DESCRIPTION OF AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 2337 "TAXPAYER BILL OF RIGHTS 2"

Scheduled for Markup

by the

HOUSE COMMITTEE ON WAYS AND MEANS

on March 21, 1996

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

March 20, 1996

JCX-7-96

CONTENTS

INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on March 21, 1996, of H.R. 2337 (introduced by Mrs. Johnson of Connecticut for herself and Mr. Matsui), the proposed "Taxpayer Bill of Rights 2." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of an amendment in the nature of a substitute for H.R. 2337 that will be offered by Mrs. Johnson and Mr. Matsui.

The description includes present law, the proposal, effective date, and a legislative background of the proposal. The provisions described in Part I generally were included in the Committee on Ways and Means reconciliation submission to the House Committee on the Budget: Subtitle C of Title XIII of H.R. 2491 as passed by the House of Representatives in 1995 (see H. Rept. 104-280, October 17, 1995). The conference agreement on H.R. 2491 (the "Balanced Budget Act of 1995," herein referred to as the "BBA of 1995") contained certain of the House-passed Taxpayer Bill of Rights 2 provisions. The provision described in Part II also was included in H.R. 2491 as passed by the Congress. H.R. 2491 was vetoed by President Clinton.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Amendment in the Nature of a Substitute to H.R. 2337 "Taxpayer Bill of Rights 2"* (JCX-7-96), March 20, 1996.

I. DESCRIPTION OF PROPOSED TAXPAYER BILL OF RIGHTS 2

1. Taxpayer advocate

a. Establishment of position of Taxpayer Advocate within Internal Revenue Service

Present Law

The Office of the Taxpayer Ombudsman was created by the Internal Revenue Service (IRS) in 1979. The Taxpayer Ombudsman's duties are to serve as the primary advocate, within the IRS, for taxpayers. As the taxpayers' advocate, the Taxpayer Ombudsman participates in an ongoing review of IRS policies and procedures to determine their impact on taxpayers, receives ideas from the public concerning tax administration, identifies areas of the tax law that confuse or create an inequity for taxpayers, and supervises cases handled under the Problem Resolution Program. Under current procedures, the Taxpayer Ombudsman is selected by the Commissioner of the IRS and serves at the Commissioner's discretion.

Description of Proposal

The proposal would establish a new position, Taxpayer Advocate, within the IRS. This would replace the position of Taxpayer Ombudsman. The Taxpayer Advocate would be appointed by and report directly to the Commissioner. Compensation of the Taxpayer Advocate would be at a level equal to that of the highest level official reporting directly to the Deputy Commissioner of the IRS.

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

The Taxpayer Advocate would be required to make two annual reports to the tax-writing Committees.

Effective Date

The proposal would be effective on the date of enactment. The first annual reports of the Taxpayer Advocate would be due in June and December, 1996.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Expansion of authority to issue Taxpayer Assistance Orders

Present Law

Section 7811(a) authorizes the Taxpayer Ombudsman to issue a Taxpayer Assistance Order (TAO). TAOs may order the release of taxpayer property levied upon by the IRS and may require the IRS to cease any action, or refrain from taking any action if, in the determination of the Taxpayer Ombudsman, the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered.

Description of Proposal

The proposal would provide the Taxpayer Advocate with broader authority to affirmatively take any action as permitted by law with respect to taxpayers who would otherwise suffer a significant hardship as a result of the manner in which the IRS is administering the tax laws. In addition, the proposal would provide that a TAO may specify a time period within which the TAO must be followed. Further, the proposal would provide that only the Taxpayer Advocate, the Commissioner of the IRS, or the Deputy Commissioner, may modify or rescind a TAO. Any official who modifies or rescinds a TAO would be required to provide the Taxpayer Advocate a written explanation of the reasons for the modification or rescission.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

2. Modifications to installment agreement provisions

a. Notification of reasons for termination of installment agreements

Present Law

Section 6159 authorizes the IRS to enter into written installment agreements with taxpayers to facilitate the collection of tax liabilities. In general, the IRS has the right to terminate (or in some instances, alter or modify) such agreements if the taxpayer provided inaccurate or incomplete information before the agreement was entered into, if the taxpayer fails to make a timely payment of an installment or another tax liability, if the taxpayer fails to provide the IRS with a requested update of financial condition, if the IRS determines that the financial condition of the taxpayer has changed significantly, or if the IRS believes collection of the tax liability is in jeopardy. If the IRS determines that the financial condition of a taxpayer that has entered into an installment agreement has changed significantly, the IRS must provide the taxpayer with a written notice that explains the IRS determination at least 30 days before altering, modifying, or terminating the installment agreement. No notice is statutorily required if the installment agreement is altered, modified, or terminated for other reasons.

Description of Proposal

The proposal would require the IRS to notify taxpayers 30 days before altering, modifying, or terminating any installment agreement for any reason other than that the collection of tax is determined to be in jeopardy. The IRS would be required to include in the notification an explanation of why the IRS intends to take this action.

Effective Date

The proposal would be effective six months after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Administrative review of termination of installment agreements

Present Law

The IRS is currently testing an appeal process for various collection actions, including installment agreements, that will permit taxpayers to appeal these collection actions to Appeals Division personnel.

Description of Proposal

The proposal would require the IRS to establish additional procedures for an independent administrative review of terminations of installment agreements for taxpayers who request a review.

Effective Date

The proposal would be effective on January 1, 1997.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

3. Abatement of interest and penalties

a. Expansion of authority to abate interest

Present Law

Any assessment of interest on any deficiency attributable in whole or in part to any error or delay by an officer or employee of the IRS (acting in his official capacity) in performing a ministerial act may be abated.

Description of Proposal

The proposal would permit the IRS to abate interest with respect to any unreasonable error or delay resulting from managerial acts as well as ministerial acts. This would include extensive delays resulting from managerial acts such as: the loss of records by the IRS, IRS personnel transfers, extended illnesses, extended personnel training, or extended leave. On the other hand, interest would not be abated for delays resulting from general administrative decisions. For example, the taxpayer could not claim that the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system resulted in an unreasonable delay in the Service's action on the taxpayer's tax return, and so the interest on any subsequent deficiency should be waived.

Effective Date

The proposal would apply to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995.

b. Review of IRS failure to abate interest

Present Law

Federal courts generally do not have the jurisdiction to review the IRS's failure to abate interest.

Description of Proposal

The proposal would grant the Tax Court jurisdiction to determine whether the IRS's failure to abate interest for an eligible taxpayer was an abuse of discretion. The action would be required to be brought within six months after the date of mailing of the Secretary's final determination not to abate interest. An eligible taxpayer would be required to meet the net worth and size requirements imposed with respect to awards of attorney's fees. No inference is intended as to whether under present law any court has jurisdiction to review IRS's failure to abate interest.

Effective Date

The proposal would apply to requests for abatement after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

c. Extension of interest-free period for payment of tax after notice and demand

Present Law

In general, a taxpayer must pay interest on late payments of tax. An interest-free period of 10 calendar days is provided to taxpayers who pay the tax due within 10 calendar days of notice and demand.

