing large partnership is required to furnish a Schedule K-1 to each partner by the first March 15 following the close of the partnership's taxable year (sec. 6031(b)). For calendar year 2012 partnerships, for example, the due date is March 15, 2013 even though the partnership return due date is April 15, 2013. However, an electing large partnership is allowed an automatic six-month extension of time to file the partnership return and the Schedule K-1s by submitting an application on form 7004 in accordance with the rules prescribed by the Treasury Regulations. Treas. Reg. sec. 1.6081-2(a)(2).

[73] Secs. 6012, 6037, 6072. Section 6012(a)(2) provides that every corporation subject to taxation under subtitle A shall be required to file an income tax return. Section 6037, which governs the returns of S corporations, provides that any return filed pursuant to section 6037 shall, for purposes of chapter 66 (relating to limitations) be treated as a return filed by the corporation under section 6012. Section 6072, which sets forth the due dates for filing various income tax returns, provides that returns of corporations with a taxable year that is a calendar year under section 6012 (and section 6037 based on the language in that section) are due March 15.

[74] Section 6081(b) provides that a corporation is allowed an automatic extension of three months to file its income tax return if the corporation files the form prescribed by the Secretary and pays on or before the due date

The annual returns required to be filed by various employee benefit plans are due on the last day of the seventh month following the close of the plan year, and may be extended up to the 15th day of the third month following the due date. For a calendar year plan, the original due date would be July 31, with a maximum extension until October 15.[75]

U.S. persons who transfer assets to, and hold interests in, foreign bank accounts or foreign entities may be subject to self-reporting requirements under both Title 26 (the Internal Revenue Code) and Title 31 (the Bank Secrecy Act) of the United States Code. With respect to account holders, a U.S. citizen, resident, or person doing business in the United States is required to keep records and file reports, as specified by the Secretary, when that person enters into a transaction or maintains an account with a foreign financial agency.[76] Regulations promulgated pursuant to broad regulatory authority granted to the Secretary in the Bank Secrecy Act[77] provide additional guidance regarding the disclosure obligation with respect to foreign accounts. Treasury Department Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts," (the "FBAR") must be filed by June 30 of the year following the year in which the $10,000 filing threshold is met.[78]

1. New due date for partnership form 1065, S corporation form 1120S and C corporation form 1120 (sec. 6201 of the discussion draft and sec. 6072 of the Code)

Description of Proposal

The proposal accelerates the due date for filing of Federal income tax returns of partnerships to conform to the due date for Federal income tax returns of S corporations, and removes C corporations from the scope of the exception to the general rule that requires income tax returns to be filed by the 15th day of the fourth month after the end of a taxable year.

Under the proposal, both partnership and S corporation returns must be filed on or before the 15th day of the third month following the close of the taxpayer's taxable year, or March 15 in the case of a calendar year taxpayer. The proposal requires that the C corporation return be filed

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prescribed for payment, the amount properly estimated as its tax. However, section 6081(a) provides that the Secretary may grant an automatic extension of up to six months to file and the Treasury regulations do so provide. Treas. Reg. sec. 1.6081-3.

[75] Treas. Reg. sec. 1.6081-11 permits an automatic extension.

[76] 31 U.S.C. sec. 5314. The term "agency" in the Bank Secrecy Act includes financial institutions.

[77] 31 U.S.C. sec. 5314(a) ("Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.").

[78] 31 C.F.R. sec. 103.27(c). The $10,000 threshold is the aggregate value of all foreign financial accounts in which a U.S. person has a financial interest or over which the U.S. person has signature or other authority.

on or before the 15th day of the fourth month after the close of a taxable year, or April 15 in the case of a calendar year taxpayer.

Effective Date

The proposal is generally effective for returns for taxable years beginning after December 31, 2014. The proposal is not effective for returns with respect to taxable years beginning in 2022 for C corporations that adopt a taxable year ending June 30.

