

**DESCRIPTION OF THE CHAIRMAN'S AMENDMENT  
IN THE NATURE OF A SUBSTITUTE TO H.R. 3991,  
THE "TAXPAYER PROTECTION AND IRS  
ACCOUNTABILITY ACT OF 2002"**

Scheduled for a Markup  
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Prepared by the Staff  
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## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's amendment in the nature of a substitute to H.R. 3991, the "Taxpayer Protection and IRS Accountability Act of 2002." The House Committee on Ways and Means has scheduled a markup of this bill for March 20, 2002.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, "*Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 3991, the "Taxpayer Protection and IRS Accountability Act of 2002"*" (JCX-20-02), March 19, 2002.

**I. MODIFICATIONS TO THE PROPOSALS  
IN H.R. 3991, THE “TAXPAYER PROTECTION  
AND IRS ACCOUNTABILITY ACT OF 2002”**

**A. Clarification of Application of Federal Tax Deposit Penalty**

The proposal in the bill to repeal the 5 and 10 percent penalty rates and apply the 2 percent rate in their place would be eliminated. Instead, the application of the Federal tax deposit penalty would be clarified so that the 10 percent penalty rate only applies in cases where the failure to deposit extends for more than 15 days.

**B. Additional Considerations to be Taken into Account  
as Bases for Accepting an Offer in Compromise**

The Chairman’s amendment would eliminate this proposal.

**C. Study of Taxpayer Notification Alternatives**

The Chairman’s amendment would eliminate this proposal.

**D. Disclosure in Judicial or Administrative Tax Proceedings of  
Return and Return Information of Persons Who  
Are Not Party to Such Proceedings**

The Chairman’s amendment would exempt from the notice and comment requirements of the bill actions to enjoin income tax return preparers,<sup>2</sup> to enjoin promoters of abusive tax shelters,<sup>3</sup> and to enjoin flagrant political expenditures of section 501(c)(3) organizations.<sup>4</sup>

**E. Elimination of Proposed Modification to Failure of IRS to Act on  
Determinations Treated as Exhaustion of Remedies**

The proposal in the bill to modify the present-law declaratory judgment procedure to provide that an organization is deemed to exhaust its administrative remedies in the case of a failure by an office, other than the office responsible for initial determinations, to make a determination at the expiration of 450 days after the request for a determination was made would be eliminated by the Chairman’s amendment. Accordingly, the present-law 270-day time period for IRS to consider a request before an organization is deemed to have exhausted administrative remedies would continue to apply to determinations by the initial office and to determinations by other offices.

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<sup>2</sup> Sec. 7407.

<sup>3</sup> Sec. 7408.

<sup>4</sup> Sec. 7409.

## **F. Low-Income Taxpayer Clinics**

The Chairman's amendment would amend the definition of low-income taxpayer clinics by excluding from eligibility for grants clinics that provide tax return preparation (unless the return preparation is in connection with a controversy with the IRS). This replaces the provision of the bill that specifies that grants may not be used for any purpose other than those specified in the Code.

## **II. ADDITIONAL PROVISIONS**

### **A. Reporting Requirements of State and Local Political Organizations**

#### **Present Law**

##### **In general**

Under present law, section 527 provides a limited tax-exempt status to "political organizations," meaning a party, committee, association, fund, account, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures (or both) for an "exempt function." These organizations generally are exempt from Federal income tax on contributions they receive, but are subject to tax on their net investment income and certain other income at the highest corporate income tax rate ("political organization taxable income"). Donors are exempt from gift tax on their contributions to such organizations. For purposes of section 527, the term "exempt function" means: the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

##### **Notice of section 527 organization**

An organization is not treated as a section 527 organization unless it has given notice to the Secretary of the Treasury, electronically and in writing, that it is a section 527 organization. The notice is not required (1) of any person required to report as a political committee under the Federal Election Campaign Act of 1971, (2) by organizations that reasonably anticipate that their annual gross receipts will always be less than \$25,000, and (3) organizations described in section 501(c). All other organizations, including State and local candidate committees, are required to file the notice.