Description of Proposal

The proposal would extend the interest-free period provided to taxpayers for the payment of the tax liability reflected in the notice from 10 calendar days to 10 business days (21 calendar days, provided that the total tax liability shown on the notice of deficiency is less than $100,000).

Effective Date

The proposal would apply in the case of any notice and demand given after December 31, 1996.

Legislative Background

The proposal was included in the BBA of 1995.

d. Abatement of penalty for failure to make required deposits of payroll taxes in certain cases

Present Law

If any person who is required to deposit taxes imposed by the Internal Revenue Code with a government depository fails to deposit such taxes on or before the prescribed date, a penalty may be imposed, unless it is shown that such failure is due to reasonable cause and not willful neglect. The penalty contains a four-tiered structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. The amount of the underpayment for this purpose is the excess of the amount of the tax required to be deposited over the amount of the tax, if any, deposited on or before the prescribed date.

Description of Proposal

The proposal would provide that the Secretary may waive this penalty with respect to an inadvertent failure to deposit any employment tax if: (a) the depositing entity meets the net worth requirements applicable for awards of attorney's fees; (b) the failure to deposit occurs during the first quarter that the depositing entity was required to deposit any employment tax; and (3) the return for the employment tax was filed on or before the due date.

The proposal also would provide that the Secretary may abate any penalty for failure to make deposits for the first time a depositing entity makes a deposit if it inadvertently sends the deposit to the Secretary instead of to the required government depository.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was contained in the Subcommittee on Oversight's recommendations to the Committee on Ways and Means with respect to a proposed Taxpayer Bill of Rights 2 (September 1995).

4. Joint returns

a. Studies of joint and several liability for married persons filing joint tax returns and other joint return-related issues

Present Law

Spouses who file a joint tax return are each fully responsible for the accuracy of the return and for the full tax liability. This is true even though only one spouse may have earned the wages or income which is shown on the return. This is "joint and several" liability. Spouses who wish to avoid joint liability may file as a "married person filing separately."

Spouses often file a joint tax return but then later are separated or divorced. If the IRS later disputes the accuracy of the joint tax returns, one spouse may be held liable for the entire tax deficiency stemming from erroneous deductions or omitted income attributable to the other spouse. Therefore, the "innocent" spouse may be held liable for the full deficiency in a subsequent audit occurring after the separation or divorce. This has resulted in a serious hardship being imposed on an "innocent spouse" in a number of cases.

In some cases, a couple addresses the responsibility for tax liability as part of their divorce decree. However, these agreements are not binding on the IRS because the IRS was not a party to the divorce proceeding. Thus, if a former spouse violates the tax responsibilities assigned to him or her in a divorce decree, the other spouse may not rely on the decree in dealing with the IRS.

Description of Proposal

The proposal would direct the Treasury Department and the General Accounting Office (GAO) to conduct separate studies analyzing several joint return-related issues.

Effective Date

The studies would be due six months after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Joint return may be made after separate returns without full payment of tax

Present Law

Taxpayers who file separate returns and subsequently determine that their tax liability would have been less if they had filed a joint return are precluded by statute from reducing their tax liability by filing jointly if they are unable to pay the entire amount of the joint return liability before the expiration of the three-year period for making the election to file jointly.

Description of Proposal

The proposal would repeal the requirement of full payment of tax liability as a precondition to switching from married filing separately status to married filing jointly status.

Effective Date

The proposal would apply to taxable years beginning after the date of the enactment.

Legislative Background

The proposal was included in the BBA of 1995.

c. Disclosure of collection activities with respect to joint returns

Present Law

The IRS does not routinely disclose collection information to a former spouse that relates to tax liabilities attributable to a joint return that was filed when married.

Description of Proposal

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

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

5. Collection activities

a. Modifications to lien and levy provisions

i. Withdrawal of public notice of lien

Present Law

The IRS must file a notice of lien in the public record, in order to protect the priority of a tax lien. A notice of tax lien provides public notice that a taxpayer owes the Government money. The IRS has discretion in filing such a notice, but may withdraw a filed notice only if the notice (and the underlying lien) was erroneously filed or if the underlying lien has been paid, bonded, or become unenforceable.

Description of Proposal

The proposal would allow the IRS to withdraw a public notice of tax lien prior to payment in full by the indebted taxpayer without prejudice, if the Secretary determines that (1) the filing of the notice was premature or otherwise not in accordance with the administrative procedures of the IRS, (2) the taxpayer has entered into an installment agreement to satisfy the tax liability with respect to which the lien was filed, (3) the withdrawal of the lien will facilitate collection of the tax liability, or (4) the withdrawal of the lien would be in the best interests of the taxpayer (as determined by the Taxpayer Advocate) and of the Government. The IRS also would be required to provide a copy of the notice of withdrawal to the taxpayer. The proposal would also require that, at the written request of the taxpayer, the IRS make reasonable efforts to give notice of the withdrawal of a lien to creditors, credit reporting agencies, and financial institutions specified by the taxpayer.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

ii. Return of levied property

Present Law

The IRS is authorized to levy on the property of a taxpayer as a means of collecting unpaid taxes. The IRS is able to return levied property to a taxpayer only when the taxpayer has overpaid its liability with respect to tax, interest, and penalty for which the property was levied.

Description of Proposal

The proposal would allow the IRS to return property (including money deposited in the Treasury) that has been levied upon if the Secretary determines that (1) the levy was premature or otherwise not in accordance with the administrative procedures of the IRS, (2) the taxpayer has entered into an installment agreement to satisfy the tax liability, (3) the return of the property will facilitate collection of the tax liability, or (4) the return of the property would be in the best interests of the taxpayer (as determined by the Taxpayer Advocate) and the Government.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

iii. Modifications in certain levy exemption amounts

Present Law

Property exempt from levy includes personal property with a value of up to $1,650 and books and tools of a trade with a value of up to $1,100.

Description of Proposal

The proposal would increase the exemption amount to $2,500 for personal property and increase the exemption amount to $1,250 for books and tools of a trade. This amount would be indexed for inflation commencing January 1, 1997.

Effective Date

The proposal would be effective with respect to levies issued after December 31, 1996.

Legislative Background

The proposal was included in the BBA of 1995.

b. Offers-in-compromise

Present Law

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. IRS regulations provide that such offers can be accepted if: the taxpayer is unable to pay the full amount of the tax liability and it is doubtful that the tax, interest, and penalties can be collected or there is doubt as to the validity of the actual tax liability. Amounts over $500 can only be accepted if the reasons for the acceptance are documented in detail and supported by an opinion of the IRS Chief Counsel.

Description of Proposal

The proposal would increase from $500 to $50,000 the amount requiring a written opinion from the Office of Chief Counsel. Compromises below the $50,000 threshold would be required to subject to continuing quality review by the IRS.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995.

6. Information returns

a. Civil damages for fraudulent filing of information returns

Present Law

Federal law provides no private cause of action to a taxpayer who is injured because a fraudulent information return has been filed with the IRS asserting that payments have been made to the taxpayer.