2. Modification of due dates by regulation (sec. 6202 of the discussion draft)

Description of Proposal

The proposal requires that the Treasury Department modify its regulations that establish extensions of due dates by conforming the extension periods to the following terms. The maximum extension for the returns of partnerships using a calendar year is a six-month period ending on September 15. The maximum extension for the returns of trusts using a calendar year is a 5-1/2 month period ending on September 30. The maximum extension for the returns of employee benefit plans using a calendar year is an automatic 3-1/2 month period ending on November 15. The maximum extension for the returns of tax-exempt organizations using a calendar year is an automatic six-month period ending on November 15. The due date for forms relating to the Annual Information Return of Foreign Trust with a United States Owner for calendar year filers is April 15 with a maximum extension for a six-month period ending on October 15.

In addition to requiring modification of the regulatory deadlines established for extensions of time to file income tax returns, the proposal establishes a statutory due date for the form required under FBAR that generally conforms to income tax filing deadlines. Under the proposal, the due date of forms relating to Report of Foreign Bank and Financial Accounts is April 15 with a maximum extension for a six-month period ending on October 15 (with a proposal for extension). The proposal permits the Secretary to waive any penalties for failure to file a timely request for an extension if the reporting period to which the penalty relates is the first period for which the taxpayer was subject to the FBAR requirements.

Effective Date

The proposal is generally effective for returns for taxable years beginning after December 31, 2014.

3. Corporations permitted statutory automatic six-month extension of income tax returns (sec. 6203 of the discussion draft and sec. 6081 of the Code)

Description of Proposal

The proposal modifies the statute to provide (consistent with current Treasury regulations) that a corporation is allowed an automatic six-month extension of time to file its Federal corporate income tax return (to October 15 for a calendar year taxpayer, assuming the new filing dates as described in section 6201 above) if the corporation files the form prescribed

by the Secretary and pays on or before the due date prescribed for payment, the amount properly estimated as its tax.

Effective Date

The proposal is effective for returns for taxable years beginning after December 31, 2014.

D. Compliance Reforms

1. Penalty for failure to file (sec. 6301 of the discussion draft and sec. 6651 of the Code)

Present Law

The Federal tax system is one of "self-assessment," *i.e.*, taxpayers are required to declare their income, expenses, and ultimate tax due, while the IRS has the ability to propose subsequent changes. This voluntary system requires that taxpayers comply with deadlines and adhere to the filing requirements. While taxpayers may obtain extensions of time in which to file their returns, the Federal tax system consists of specific due dates of returns. In order to foster compliance in meeting these deadlines, Congress has enacted a penalty for the failure to timely file tax returns.[79]

A taxpayer who fails to file a tax return on or before its due date is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 25 percent of the net amount.[80] If the failure to file a return is fraudulent, the taxpayer is subject to a penalty equal to 15 percent of the net amount of tax due for each month the return is not filed, up to a maximum of 75 percent of the net amount.[81] The net amount of tax due is the amount of tax required to be shown on the return reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credits against tax which may be claimed on the return.[82] The penalty will not apply if it is shown that the failure to file was due to reasonable cause and not willful neglect.[83]

If a return is filed more than 60 days after its due date, and unless it is shown that such failure is due to reasonable cause, then the failure to file penalty may not be less than the lesser of $135 or 100 percent of the amount required to be shown as tax on the return. 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.[84] 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 $135 or 100 percent of the amount required to be shown on the return.[85]

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[79] See *United States v. Boyle*, 469 U.S. 241, 245 (1985).

[80] Sec. 6651(a)(1).

[81] Sec. 6651(f).

[82] Sec. 6651(b)(1).

[83] Sec. 6651(a)(1).

[84] Sec. 6651(c)(1).

[85] *Ibid*.