The notice is required to be transmitted no later than 24 hours after the date on which the organization is organized. The notice is required to include the following information: (1) the name and address of the organization and its electronic mailing address, (2) the purpose of the organization, (3) the names and addresses of the organization's officers, highly compensated employees, contact person, custodian of records, and members of the organization's Board of Directors, (4) the name and address of, and relationship to, any related entities, and (5) such other information as the Secretary may require.

The notice of status as a section 527 organization is required to be disclosed to the public by the IRS and by the organization. In addition, the Secretary of the Treasury is required to make publicly available on the Internet and at the offices of the IRS a list of all political organizations that file a notice with the Secretary under section 527 and the name, address, electronic mailing address, custodian of records, and contact person for such organization. The IRS is required to make this information available within five business days after the Secretary of the Treasury receives a notice from a section 527 organization.

An organization that fails to file the notice is not treated as a section 527 organization and its exempt function income is taken into account in determining taxable income.

### **Disclosure by political organizations of expenditures and contributors**

A political organization that accepts a contribution or makes an expenditure for an exempt function during any calendar year is required to file with the Secretary of the Treasury certain reports. The following reports are required: either (1) in the case of a calendar year in which a regularly scheduled election is held, quarterly reports, a pre-election report, and a post-general election report and, in the case of any other calendar year, a report covering January 1 to June 30 and July 1 to December 31, or (2) monthly reports for the calendar year, except that, in lieu of the reports due for November and December of any year in which a regularly scheduled general election is held, a pre-general election report, a post-general election report, and a year end report are to be filed.

The reports are required to include the following information: (1) the amount of each expenditure made to a person if the aggregate amount of expenditures to such person during the calendar year equals or exceeds \$500 and the name and address of the person (in the case of an individual, including the occupation and name of the employer of the individual); and (2) the name and address (in the case of an individual, including the occupation and name of employer of such individual) of all contributors that contributed an aggregate amount of \$200 or more to the organization during the calendar year and the amount of the contribution.

The disclosure requirements do not apply (1) to any person required to report as a political committee under the Federal Election Campaign Act of 1971, (2) to any State or local committee of a political party or political committee of a State or local candidate, (3) to any organization that reasonably anticipates that it will not have gross receipts of \$25,000 or more for any taxable year, (4) to any organization described in section 501(c), or (5) with respect to any expenditure that is an independent expenditure (as defined in section 301 of the Federal Election Campaign Act of 1971).

For purposes of the disclosure requirements, the term “election” means (1) a general, special, primary, or runoff election for a Federal office, (2) a convention or caucus of a political party that has authority to nominate a candidate for Federal office, (3) a primary election held for the selection of delegates to a national nominating convention of a political party, or (4) a primary election held for the expression of a preference for the nomination of individuals for election to the office of President.

The IRS is required to make available to the public any report filed by a political organization. In addition, the organization is required to make any such report available to the public. A penalty is imposed for failure to file a report or provide required information in the report.

### **Return requirements for section 527 organizations**

Under present law, a section 527 organization that has political organization taxable income is required annually to file Form 1120-POL (Return of Organization Exempt from Income Tax). Section 527 organizations that do not have political organization taxable income but have gross receipts of \$25,000 or more during the taxable year also are required to file an income tax return. The gross receipts requirement does not apply to political organizations that are subject to section 527 solely by reason of section 527(f)(1) (which makes certain charities subject to section 527 based on the charity's political activities). The annual return must be made available to the public by the organization and by the IRS. In addition, section 527 organizations that are required to file Form 1120-POL also are required to file an annual information return, Form 990 (Return of Organization Exempt from Income Tax).

### **Description of Proposal**

The proposal would provide that a political organization that is a political committee of a State or local candidate, or a local committee of a political party, as defined by State law, is exempt from the requirement to provide notice to the Secretary of its formation and purpose.