Description of Proposal

The proposal would provide that, if any person willfully files a fraudulent information return with respect to payments purported to have been made to another person, the other person may bring a civil action for damages against the person filing that return. A copy of the complaint initiating the action would be required to be provided to the IRS. Recoverable damages would be the greater of (1) $5,000 or (2) the amount of actual damages (including the costs of the action) and, in the court's discretion, reasonable attorney's fees. The court would be required to specify in any decision awarding damages the correct amount (if any) that should have been reported on the information return. An action seeking damages under this provision would be required to be brought within six years after the filing of the fraudulent information return, or one year after the fraudulent information return would have been discovered through the exercise of reasonable care, whichever is later.

Effective Date

The proposal would apply to fraudulent information returns filed after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Requirement to conduct reasonable investigations of information returns

Present Law

Deficiencies determined by the IRS are generally afforded a presumption of correctness.

Description of Proposal

The proposal would provide that, in any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return (Form

1099 or Form W-2) filed by a third party and the taxpayer has fully cooperated with the IRS, the Government would have the burden of producing reasonable and probative information concerning the deficiency (in addition to the information return itself). Fully cooperating with the IRS would include (but not be limited to) the following: bringing the reasonable dispute over the item of income to the attention of the IRS within a reasonable period of time, and providing (within a reasonable period of time) access to and inspection of all witnesses, information, and documents within the control of the taxpayer (as reasonably requested by the Secretary).

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

7. Awarding of costs and certain fees

a. United States must establish that its position in a proceeding was substantially justified

Present Law

Under section 7430, a taxpayer who successfully challenges a determination of deficiency by the IRS may recover attorney's fees and other administrative and litigation costs if the taxpayer qualifies as a "prevailing party." A taxpayer qualifies as a prevailing party if it: (1) establishes that the position of the United States was not substantially justified; (2) substantially prevails with respect to the amount in controversy or with respect to the most significant issue or set of issues presented; and (3) meets certain net worth and (if the taxpayer is a business) size requirements. A taxpayer must exhaust administrative remedies to be eligible to receive an award of attorney's fees.

Description of Proposal

The proposal would provide that, once a taxpayer substantially prevails over the IRS in a tax dispute, the IRS has the burden of proof to establish that it was substantially justified in maintaining its position against the taxpayer. This would switch the current procedure which places the burden of proof on the taxpayer to establish that the IRS was not substantially justified in maintaining its position. Therefore, the successful taxpayer would receive an award of attorney's fees unless the IRS satisfies its burden of proof. The proposal would also establish a rebuttable presumption that the position of the United States was not substantially justified if the IRS did not follow in the administrative proceeding (1) its published regulations, revenue rulings, revenue procedures, information releases, notices, or announcements, or (2) a private letter ruling, determination letter, or technical advice memorandum issued to the taxpayer. This proposal would only apply to the version of IRS guidance that is most current on the date the IRS's position was taken.

Effective Date

The proposal would be effective for proceedings commenced after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Increased limit on attorney's fees

Present Law

Attorney's fees recoverable by prevailing parties as litigation or administrative costs was originally set at $75 per hour.

Description of Proposal

The proposal would raise the statutory rate to $110 per hour, indexed for inflation beginning after 1996.

Effective Date

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

Legislative Background

The proposal was included in the BBA of 1995.

c. Failure to agree to extension not taken into account

Present Law

To qualify for an award of attorney's fees, the taxpayer must have exhausted the administrative remedies available within the IRS.

Description of Proposal

The proposal would provide that any failure to agree to an extension of the statute of limitations cannot be taken into account for purposes of determining whether a taxpayer has exhausted the administrative remedies for purposes of determining eligibility for an award of attorney's fees.

Effective Date

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

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

d. Award of litigation costs permitted in declaratory judgment proceedings

Present Law

Section 7430(b)(3) denies any reimbursement for attorney's fees in all declaratory judgment actions, except those actions related to the revocation of an organization's qualification under section 501(c)(3) (relating to tax-exempt status).

Description of Proposal

The proposal would eliminate the present-law restrictions on awarding attorney's fees in all declaratory judgment proceedings.

Effective Date

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

Legislative Background

The proposal was included in the BBA of 1995.

8. Modification to recovery of civil damages for unauthorized collection actions

a. Increase in limit on recovery of civil damages for unauthorized collection actions

Present Law

A taxpayer may sue the United States for up to $100,000 of damages caused by an officer or employee of the IRS who recklessly or intentionally disregards provisions of the Internal Revenue Code or the Treasury regulations promulgated thereunder in connection with the collection of Federal tax with respect to the taxpayer.

Description of Proposal

The proposal would increase the cap from $100,000 to $1 million.

Effective Date

The proposal would apply to unauthorized collection actions by IRS employees that occur after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995.

b. Court discretion to reduce award for litigation costs for failure to exhaust administrative remedies

Present Law

A taxpayer suing the United States for civil damages for unauthorized collection activities must exhaust administrative remedies to be eligible for an award.

Description of Proposal

The proposal would permit (but would not require) a court to reduce an award if the taxpayer has not exhausted administrative remedies.

Effective Date

The proposal would be effective for proceedings commenced after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

9. Modification to penalty for failure to collect and pay over tax

a. Preliminary notice requirement

Present Law

Under section 6672, a "responsible person" is subject to a penalty equal to the amount of trust fund taxes that are not collected or paid to the government on a timely basis. An individual the IRS has identified as a responsible person is permitted an administrative appeal on the question of responsibility.

Description of Proposal

The proposal would require the IRS to issue a notice to an individual the IRS had determined to be a responsible person with respect to unpaid trust fund taxes at least 60 days prior to issuing a notice and demand for the penalty. The statute of limitations would not expire before the date 90 days after the date on which the notice was mailed. The proposal would not apply if the Secretary finds that the collection of the penalty is in jeopardy.

Effective Date

The proposal would apply to assessments made after June 30, 1996.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Disclosure of certain information where more than one person subject to penalty

Present Law

The IRS may not disclose to a responsible person the IRS's efforts to collect unpaid trust fund taxes from other responsible persons, who may also be liable for the same tax liability.

Description of Proposal

The proposal would require the IRS, if requested in writing by a person considered by the IRS to be a responsible person, to disclose in writing to that person the name of any other person the IRS has determined to be a responsible person with respect to the tax liability. The IRS would be required to disclose in writing whether it has attempted to collect this penalty from other responsible persons, the general nature of those collection activities, and the amount (if any) collected. Failure by the IRS to follow this provision would not absolve any individual for any liability for this penalty.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

c. Right of contribution from multiple responsible parties

Present Law

A responsible person may seek to recover part of the amount which he has paid to the IRS from other individuals who also may have the obligations of a responsible person but who have not yet contributed their proportionate share of their liability under section 6672. Taxpayers must pursue such claims for contribution under state law (to the extent state law permits such claims). The variations in state law sometimes make it difficult or impossible to press successful suits in state courts to force a contribution from other responsible persons.