The failure to file penalty applies to all returns required to be filed under subchapter A of Chapter 61 (relating to income tax returns of an individual, fiduciary of an estate or trust, or corporation; self employment tax returns, and estate and gift tax returns), subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), and subchapter A of chapter 53 (relating to machine guns and certain other firearms).[86] The failure to file penalty does not apply to any failure to pay estimated tax required to be paid by sections 6654 or 6655.[87]

Description of Proposal

Under the proposal, if a return is filed more than 60 days after its due date, then the failure to file penalty may not be less than the lesser of $400 or 100 percent of the amount required to be shown as tax on the return.

Effective Date

The proposal applies to returns with filing due dates (including extensions) after December 31, 2014.

2. Penalty for failure to file correct information returns and provide payee statements (sec. 6302 of the discussion draft and secs. 6721 and 6722 of the Code)

Present Law

Failure to comply with the information reporting requirements results in penalties, which may include a penalty for failure to file the information return,[88] to furnish payee statements,[89] or to comply with other various reporting requirements.[90] No penalty is imposed if the failure is due to reasonable cause.[91]

Any person who is required to file an information return, but 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 information return is filed. If a person files an 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 $30 per return ("first-tier penalty"), with a maximum penalty of $250,000 per calendar year. If a person files an information return after the date that is 30 days after the prescribed filing date

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[86] Sec. 6651(a)(1).

[87] Sec. 6651(e).

[88] Sec. 6721.

[89] Sec. 6722.

[90] Sec. 6723. The penalty for failure to timely comply with a specified information reporting requirement is $50 per failure, not to exceed $100,000 per calendar year.

[91] Sec. 6724.

but on or before August 1, the amount of the penalty is $60 per return ("second-tier penalty"), with a maximum penalty of $500,000 per calendar year. If an information return is not filed on or before August 1 of any year, the amount of the penalty is $100 per return ("third-tier penalty"), with a maximum penalty of $1,500,000 per calendar year. If a failure to file is due to intentional disregard of a filing requirement, the minimum penalty for each failure is $250, with no calendar year limit.

Lower maximum levels for this failure to file correct information return 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: $75,000 (instead of $250,000) if the failures are corrected on or before 30 days after the prescribed filing date; $200,000 (instead of $500,000) if the failures are corrected on or before August 1; and $500,000 (instead of $1,500,000) if the failures are not corrected on or before August 1.

Any person who is required to furnish a payee statement 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 payee statement is furnished, similar to the penalty for filing an information return discussed above. A first-tier penalty is $30, subject to a maximum of $250,000, a second-tier penalty is $60 per statement, up to $500,000, and a third-tier penalty is $100, up to a maximum of $1,500,000. If a failure to file is due to intentional disregard of a filing requirement, the minimum penalty for each failure is $250, with no calendar year limit.

Lower maximum levels for this failure to furnish correct payee statement 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: $75,000 (instead of $250,000) if the failures are corrected on or before 30 days after the prescribed filing date; $200,000 (instead of $500,000) if the failures are corrected on or before August 1; and $500,000 (instead of $1,500,000) if the failures are not corrected on or before August 1.

Both the failure to file and failure to furnish penalties are adjusted to account for inflation every five years with the first adjustment to take place after 2012, effective for each year thereafter.

Description of Proposal

The proposal modifies the dollar values of the failure to file penalties and the failure to furnish payee statement penalties as follows.

The proposal increases the first-tier penalties from $30 to $50, and increases the calendar year maximum from $250,000 to $500,000. The second-tier penalties are increased from $60 to $100, and the calendar year maximum is increased from $500,000 to $1,500,000. The third-tier penalties are increased from $100 to $250, and the calendar year maximum is increased from $1,500,000 to $3,000,000. For small business filers, the calendar year maximum is increased from $75,000 to $175,000 for the first-tier penalty, from $200,000 to $500,000 for the second-tier penalty, and from $500,000 to $1,000,000 for the third-tier penalty.