In addition, the proposal would exempt certain State or local political organizations from the requirement provided by section 527(j)(2) to file regular reports with the Secretary detailing contribution and expenditure information. To be exempt from such reporting requirements under the proposal: (1) the organization must not engage in any exempt function activities other than to influence or attempt to influence the selection, nomination, election, or appointment of any individual to any State or local public office or office in a State or local political organization; (2) during the calendar year, the organization must be required to report under State or local law information regarding the organization's expenditures and contributions (including information regarding the person who makes such contribution or receives such expenditure) that is substantially similar to the information that otherwise would be required to be reported; (3) the agency with which such information is filed must make the filed information public; (4) the organization filing the information must make the information available for public inspection in a manner similar to that required of reports filed with the IRS; and (5) no candidate for nomination or election to Federal elective office or individual holding such a Federal office can control or materially participate in the direction of the organization, or direct, in whole or in part, expenditures or fundraising activities of the organization.

Under the proposal, a political organization would be required to file an income tax return (Form 1120-POL) only if such organization has political organization taxable income for the taxable year. Thus, political organizations without political organization taxable income and with gross receipts of at least \$25,000 for the taxable year would no longer be required to file an income tax return. The proposal would change the present law rule that an information return (Form 990) is required to be filed by organizations that are required to file an income tax return.

Instead, under the proposal, information returns would be required to be filed by political organizations that have gross receipts of \$25,000 or more for the taxable year with the following exceptions: (1) State or local political organizations that are exempt from the 527(j) reporting requirement, (2) State or local committees of a political party, or political committees of a State or local candidate, as defined by State law, (3) a caucus or association of State or local elected officials, (4) a national association of State or local officials, (5) a committee of a candidate for Federal office authorized by section 301(6) of the Federal Election campaign Act, and (6) a national committee of a political party (as defined in section 301(14) of the Federal Election Campaign Act).<sup>5</sup> In addition, under the proposal, political organizations with political organization taxable income and gross receipts for the taxable year of less than \$25,000 would no longer be required to file an information return. Also, as under present law, the Secretary would have the discretion to waive the information return filing requirement.

The proposal would give the Secretary the authority to waive all or any portion of the taxes imposed on an organization for failure to notify the Secretary of the organization's establishment or the penalties imposed for failure to file a report. Such waiver would be subject to a showing by the organization that the failure was due to reasonable cause and not to willful neglect.

The proposal would further provide that the Secretary in consultation with the Federal Election Commission shall publicize the effects of these changes and the interaction of the requirements to file a notification or report under section 527 and reports under the Federal Election Campaign Act of 1971.

Finally, the proposal would make the following technical corrections. The proposal would clarify that in computing taxable income for organizations that fail to notify the Secretary of their status as a political organization, all exempt function income, whether or not segregated for use for an exempt function, is taken into account. The proposal would also clarify that penalties imposed for failure to report under section 527(j) will be assessed and collected in the same manner as penalties imposed on exempt organizations for failure to file returns (sec. 6652(c)). The proposal would apply the penalty for fraudulent returns, statements, or other documents (sec. 7207) to the notification (527(i)) and reporting (527(j)) requirements of political organizations. In addition, the proposal would eliminate the requirement that political organizations provide notice of their existence both in writing and electronically. Thus, either form of notice would be permitted. The proposal would further direct the Secretary to develop procedures for electronic filing of such notices and of reports required under section 527(j).

### **Effective Date**

The technical corrections clarifying the treatment of unsegregated exempt function income and the treatment of penalties imposed under section 527(j) would be effective for

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<sup>5</sup> As under present law, the bill provides that organizations that are political organizations for a taxable year solely because of section 527(f)(1) (which provides for a tax on organizations exempt from tax under section 501(c) if such an organization makes an exempt function expenditure) are not required to file an information return.

failures to notify or report on or after the date of enactment. The requirement that the Secretary publicize the effects of the proposal would be effective on the date of enactment. All other provisions would be effective as of July 1, 2000.

## **B. Extend the Due Date for Electronically Filed Tax Returns**

### **Present Law**

In general, individuals must file their income tax returns and pay the full amount owed by April 15 (sec. 6072(a)). This deadline applies regardless of the method the taxpayer may choose to submit the tax return to the IRS. The Secretary may grant reasonable extensions of time for filing returns, but in general the time for paying tax may not be extended (sec. 6081(a)). Failure to file or pay on a timely basis may subject the taxpayer to interest and penalties.