Description of Proposal

If more than one person is liable for this penalty, each person who paid the penalty would be entitled to recover from other persons who are liable for the penalty an amount equal to the excess of the amount paid by such person over such person's proportionate share of the penalty. This proceeding would be a Federal cause of action and must be entirely separate from any proceeding involving IRS's collection of the penalty from any responsible party (including a proceeding in which the United States files a counterclaim or third-party complaint for collection of the penalty).

Effective Date

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

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

d. Board members of tax-exempt organizations

Present Law

Under section 6672, "responsible persons" of tax-exempt organizations are subject to a penalty equal to the amount of trust fund taxes that are not collected and paid to the Government on a timely basis.

Description of Proposal

The proposal would clarify that the section 6672 responsible person penalty is not to be imposed on volunteer, unpaid members of any board of trustees or directors of a tax-exempt organization to the extent such members are solely serving in an honorary capacity, do not participate in the day-to-day or financial activities of the organization, and do not have actual knowledge of the failure. The proposal cannot operate in such a way as to eliminate all responsible persons from responsibility.

The proposal would require the IRS to develop materials to better inform board members of tax-exempt organizations (including voluntary or honorary members) that they may be treated as responsible persons. The IRS would be required to make such materials routinely available to tax-exempt organizations. The proposal would also require the IRS to clarify its instructions to IRS employees on application of the responsible person penalty with regard to honorary or volunteer members of boards of trustees or directors of tax-exempt organizations.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

10. Modifications of rules relating to summonses

a. Enrolled agents included as third-party recordkeepers

Present Law

Section 7609 contains special procedures that the IRS must follow before it issues a third- party summons. A third-party summons is a summons issued to a third-party recordkeeper compelling him to provide information with respect to the taxpayer. An example of this would be a summons served on a stock brokerage house to provide data on the securities trading of the taxpayer-client.

If a third-party summons is served on a third-party recordkeeper listed in section 7609(a)(3), then the taxpayer must receive notice of the summons and have an opportunity to challenge the summons in court. Otherwise the taxpayer has no statutory right to receive notice of the summons and accordingly he will not have the opportunity to challenge it in court.

Section 7609(a)(3) lists attorneys and accountants as third-party recordkeepers, but it does not list "enrolled agents", who are authorized to practice before the IRS.

Description of Proposal

The proposal would include enrolled agents as third-party recordkeepers.

Effective Date

The proposal would apply to summonses issued after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995.

b. Safeguards relating to designated summonses; annual report to Congress on designated summonses

Present Law

The period for assessment of additional tax with respect to most tax returns, corporate or otherwise, is three years. The IRS and the taxpayer can together agree to extend the period, either for a specified period of time or indefinitely. The taxpayer may terminate an indefinite agreement to extend the period by providing notice to the IRS.

During an audit, the IRS may informally request that the taxpayer provide additional information necessary to arrive at a fair and accurate audit adjustment, if any adjustment is warranted. Not all taxpayers cooperate by providing the requested information on a timely basis. In some cases the IRS seeks information by issuing an administrative summons. Such a summons will not be judicially enforced unless the Government (as a practical matter, the Department of Justice) seeks and obtains an order for enforcement in Federal court. In addition, a taxpayer may petition the court to quash an administrative summons where this is permitted by statute.[2]

In certain cases, the running of the assessment period is suspended during the period when the parties are in court to obtain or avoid judicial enforcement of an administrative summons. Such a suspension is provided in the case of litigation over a third-party summons (sec. 7609(e)) or litigation over a summons regarding the examination of a related party transaction. Such a suspension can also occur with respect to a corporate tax return if a summons is issued at least 60 days before the day on which the assessment period (as extended) is scheduled to expire. In this case, suspension is only permitted if the summons clearly states

---

[2] Petitions to quash are permitted, for example, in connection with the examination of certain related party transactions under section 6038A(e)(4), and in the case of certain third-party summonses under section 7609(b)(2).

that it is a "designated summons" for this purpose. Only one summons may be treated as a designated summons for purposes of any one tax return. The limitations period is suspended during the judicial enforcement period of the designated summons and of any other summons relating to the same tax return that is issued within 30 days after the designated summons is issued.

Under current internal procedures of the IRS, no designated summons is issued unless first reviewed by the Office of Chief Counsel to the IRS, including review by an IRS Deputy Regional Counsel for the Region in which the examination of the corporation's return is being conducted.

Description of Proposal

The proposal would require that issuance of any designated summons with respect to a corporation's tax return must be preceded by review of such issuance by the Regional Counsel, Office of Chief Counsel to the IRS, for the Region in which the examination of the corporation's return is being conducted.

The proposal would also limit the use of a designated summons to corporations (or to any other person to whom the corporation has transferred records) that are being examined as part of the Coordinated Examination Program (CEP) or its successor. CEP audits cover about 1,600 of the largest corporate taxpayers. If a corporation moves between CEP and non-CEP audit categories, only the tax years covered by the CEP may be the subject of a designated summons. The proposal would not affect Code section 6038A(e)(1), which relates to a U.S. reporting corporation that acts merely as the agent of the foreign related party by receiving summonses on behalf of the foreign party.

The proposal would also require that the Treasury report annually to the Congress on the number of designated summonses issued in the preceding 12 months.

Effective Date

The proposal would apply to summonses issued after date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

11. Relief from retroactive application of Treasury Department regulations

Present Law

Under section 7805(b), Treasury may prescribe the extent (if any) to which regulations shall be applied without retroactive effect.

Description of Proposal

The proposal would provide that temporary and proposed regulations must have an effective date no earlier than the date of publication in the Federal Register or the date on which any notice substantially describing the expected contents of such regulation is issued to the public. Any regulations filed or issued within 18 months of the enactment of the statutory provision to which the regulation relates may be issued with retroactive effect. This general prohibition on retroactive regulations may be superseded by a legislative grant authorizing the Treasury to prescribe the effective date with respect to a statutory provision. The Treasury may issue retroactive temporary or proposed regulations to prevent abuse. The Treasury also may issue retroactive temporary, proposed, or final regulations to correct a procedural defect in the issuance of a regulation. Treasury may provide that taxpayers may elect to apply a temporary or proposed regulation retroactively from the date of publication of the regulation. Final regulations may take effect from the date of publication of the temporary or proposed regulation to which they relate. The proposal would not apply to any regulation relating to internal Treasury Department policies, practices, or procedures. Present law with respect to rulings would be unchanged.

Effective Date

The proposal would apply with respect to regulations that relate to statutory provisions enacted on or after the date of enactment.

Legislative Background

The proposal (with slight modifications) was included in the BBA of 1995 as passed by the House of Representatives.

12. Miscellaneous provisions

a. Phone numbers of person providing payee statement required to be shown on such statement

Present Law

Information returns must contain the name and address of the payor.

Description of Proposal

The proposal would require that information returns contain the name, address, and phone number of the information contact of the person required to make the information return. A payor may, for example, provide the phone number of the department with the relevant information. It would be intended that the telephone number provide direct access to individuals with immediate resources to resolve a taxpayer's questions in an expeditious manner.