If one or more failures are due to intentional disregard of the filing or information reporting requirement, the minimum penalty is increased from $250 to $500 for each return with respect to which such a failure occurs and the $3,000,000 limitation on total amounts imposed does not apply.

Effective Date

The proposal applies to information returns and statements required to be filed after December 31, 2014.

3. Clarification of six-year statute of limitations in case of overstatement of basis (sec. 6303 of the discussion draft and sec. 6501(e) of the Code)

Present Law

Taxes are generally required to be assessed within three years after a taxpayer's return is filed, whether or not it was timely filed.[92] There are several circumstances under which the general three-year limitations period does not begin to run. If no return is filed,[93] if a false or fraudulent return filed with the intent to evade tax is filed, if private foundation status is terminated, or a gift tax for certain gifts is not properly disclosed, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.[94]

Other exceptions to the general rule result in an extension of the limitations period otherwise applicable. For example, the limitation period may be extended by taxpayer consent.[95] Failure to disclose or report certain information may also result in extensions of the statute of limitations. For example, failure to disclose a listed transaction as required under section 6011 on any return or statement for a taxable year will result in an extension that ensures that the limitations period remains open for at least one year from the date the requisite information is provided. The limitation period with respect to such transaction will not expire before the date which is one year after the earlier of (1) the date on which the Secretary is provided the information so required, or (2) the date that a "material advisor" (as defined in section 6111) makes its section 6112(a) list available for inspection pursuant to a request by the Secretary under section 6112(b)(1)(A).[96] In addition to the exceptions described above, there are also circumstances under which the three-year limitation period is suspended.[97]

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[92] Sec. 6501(a). Returns that are filed before the date they are due are deemed filed on the due date. See sec. 6501(b)(1) and (2).

[93] Sec. 6501(c)(3).

[94] Sec. 6501(c)(1) and (2).

[95] Sec. 6501(c)(4).

[96] Sec. 6501(c)(10).

[97] For example, service of an administrative summons triggers the suspension either (1) beginning six months after service (in the case of John Doe summonses) or (2) when a proceeding to quash a summons is initiated

A separate limitations period of six years from the date a return is filed is established for substantial omissions of items from gross income. An omission from gross income is substantial if the omission exceeds 25 percent of the gross income reported on the return or if the amount omitted exceeds $5,000 and is attributable to a foreign financial asset within the meaning of section 6038D (without regard to dollar thresholds and regulatory exceptions to reporting based on existence of duplicative disclosure requirements).[98] Amounts that are disclosed on a return, even if not reflected in the amount recorded as gross income, are generally not considered to have been omitted for purposes of determining whether the 25 percent threshold was exceeded. For a trade or business, the threshold for determining a substantial omission is 25 percent of the gross receipts. For all others, an amount is considered to have been disclosed on a return if it is presented in a manner that is "adequate to apprise the Secretary of the nature and amount of such item."[99] An overstatement of basis that contributes to an understatement of income due is not itself considered to be an omission of income, without regard to whether the return reveals the computation of basis.[100]

Description of Proposal

In determining whether an amount greater than 25 percent of gross income was omitted from a return, the proposal provides that an understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission of gross income, without regard to whether or not the amount of unrecovered cost or basis claimed is disclosed on the return.

Effective Date

The proposal applies to returns filed after the date of enactment, as well as to any other return for which the assessment period specified in section 6501 had not expired as of that date.

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by a taxpayer named in a summons to a third-party record-keeper. Judicial proceedings initiated by the government to enforce a summons generally do not suspend the limitation period.

[98] Sec. 6501(e)(1). Similar six year limitations periods are established for estate and gift taxes as well as excise taxes, based on 25 percent omissions from items required to be reported on the relevant tax returns. See secs. 6501(e)(2) and (3).

[99] Sec. 6501(e)(1)(B).