Effective Date

The proposal would apply to statements required to be furnished after December 31, 1996 (determined without regard to any extension).

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

b. Required notice to taxpayers of certain payments

Present Law

If the IRS receives a payment without sufficient information to properly credit it to a taxpayer's account, the IRS may attempt to contact the taxpayer. If contact cannot be made, the IRS places the payment in an unidentified remittance file.

Description of Proposal

The proposal would require the IRS to make reasonable efforts to notify, within 60 days, those taxpayers who have made payments which the IRS cannot associate with the taxpayer.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

c. Unauthorized enticement of information disclosure

Present Law

No statutory disincentive applies to IRS employees who entice a tax professional to disclose information about clients in exchange for the favorable treatment of the taxes of the professional.

Description of Proposal

If any officer or employee of the United States intentionally compromises the determination or collection of any tax due from an attorney, certified public accountant, or enrolled agent representing a taxpayer in exchange for information conveyed by the taxpayer to the attorney, certified public accountant, or enrolled agent for purposes of obtaining advice concerning the taxpayer's tax liability, the taxpayer would be permitted to bring a civil action for damages against the United States in a district court of the United States. Upon a finding of liability, damages would equal the lesser of $500,000 or the sum of (1) actual economic damages sustained by the taxpayer as a proximate result of the information disclosure and (2) the costs of the action. These remedies would not apply to information conveyed to an attorney, certified public accountant, or enrolled agent for the purpose of perpetrating a fraud or crime.

Effective Date

The proposal would apply to actions taken after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

d. Annual reminders to taxpayers with outstanding delinquent accounts

Present Law

There is no statutory requirement in the Code that the IRS send annual reminders to persons who have outstanding tax liabilities.

Description of Proposal

The proposal would require the IRS to send taxpayers an annual reminder of their outstanding tax liabilities. The fact that a taxpayer did not receive a timely, annual reminder notice would not affect the tax liability.

Effective Date

The proposal would require the IRS to send annual reminder notices beginning in 1997.

Legislative Background

The proposal was included in the BBA of 1995.

e. Disclosure of returns and return information to designee of taxpayer

Present Law

Under present law, the IRS is authorized to disclose the return of any taxpayer, or return information pertaining to a taxpayer, to such person(s) as the taxpayer has designated in a written request.

Description of Proposal

The proposal would delete the word "written" from the requirement that "written consent" from the taxpayer is necessary for the disclosure of taxpayer information to a designated third party. Allowing the IRS to adopt alternatives to the written request requirement would expedite such changes and facilitate the development and implementation of Tax System Modernization projects. It is anticipated that the IRS would continue to utilize its regulatory authority to impose reasonable restrictions on the form in which a request is made, and that the IRS would in no event accept an unconfirmed verbal request.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

f. Report on netting of interest on overpayments and liabilities

Present Law

If any portion of a tax is satisfied through the crediting of an overpayment of tax, no interest is imposed on that portion of the tax for any period during which, if the credit had not been made, interest would have been allowable.

Description of Proposal

The proposal would require the Secretary of the Treasury to conduct a study of the manner in which the IRS has implemented the netting of interest on overpayments and underpayments and the policy and administrative implications of global netting. The Treasury would be required to hold a public hearing to receive comments from any interested party prior to submitting the report of its study to the tax writing committees.

Effective Date

The report would be due six months after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

g. Expenses of detection of underpayments and fraud

Present Law

The Secretary may, pursuant to regulations, pay rewards for information leading to the detection and punishment of violations of the Internal Revenue laws.

Description of Proposal

The proposal would clarify that rewards may be paid for information relating to civil violations, as well as criminal violations. The proposal would also provide that the rewards are to be paid out of the proceeds of amounts (other than interest) collected by reason of the information provided. The proposal would also require an annual report on the rewards program.

Effective Date

The proposal would be effective six months after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

h. Five-year extension of authority for undercover operations

Present Law

The Anti-Drug Abuse Act of 1988 exempted IRS undercover operations from the otherwise applicable statutory restrictions controlling the use of Government funds (which generally provide that all receipts be deposited in the general fund of the Treasury and all expenses be paid out of appropriated funds). In general, the exemption permits the IRS to "churn" the income earned by an undercover operation to pay additional expenses incurred in the undercover operation. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations. The exemption originally expired on December 31, 1989, and was extended by the Comprehensive Crime Control Act of 1990 to December 31, 1991. The IRS has not had the authority to churn funds from its undercover operations since 1991.

Description of Proposal

The proposal would reinstate the IRS's offset authority under section 7608(c) from the date of enactment until January 1, 2002. The proposal would amend the IRS annual reporting requirement under section 7608(c)(4)(B) to require the provision of the following data: (1) the date the operation was initiated; (2) the date offsetting was approved; (3) the total current expenditures and the amount and use of proceeds of the operation; (4) a detailed description of the undercover operation projected to generate proceeds, including the potential violation being investigated, and whether the operation is being conducted under grand jury auspices; and (5) the results of the operation to date, including the results of criminal proceedings.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

i. Disclosure of returns on cash transactions

Present Law

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

Under section 6050I, any person who receives more than $10,000 in cash in one transaction (or two or more related transactions) in the course of a trade or business generally must file an information return (Form 8300) with the IRS specifying the name, address, and taxpayer identification number of the person from whom the cash was received and the amount of cash received.

The Anti-Drug Abuse Act of 1988 provided a special rule permitting the IRS to disclose these information returns to other Federal agencies for the purpose of administering Federal criminal statutes. The special rule originally was to expire after November 18, 1990, and was extended by the Comprehensive Crime Control Act of 1990 to November 18, 1992.

Description of Proposal

The proposal would permanently extend the special rule for disclosing Form 8300 information. Moreover, the proposal would permit disclosures not only to Federal agencies but also to State, local and foreign agencies and for civil, criminal and regulatory purposes (i.e., generally in the same manner as Currency Transaction Reports filed by financial institutions under the Bank Secrecy Act.) Disclosure, however, would not be permitted to any such agency for purposes of tax administration. The proposal would also (1) extend the dissemination policies and guidelines under section 6103 to people having access to Form 8300 information, and (2) apply section 6103 sanctions to persons having access to Form 8300 information that disclose this information without proper authorization.

Effective Date

The proposal would be effective on the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995 as passed by the House of Representatives.

II. DESCRIPTION OF PROPOSED REVENUE OFFSETS

1. Application of failure-to-pay penalty to substitute returns

Present Law

Section 6651(a)(2) provides that the IRS may assess a penalty for failure to pay tax from the due date of the return until the tax is paid. If no return is filed by the taxpayer and the IRS files a substitute return under section 6020, the tax on which the penalty is measured is considered a deficiency assessable under section 6212 or 6213, and the failure to pay penalty begins to accumulate 10 days after the IRS sends the taxpayer a notice and demand for payment of the tax.