[100] *Home Concrete & Supply, LLC. v. United States*, 132 S. Ct. 1836; 182 L. Ed. 2d 746 (2012). In deciding in favor of the taxpayer, the Supreme Court followed its interpretation of the word "omits" in a predecessor to section 6501. See *The Colony Inc., v. Commissioner*, 357 U.S. 28 (1958). Having previously interpreted an unambiguous term in the statute, the Court held that a contrary interpretation by the Secretary in Treas. Reg. sec. 301.6501(e)-1 was invalid.

4. Reform of rules related to qualified tax collection contracts (sec. 6304 of the discussion draft and sec. 6306 of the Code)

Present Law

Code section 6306 permits the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities of any type[101] and to arrange payment of those taxes by the taxpayers. There must be an assessment pursuant to section 6201 in order for there to be an outstanding tax liability. An assessment is the formal recording of the taxpayer's tax liability that fixes the amount payable. An assessment must be made before the IRS is permitted to commence enforcement actions to collect the amount payable. In general, an assessment is made at the conclusion of all examination and appeals processes within the IRS.[102]

Several steps are involved in the deployment of private debt collection companies. First, the private debt collection company contacts the taxpayer by letter.[103] If the taxpayer's last known address is incorrect, the private debt collection company searches for the correct address. Second, the private debt collection company telephones the taxpayer to request full payment.[104] If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as five years. If the taxpayer is unable to pay the outstanding tax liability in full over a five-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.

The Code specifies several procedural conditions under which the provision would operate. 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 are made statutorily applicable to employees of private sector debt collection companies. Third, subcontractors are prohibited from having contact with taxpayers, providing quality assurance services, and composing debt collection notices; any other service provided by a subcontractor must receive prior approval from the IRS.

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[101] This provision generally applies to any type of tax imposed under the Internal Revenue Code.

[102] An amount of tax reported as due on the taxpayer's tax return is considered to be self-assessed. If the IRS determines that the assessment or collection of tax will be jeopardized by delay, it has the authority to assess the amount immediately (sec. 6861), subject to several procedural safeguards.

[103] The provision requires that the IRS disclose confidential taxpayer information to the private debt collection company. Section 6103(n) permits disclosure of returns and return information for "the providing of other services ... for purposes of tax administration."

[104] The private debt collection company is not permitted to accept payment directly. Payments are required to be processed by IRS employees.

The Code creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies will be paid out of this fund. The Code prohibits the payment of fees for all services in excess of 25 percent of the amount collected under a tax collection contract.

The Code also provides that up to 25 percent of the amount collected may be used for IRS collection enforcement activities. The law also requires Treasury to provide a biennial report to the Committee on Finance and the Committee on Ways and Means. The report is to include, among other items, a cost benefit analysis, the impact of the debt collection contracts on collection enforcement staff levels in the IRS, and an evaluation of contractor performance.

The Omnibus Appropriations Act of 2009 (the "Act"), which made appropriations for the fiscal year ending September 30, 2009, included a provision stating that none of the funds made available in the Act could be used to fund or administer section 6306.[105] Around the same time, the IRS announced that the IRS would not renew its contracts with private debt collection agencies.[106]

Description of Proposal

The proposal requires the Secretary to enter into qualified tax collection contracts for the collection of inactive tax receivables. Inactive tax receivables are defined as any tax receivable (i) removed from the active inventory for lack of resources or inability to locate the taxpayer, (ii) for which more than 1/3 of the applicable limitations period has lapsed and no IRS employee has been assigned to collect the receivable; and (iii) for which, a receivable has been assigned for collection but more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection. Tax receivables are defined as any outstanding assessment which the IRS includes in potentially collectible inventory.

The proposal designates certain tax receivables as not eligible for collection under qualified tax collection contracts, specifically a contract that: (i) is subject to a pending or active offer-in-compromise or installment agreement; (ii) is classified as an innocent spouse case; (iii) involves a taxpayer identified by the Secretary as being (a) deceased, (b) under the age of 18, (c) in a designated combat zone, or (d) a victim of identity theft; (iv) is currently under examination, litigation, criminal investigation, or levy; or (v) is currently subject to a proper exercise of a right of appeal. The proposal grants authority to the Secretary to prescribe procedures for taxpayers in presidentially declared disaster areas to request relief from immediate collection measures under the proposal.

The proposal requires the Secretary to give priority to private collection contractors and debt collection centers currently approved by the Treasury Department's Financial Management Service on the schedule required under section 3711(g) of title 31 of the United States Code, to the extent appropriate to carry out the purposes of the proposal.

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[105] Pub. L. No. 111-8, March 11, 2009.

[106] IR-2009-19, March 5, 2009.

The proposal adds an additional exception to section 6103 to allow contractors to identify themselves as such and disclose the nature, subject, and reason for the contact. Disclosures are permitted only in situations and under conditions approved by the Secretary.

The proposal requires the Secretary to prepare two reports for the House Committee on Ways and Means and the Senate Committee on Finance. The first report is required annually and due not later than 90 days after each fiscal year and is required to include: (i) the total number and amount of tax receivables provided to each contractor for collection under this section; (ii) the total amounts collected by and installment agreements resulting from the collection efforts of each contactor and the collection costs incurred by the IRS; (iii) the impact of such contacts on the total number and amount of unpaid assessments, and on the number and amount of assessments collected by IRS personnel after initial contact by a contractor; (iv) the amount of fees retained by the Secretary under subsection (e) and a description of the use of such funds; and (v) a disclosure safeguard report in a form similar to that required under section 6103(p)(5).

The second report is required biannually and is required to include: (i) an independent evaluation of contactor performance; and (ii) a measurement plan that includes a comparison of the best practices used by private collectors to the collection techniques used by the IRS and mechanisms to identify and capture information on successful collection techniques used by the contractors that could be adopted by the IRS.

Effective Date

The proposal applies to tax receivables identified by the Secretary after the date of enactment. The requirement to give priority to certain private collection contractors and debt collection centers applies to contracts and agreements entered into after the date of enactment, and the new exception to section 6103 applies to disclosures made after the date of enactment. The requirement of the reports to Congress is effective on the date of enactment.

5. 100 percent continuous levy authority on payments to Medicare providers and suppliers (sec. 6305 of the discussion draft and sec. 6331 of the Code)

Present Law

In general

Levy is the administrative authority of the IRS to seize a taxpayer's property, or rights to property, to pay the taxpayer's tax liability.[107] Generally, the IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property,[108] the property is not exempt from levy,[109] and the IRS has provided both notice of intention to levy[110] and notice of the right

[107] Sec. 6331(a). Levy specifically refers to the legal process by which the IRS orders a third party to turn over property in its possession that belongs to the delinquent taxpayer named in a notice of levy.

[108] *Ibid*.

[109] Sec. 6334.

to an administrative hearing (the notice is referred to as a "collections due process notice" or "CDP notice" and the hearing is referred to as the "CDP hearing")[111] at least 30 days before the levy is made. A levy on salary or wages generally is continuously in effect until released.[112] A Federal tax lien arises automatically when: (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 10 days after the notice and demand.[113]

The notice of intent to levy is not required if the Secretary finds that collection would be jeopardized by delay. The standard for determining whether jeopardy exists is similar to the standard applicable when determining whether assessment of tax without following the normal deficiency procedures is permitted.[114]

The CDP notice (and pre-levy CDP hearing) is not required if: (1) the Secretary finds that collection would be jeopardized by delay; (2) the Secretary has served a levy on a State to collect a Federal tax liability from a State tax refund; (3) the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served; or (4) the Secretary has served a Federal contractor levy. In each of these four cases, however, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy.[115]

Federal payment levy program

To help the IRS collect taxes more effectively, the Taxpayer Relief Act of 1997[116] authorized the establishment of the Federal Payment Levy Program ("FPLP"), which allows the IRS to continuously levy up to 15 percent of certain "specified payments" by the Federal government if the payees are delinquent on their tax obligations. With respect to payments to vendors of goods, services, or property sold or leased to the Federal government, the continuous levy may be up to 100 percent of each payment.[117] The levy (either up to 15 percent or up to 100 percent) generally continues in effect until the liability is paid or the IRS releases the levy.