Description of Proposal

The proposal would apply the failure to pay penalty to substitute returns in the same manner as the penalty applies to delinquent filers.

Effective Date

The proposal would apply in the case of any return the due date for which (determined without regard to extensions) is after the date of enactment.

Legislative Background

The proposal was included in the BBA of 1995.

2. Penalty on amounts of private excess benefits

Present Law

Private inurement

Charities.--Section 501(c)(3) specifically conditions tax-exempt status for all organizations described in that section on the requirement that no part of the net earnings of the organization inures to the benefit of any private shareholder or individual (the so-called "private inurement test").

Social welfare organizations.--A tax-exempt social welfare organization described in section 501(c)(4) must be organized on a non-profit basis and must be operated exclusively for the promotion of social welfare. In contrast to section 501(c)(3), however, there is no specific statutory rule in section 501(c)(4) prohibiting the net earnings of a social welfare organization described in section 501(c)(4) from inuring to the benefit of a private shareholder or individual.[3]

Other organizations.--Other tax-exempt organizations, such as labor and agricultural organizations described in section 501(c)(5) and business leagues described in section 501(c)(6) are subject to the private inurement test, as a result of explicit statutory language or Treasury Department regulations.

Sanctions for private inurement and other violations of exemption standards

Organizations described in section 501(c)(3) are classified as either public charities or private foundations. Penalty excise taxes may be imposed under the Code when a public charity makes political expenditures (sec. 4955) or excessive lobbying expenditures (secs. 4911 and 4912). However, the Code generally does not provide for the imposition of penalty excise taxes in cases where a 501(c)(3) public charity or a section 501(c)(4) social welfare organization engages in a transaction that results in private inurement. In such cases, the only sanction that specifically is authorized under the Code is revocation of the organization's tax-exempt status. A transaction engaged in by a private foundation (but not a public charity) is subject to special penalty excise taxes under the Code if the transaction is a prohibited "self-dealing" transaction (sec. 4941) or does not accomplish a charitable purpose (sec. 4945).

Filing and public disclosure rules

Tax-exempt organizations (other than churches and certain small organizations) are required to file an annual information return (Form 990) with the Internal Revenue Service ("IRS"), setting forth the organization's items of gross income and expenses attributable to such income, disbursements for tax-exempt purposes, plus certain other information for the taxable year. Private foundations are required to allow public inspection at the foundation's principal office of their current annual information return. Other tax-exempt organizations, including public charities, are required to allow public inspection at the organization's principal office (and certain regional or district offices) of their annual information returns for the three most recent taxable years (sec. 6104(e)). The Code also requires that tax-exempt organizations allow public inspection of the organization's application to the IRS for recognition of tax-exempt status, the IRS determination letter, and certain related documents. In addition, upon written request to the IRS, members of the general public are permitted to inspect annual information returns of tax-exempt organizations and applications for recognition of tax-exempt status (and related documents) at the National Office of the IRS in Washington, D.C. A person making such a written request is notified by the IRS when the material is available for inspection at the National

---

[3] Even where no prohibited private inurement exists, however, more than incidental private benefits conferred on individuals may result in the organization not being operated "exclusively" for an exempt purpose. See, e.g., American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989).

Office, where notes may be taken of the material open for inspection, photographs taken with the person's own equipment, or copies of such material obtained from the IRS for a fee (Treas. Reg. secs. 301.6104(a)-6 and 301.6104(b)-1).

Section 6652(c)(1)(A) provides that a tax-exempt organization that fails to file a complete and accurate Form 990 is subject to a penalty of $10 for each day during which such failure continues (with a maximum penalty with respect to any one return of the lesser of $5,000 or five percent of the organization's gross receipts for the year). Section 6652(c)(1)(C) provides that tax-exempt organizations that fail to make certain annual returns and applications for exemption available for public inspection are subject to a penalty of $10 for each day the failure continues (with a maximum penalty with respect to any one return not to exceed $5,000, and without limitation with respect to applications). In addition, section 6685 provides a penalty for willfully failing to make an annual return or application available for public inspection of $1,000 per return or application.

Description of Proposal

Extend private inurement prohibition to social welfare organizations

The proposal would amend section 501(c)(4) explicitly to provide that a social welfare organization or other organization described in that section would be eligible for tax-exempt status only if no part of its net earnings inures to the benefit of any private shareholder or individual.

In addition, the proposal would provide that the private inurement rule will not be violated solely because of an allocation or return of net margins or capital to the members of a nonprofit association or organization that operates on a cooperative basis in accordance with its incorporating statute and bylaws (substantially as in existence on the date of enactment) and was determined to be exempt from Federal income tax under section 501(c)(4) prior to the date of enactment. However, such cooperative organizations would be subject to the general private inurement proscription with respect to any other type of transaction.

Effective date.--This provision generally would be effective on September 14, 1995. However, under a special transition rule, the provision would not apply to inurement occurring prior to January 1, 1997, if such inurement results from a written contract that was binding on September 13, 1995, and at all times thereafter before such inurement occurred, and the terms of which have not materially changed.

Intermediate sanctions for excess benefit transactions

The proposal would impose penalty excise taxes as an intermediate sanction in cases where organizations exempt from tax under section 501(c)(3) or 501(c)(4) (other than private foundations, which are subject to a separate penalty regime under current law) engage in an "excess benefit transaction." In such cases, intermediate sanctions could be imposed on certain disqualified persons (i.e., insiders) who improperly benefit from an excess benefit transaction and on organization managers who participate in such a transaction knowing that it is improper.

An "excess benefit transaction" would be defined as: (1) any transaction in which an economic benefit is provided to, or for the use of, any disqualified person if the value of the economic benefit provided directly by the organization (or indirectly through a controlled entity[4]) to such person exceeds the value of consideration (including performance of services) received by the organization for providing such benefit; and (2) to the extent provided in Treasury Department regulations, any transaction in which the amount of any economic benefit provided to, or for the use of, any disqualified person is determined in whole or in part by the revenues of the organization, provided that the transaction constitutes prohibited inurement under present-law section 501(c)(3) or under section 501(c)(4), as amended. Thus, "excess benefit transactions" subject to excise taxes would include transactions in which a disqualified person engages in a non-fair-market-value transaction with an organization or receives unreasonable compensation, as well as financial arrangements (to the extent provided in Treasury regulations) under which a disqualified person receives payment based on the organization's income in a transaction that violates the present-law private inurement prohibition. The Treasury Department would be instructed to issue prompt guidance providing examples of revenue-sharing arrangements that violate the private inurement prohibition, and such guidance would be applicable on a prospective basis.[5]

Existing tax-law standards (see sec. 162) would apply in determining reasonableness of compensation and fair market value.[6] In applying such standards, it is intended that the parties to a transaction would be entitled to rely on a rebuttable presumption of reasonableness with respect to a compensation arrangement with a disqualified person if such arrangement was approved by a board of directors or trustees (or committee thereof) that: (1) was composed entirely of individuals unrelated to and not subject to the control of the disqualified person(s)

---

[4] A tax-exempt organization could not avoid the private inurement proscription by causing a controlled entity to engage in an excess benefit transaction. Thus, for example, if a tax-exempt organization causes its taxable subsidiary to pay excessive compensation to an individual who is a disqualified person with respect to the parent organization, such transaction would be an excess benefit transaction.