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[110] Sec. 6331(d).

[111] Sec. 6330. The notice and the hearing are referred to collectively as the CDP requirements.

[112] Secs. 6331(e) and 6343.

[113] Sec. 6321.

[114] Secs. 6331(d)(3), and 6861.

[115] Sec. 6330(f).

[116] Pub. L. No. 105-34.

[117] Sec. 6331(h)(3). The word "property" was added to "goods or services" in section 301 of the "3% Withholding Repeal and Job Creation Act," Pub. L. No. 112-56.

Under FPLP, the IRS matches its accounts receivable records with Federal payment records maintained by the Department of the Treasury's Financial Management Service ("FMS"), such as certain Social Security benefit and Federal wage records. When these records match, the delinquent taxpayer is provided both the notice of intention to levy and the CDP notice. If the taxpayer does not respond after 30 days, the IRS can instruct FMS to levy the taxpayer's Federal payments. Subsequent payments are continuously levied until such time that the tax debt is paid or the IRS releases the levy.

Payments to Medicare Providers

In 2008, the Government Accountability Office ("GAO") found that over 27,000 Medicare providers (*i.e.*, about six percent of all such providers) owed more than $2 billion of tax debt, consisting largely of individual income and payroll taxes.[118] As of 2008, the Centers for Medicare & Medicaid Services ("CMS") had not incorporated most of its Medicare payments into the continuous levy program, despite the IRS authority to continuously levy up to 15 percent of these payments. The GAO noted that CMS officials promised to incorporate about 60 percent of all Medicare fee-for-service payments into the levy program by October 2008 and the remaining 40 percent in the next several years. Following the GAO study, Congress directed CMS to participate in the FPLP and ensure that all Medicare provider and supplier payments are processed through it, in specified graduated percentages, by the end of fiscal year 2011.[119] CMS has since incorporated its payments into the continuous levy program to ensure that it collects delinquent tax debts from Medicare providers as authorized.

Description of Proposal

The proposal allows the Secretary to levy up to 100 percent of a payment to a Medicare provider to collect unpaid taxes.

Effective Date

The proposal is effective for levies issued after the date of enactment.

[118] Government Accountability Office, *Medicare: Thousands of Medicare Providers Abuse the Federal Tax System* (GAO-08-618), June 13, 2008.

[119] Medicare Improvement for Patients and Providers Act of 2008, Pub. L. No. 110-275, sec. 189.

6. Treatment of refundable credits for purposes of certain penalties (sec. 6306 of the discussion draft and secs. 6664 and 6676 of the Code)

Present Law

Underpayment penalties

Under present law, an accuracy-related penalty or a fraud penalty may be imposed on certain underpayments of tax.[120] The Code imposes a 20 percent penalty on the portion of an underpayment attributable to: negligence or disregard of rules or regulations, a substantial understatement, a substantial valuation overstatement, a substantial overstatement of pension liabilities, a substantial estate or gift tax valuation understatements, any disallowance of tax benefits by reason of lacking economic substance, or any undisclosed foreign financial asset understatement.[121] A penalty of 75 percent of an underpayment is imposed in the case of fraud. An exception to these penalties for reasonable cause generally applies.[122] An underpayment, for this purpose, means the excess of the amount of tax imposed over the amount of tax shown on the return.[123]

These penalties are assessed in the same manner as taxes.[124] In the case of income taxes, a taxpayer may contest any deficiency in tax determined by the IRS in the Tax Court before an assessment of the tax may be made.[125] Generally a deficiency in tax is the excess of the amount of tax imposed over the amount of tax shown on the return.[126]