[5] Under present law, certain revenue sharing arrangements have been determined not to constitute private inurement (see e.g., GCM 38283; GCM 38905; and GCM 39674) and, under the proposal, it would continue to be the case that not all revenue sharing arrangements would be improper private inurement. However, legislative history would indicate that no inference is intended that Treasury or the Internal Revenue Service are bound by any particular prior unpublished rulings in this area.

[6] In this regard, the conferees intend that an individual need not necessarily accept reduced compensation merely because he or she renders services to a tax-exempt, as opposed to a taxable, organization. Cf. Treas. Reg. sec. 53.4941(d)-3(c)(1).

involved in the arrangement[7]; (2) obtained and relied upon appropriate data as to comparability (e.g., compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the location of the organization, including the availability of similar specialties in the geographic area; independent compensation surveys by nationally recognized independent firms; or actual written offers from similar institutions competing for the services of the disqualified person); and (3) adequately documented the basis for its determination (e.g., the record includes an evaluation of the individual whose compensation was being established and the basis for determining that the individual's compensation was reasonable in light of that evaluation and data).[8] If these three criteria are satisfied, penalty excise taxes could be imposed under the proposal only if the IRS develops sufficient contrary evidence to rebut the probative value of the evidence put forth by the parties to the transaction (e.g., the IRS could establish that the compensation data relied upon by the parties was not for functionally comparable positions or that the disqualified person, in fact, did not substantially perform the responsibilities of such position). A similar rebuttable presumption would arise with respect to the reasonableness of the valuation of property sold or otherwise transferred (or purchased) by an organization to (or from) a disqualified person if the sale or transfer (or purchase) is approved by an independent board that uses appropriate comparability data and adequately documents its determination. The Secretary of the Treasury and IRS would be instructed to issue guidance in connection with the reasonableness standard that incorporates this presumption.

The proposal would specifically provide that the payment of personal expenses and benefits to or for the benefit of disqualified persons, and non-fair-market-value transactions benefiting such persons, would be treated as compensation only if it is clear that the organization intended and made the payments as compensation for services. In determining whether such payments or transactions are, in fact, compensation, the relevant factors would include whether the appropriate decision-making body approved the transfer as compensation in accordance with established procedures and whether the organization and the recipient reported the transfer (except in the case of non-taxable fringe benefits) as compensation on the relevant forms (i.e., the organization's Form 990, the Form W-2 or Form 1099 provided by the organization to the recipient, the recipient's Form 1040, and other required returns).[9]

---

[7] A reciprocal approval arrangement whereby an individual approves compensation of the disqualified person, and the disqualified person, in turn, approves the individual's compensation does not satisfy the independence requirement.

[8] The fact that a State or local legislative or agency body may have authorized or approved of a particular compensation package paid to a disqualified person would not be determinative of the reasonableness of compensation paid for purposes of the excise tax penalties provided for by the proposal. Similarly, such authorization or approval would not be determinative of whether a revenue sharing arrangement violates the private inurement proscription.

[9] With the exception of nontaxable fringe benefits described in present-law section 132 and other types of nontaxable transfers such as employer-provided health benefits and contributions

Consistent with the rule that payment of personal expenses and benefits to or for the benefit of disqualified persons and nonfair-market value transactions benefiting such persons are treated as compensation only if it is clear that the organization intended and made the payments as compensation for services, any reimbursements by the organization of excise tax liability would be treated as an excess benefit unless they are included in the disqualified person's compensation during the year the reimbursement is made. The total compensation package, including the amount of any reimbursement, would be subject to the reasonableness requirement. Similarly, the payment by an applicable tax-exempt organization of premiums for an insurance policy providing liability insurance to a disqualified person for excess benefit taxes would be an excess benefit transaction unless such premiums are treated as part of the compensation paid to such disqualified person.[10]

"Disqualified person" would mean any individual who is in a position to exercise substantial influence over the affairs of the organization, whether by virtue of being an organization manager or otherwise.[11] In addition, "disqualified persons" include certain family

---

to qualified pension plans, an organization could not demonstrate at the time of an IRS audit that it clearly indicated its intent to treat economic benefits provided to a disqualified person as compensation for services merely by claiming that such benefits may be viewed as part of the disqualified person's total compensation package. Rather, the organization would be required to provide substantiation that is contemporaneous with the transfer of economic benefits at issue.

[10] In addition, because individuals may be both members of, and disqualified persons with respect to, a non-exclusive applicable tax-exempt organization (e.g., a museum or neighborhood civic organization) and receive certain benefits (e.g., free admission, discounted gift shop purchases) in their capacity as members (rather than in their capacity as disqualified persons), legislative history would express the expectation that the Treasury Department would provide guidance clarifying that such membership benefits may be excluded from consideration under the private inurement proscription and intermediate sanction rules.

[11] Under the proposal, a person could be in a position to exercise substantial influence over a tax-exempt organization despite the fact that such person is not an employee of (and receives no compensation directly from) a tax-exempt organization, but is formally an employee of (and is directly compensated by) a subsidiary -- even a taxable subsidiary -- controlled by the parent tax-exempt organization.

members and 35-percent owned entities[12] of a disqualified person, as well as any person who was a disqualified person at any time during the five-year period prior to the transaction at issue. A person having the title of "officer, director, or trustee" would not automatically have the status of a disqualified person.[13] In addition, the Secretary of Treasury would have authority to promulgate rules exempting broad categories of individuals from the category of "disqualified persons" (e.g., full-time bona fide employees who receive economic benefits of less than a threshold amount or persons who have taken a vow of poverty).

A disqualified person who benefits from an excess benefit transaction would be subject to a first-tier penalty tax equal to 25 percent of the amount of the excess benefit (i.e., the amount by which a transaction differs from fair market value, the amount of compensation exceeding reasonable compensation, or (under Treasury regulations) the amount of a prohibited transaction based on the organization's gross or net income). Organization managers who participate in an excess benefit transaction knowing that it is an improper transaction would be subject to a first-tier penalty tax of 10 percent of the amount of the excess benefit (subject to a maximum penalty of $10,000).[14]

Additional, second-tier taxes could be imposed on a disqualified person if there is no correction of the excess benefit transaction within a specified time period.[15] In such cases, the disqualified person would be subject to a penalty tax equal to 200 percent of the amount of

---

[12] Family members would be determined under present-law section 4946(d), except that such members also would include siblings (whether by whole or half blood) of the individual, and spouses of such siblings. "35-percent owned entities" mean corporations in which disqualified persons own stock possessing more than 35 percent of the combined voting power, as well as partnerships and trusts or estates in which disqualified persons own more than 35 percent of the profits interest or beneficial interest. As under present-law section 4946(a), the term "combined voting power" includes voting power represented by holdings of voting stock, actual or constructive, but does not include voting rights held only as a director or trustee. See Treas. Reg. sec. 53.4946-1(a)(5).

[13] The IRS has issued a general counsel memorandum indicating that all physicians are considered "insiders" for purposes of applying the private inurement proscription. Legislative history would express the intent that physicians will be disqualified persons only if they are in a position to exercise substantial influence over the affairs of an organization.

[14] In determining who is an organization manager, it is intended that principles similar to those set forth in regulations issued under sections 4946 and 4955 with respect to final authority or responsibility for an expenditure be applied. (See Treas. Reg. secs. 53.4946-1(f)(1)(ii), 53.4946-1(f)(2), 53.4955-1(b)(2)(ii)(B), and 53.4955-1(b)(2)(iii)).

[15] Correction would be required to be made on or prior to the earlier of (1) the date of mailing of a notice of deficiency under section 6212 with respect to the first-tier penalty excise tax imposed on the disqualified person, or (2) the date on which such tax is assessed.

excess benefit. For this purpose, the term "correction" would mean undoing the excess benefit to the extent possible and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

The intermediate sanctions for "excess benefit transactions" could be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status.[16] If more than one disqualified person or manager is liable for a penalty excise tax, then all such persons would be jointly and severally liable for such tax. As under current law, a three-year statute of limitations would apply, except in the case of fraud (sec. 6501). Under the proposal, the IRS would have authority to abate the excise tax penalty (under present-law section 4962) if it is established that the violation was due to reasonable cause and not due to willful neglect and the transaction at issue was corrected within the specified period.

To prevent avoidance of the penalty excise taxes in cases of private inurement of assets of a previously tax-exempt organization, the proposal would provide that an organization will be treated as an applicable tax-exempt organization subject to the excise taxes on excess benefit transactions if, at any time during the 5-year period preceding the transaction, it was a tax-exempt organization described in section 501(c)(3) or 501(c)(4), or a successor to such an organization.

Effective date.--The provision generally would apply to excess benefit transactions occurring on or after September 14, 1995. The provision does not apply, however, to any benefits arising out of a transaction pursuant to a written contract which was binding on September 13, 1995, and at all times thereafter before such benefits arose, and the terms of which have not materially changed.

In addition, legislative history would indicate that parties to transactions entered into after September 13, 1995, and before January 1, 1997, would be entitled to rely on the rebuttable presumption of reasonableness if, within a reasonable period (e.g., 90 days) after entering into the compensation package, the parties satisfy the three criteria that give rise to the presumption. After December 31, 1996, the rebuttable presumption should arise only if the three criteria are satisfied prior to payment of the compensation (or, to the extent provided by the Secretary of the Treasury, within a reasonable period thereafter).

---

[16] In general, the intermediate sanctions would be the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether, on the whole, the organization functions as a charitable or other tax-exempt organization. In practice, revocation of tax-exempt status, with or without the imposition of excise taxes, would occur only when the organization no longer operates as a charitable organization.

Additional filing and public disclosure rules

Reporting of information with respect to certain disqualified persons, excise tax penalties and excess benefit transactions.-- Tax-exempt organizations would be required to disclose on their Form 990 such information with respect to disqualified persons as the Secretary of the Treasury may prescribe. Legislative history would indicate that this requirement is not intended to limit the Secretary's authority under section 6033(a)(1) to require information on annual returns filed by exempt organizations for the purpose of carrying out the internal revenue laws. In addition, exempt organizations would be required to disclose on their Form 990 such information as the Secretary of the Treasury may require with respect to "excess benefit transactions" (described above) and any other excise tax penalties paid during the year under present-law sections 4911 (excess lobbying expenditures), 4912 (disqualifying lobbying expenditures), or 4955 (political expenditures), including the amount of the excise tax penalties paid with respect to such transactions, the nature of the activity, and the parties involved.[17]

Furnishing copies of documents.--The proposal also would provide that a tax-exempt organization that is subject to the public inspection rules of present-law section 6104(e)(1) (i.e., any tax-exempt organization, other than a private foundation, that files a Form 990) is required to comply with requests made in writing or in person from individuals who seek a copy of the organization's Form 990 or the organization's application for recognition of tax-exempt status and certain related documents. Upon such a request, the organization is required to supply copies without charge other than a reasonable fee for reproduction and mailing costs. If so requested, copies must be supplied of the Forms 990 for any of the organization's three most recent taxable years. If the request for copies is made in person, then the organization must immediately provide such copies. If the request for copies is made in writing, then copies must be provided within 30 days. However, an organization could be relieved of its obligation to provide copies if, in accordance with regulations to be promulgated by the Secretary of Treasury, (1) the organization has made the requested documents widely available or (2) the Secretary of the Treasury determined, upon application by the organization, that the organization was subject to a harassment campaign such that a waiver of the obligation to provide copies would be in the public interest.

Penalties for failure to file timely or complete return.--The section 6652(c)(1)(A) penalty imposed on a tax-exempt organization that either fails to file a Form 990 in a timely manner or fails to include all required information on a Form 990 would be increased from the present-law level of $10 for each day the failure continues (with a maximum penalty with respect to any one

[17] The penalties applicable to failure to file a timely, complete, and accurate return would apply for failure to comply with these requirements. In addition, it would be intended that the IRS implement its plan to require additional Form 990 reporting regarding (1) changes to the governing board or the certified accounting firm, (2) such information as the Treasury Secretary may require relating to professional fundraising fees paid by the organization, and (3) aggregate payments (by related entities) in excess of $100,000 to the highest-paid employees.

return of the lesser of $5,000 or five percent of the organization's gross receipts) to $20 for each day the failure continues (with a maximum penalty with respect to any one return of the lesser of $10,000 or five percent of the organization's gross receipts). Under the proposal, organizations with annual gross receipts exceeding $1 million would be subject to a penalty under section 6652(c)(1)(A) of $100 for each day the failure continues (with a maximum penalty with respect to any one return of $50,000). As under present law, no penalty may be imposed under section 6652(c)(1)(A) if it were shown that the failure to file a complete return was due to reasonable cause (sec. 6652(c)(3)).

Penalties for failure to allow public inspection or provide copies.--The section 6652(c)(1)(C) penalty imposed on tax-exempt organizations that fail to allow public inspection or provide copies of certain annual returns or applications for exemption would be increased from the present-law level of $10 per day (with a maximum of $5,000) to $20 per day (with a maximum of $10,000). In addition, the section 6685 penalty for willful failure to allow public inspections or provide copies would be increased from the present-law level of $1,000 to $5,000.

Effective date.--The public inspection provisions governing tax-exempt organizations generally would apply to requests made no earlier than 60 days after the date on which Treasury publishes the anti-harassment regulations required under the proposal. However, the legislative history would express the expectation that organizations would comply voluntarily with the public inspection provisions prior to the issuance of such regulations. The provisions regarding the reporting on annual returns of excise tax penalties and excess benefit transactions would be effective for returns with respect to taxable years beginning on or after the date of enactment.