The Code allows certain credits against the income tax.[127] Most of the credits may not exceed the taxpayer's income tax. However certain credits ("refundable credits") may exceed the tax and the amount of these credits in excess of the tax imposed (reduced by the other credits) is

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[120] Secs. 6662 and 6663. Present law also imposes a separate accuracy-related 20 percent penalty on portions of an underpayment attributable to a listed or reportable transaction. Sec. 6662A(a). The penalty increases to 30 percent if the transaction is not adequatelydisclosed. Secs. 6662A(c) and 6664(d)(2)(A).

[121] The 20 percent penalty is increased to 40 percent when there is a gross valuation misstatement involving a substantial valuation overstatement, a substantial overstatement of pension liabilities, a substantial estate or gift tax valuation understatement, or when a transaction lacking economic substance is not properly disclosed. Secs. 6662(h) and 6662(i).

[122] Sec.6664(c). There is no reasonable cause exception for tax benefits disallowed by reason of a transaction lacking economic substance and certain valuation overstatements related to charitable deduction property.

[123] Sec. 6664(a). Previous assessments and rebates may also be taken into account.

[124] Sec. 6665(a).

[125] Sec. 6211-6215.

[126] Sec. 6211. Previous assessments and rebates may also be taken into account.

[127] Secs. 21-54AA.

an overpayment which creates a refund or credit.[128] Refundable credits include a portion of the child credit, the American opportunity tax credit, and the earned income credit.[129]

In determining a deficiency in tax, the refundable credits in excess of tax are treated as negative amounts of tax.[130] Thus, the amounts of tax imposed and the tax shown on the return may be negative amounts. The Code does not provide a similar rule for the determination of an underpayment for purposes of the penalties.[131]

The Tax Court ruled that for purposes of determining the amount of an underpayment for purposes of the penalty provisions, the tax shown on the return may not be less than zero.[132] Thus, no accuracy-related penalty or fraud penalty may be imposed to the extent the refundable credits reduce the tax imposed below zero.

Erroneous claims

Present law imposes a penalty of 20 percent on the amount by which a claim for refund or credit exceeds the amount allowable unless it is shown that the claim has a reasonable basis.[133] The penalty does not apply to claims relating to the earned income credit. The penalty does not apply to the portion of any claim to which the accuracy-related and fraud penalties apply. The deficiency procedures do not apply to this penalty.

Description of Proposal

The proposal amends the definition of underpayment applicable to the determination of accuracy-related and fraud penalties by incorporating in the definition the rule that in determining the tax imposed and the amount of tax shown on the return, the excess of the refundable credits over the tax is taken into account as negative amount of tax. Thus, if a taxpayer files an income tax return erroneously claiming refundable credits in excess of tax, there is an underpayment on which a penalty may be imposed.

The proposal also repeals the exception from the erroneous claims penalty for the earned income credit.

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[128] Sec. 6401(b).

[129] Refundable credits include credits for withholding of taxes. Treas. Reg. secs. 1-6664-2(b) and (c) provide special rules for the withholding credits.

[130] Sec. 6211(b)(4).

[131] The Improved Penalty Administration and Compliance Tax Act (the "Act"), Pub. L. No. 101-239, sec. 7721(c), revised the penalties to provide a single accuracy-related penalty for various types of misconduct. The definition of underpayment for purposes of similar penalties prior to that Act was defined by reference to the definition of a deficiency. See sec. 6653(c)(1) prior to its repeal by the Act.

[132] *Rand v. Commissioner*, 141 T.C. No. 12 (November 18, 2013).

[133] Sec. 6676.

Effective Date

The proposal amending the definition of underpayment is effective for all open tax years. The proposal repealing the exception from the erroneous claims penalty is effective for claims filed after February 26, 2014.