### **Description of Proposal**

The proposal would extend the due date for filing and paying individual income taxes to April 30 provided that the taxpayer files the return electronically and pays the entire balance due electronically by that date. The due date for filing by any other method or for filing electronically but paying the balance due by non-electronic means would not be changed.

### **Effective Date**

The proposal would be effective for returns filed after December 31, 2002.

## **C. Restoration of Retirement Savings After Improper Levy**

### **Present Law**

Distributions from an individual retirement arrangement (“IRA”) made on account of an IRS levy are includible in the gross income of the individual under the rules applicable to the IRA subject to the levy. Thus, in the case of a traditional IRA, the amount withdrawn as a result of a levy is includible in gross income except to the extent such amount represents a return of nondeductible contributions (i.e., basis). In the case of a Roth IRA, earnings on a distribution are excludable from gross income if the distribution is made (1) after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA and (2) after attainment of age 59-1/2 or on account of certain other circumstances. Amounts withdrawn from an IRA due to a levy, are not subject to the 10-percent early withdrawal tax, regardless of whether the amount is includible in income.

Present law provides rules under which the IRS returns amounts subject to a wrongful levy. In such cases, the IRS generally is required to pay interest on the amount subject to the wrongful levy at the overpayment rate.

Present law does not provide special rules to allow taxpayers to recontribute to an IRA amounts withdrawn from an IRA pursuant to a wrongful levy. Thus, if a taxpayer wishes to contribute such returned amounts to an IRA, the contribution would be subject to the normally applicable rules for IRA contributions.

### **Description of Proposal**

Under the proposal, a taxpayer would be able to recontribute amounts returned by the IRS as a result of a wrongful levy (and interest thereon) within 60 days of receipt by the taxpayer, without regard to the normally applicable limits on IRA contributions. The contribution would have to be made to the same type of IRA from which the amounts were withdrawn. Interest paid by the IRS on the amount released from the levy<sup>6</sup> that is contributed to the IRA would be considered an after-tax contribution for purposes of the taxpayer's basis in the IRA. In addition, the any tax attributable to recontributed amounts would be abated.

### **Effective Date**

The proposal would be effective for amounts returned to the taxpayer after December 31, 2002.

## **D. Allow the Financial Management Service to Retain Transaction Fees from Levied Amounts**

### **Present Law**

To facilitate the collection of tax, the IRS can generally levy upon all property and rights to property of a taxpayer (sec. 6331). With respect to specified types of recurring payments,<sup>7</sup> the IRS may impose a continuous levy of up to 15 percent of each payment, which generally continues in effect until the liability is paid (sec. 6331(h)). Continuous levies imposed by the IRS on specified Federal payments are administered by the Financial Management Service (FMS) of the Department of the Treasury. FMS is generally responsible for making most non-defense related Federal payments. FMS is required to charge the IRS for the costs of developing and operating this continuous levy program. The IRS pays these FMS charges out of its appropriations.

### **Description of Proposal**

The proposal would allow FMS to retain a portion of the levied funds as payment of these FMS fees. The amount credited to the taxpayer's account would not, however, be reduced by this fee.

### **Effective Date**

The proposal would be effective on the date of enactment.

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<sup>6</sup> Such interest would be excluded from the taxpayer's gross income under another provision of the proposal.

<sup>7</sup> The payments to which this provision applies are (1) Federal payments (except payments for which eligibility is based on the income or assets of the taxpayer, (2) unemployment benefits, (3) workmen's compensation, (4) wages, (5) certain public assistance payments, and (6) annuities or pensions under Railroad Retirement or Railroad Unemployment.

## **E. Capital Gains Treatment to Apply to Outright Sales of Timber by Landowners**

### **Present Law**

Under present law, a taxpayer disposing of timber held for more than one year is eligible for capital gains treatment in three situations. First, if the taxpayer sells or exchanges timber which is a capital asset (sec. 1221) or property used in the trade or business (sec. 1231), the gain generally is long-term capital gain; however, if the timber is held for sale to customers in the taxpayer's business, the gain will be ordinary income. Second, if the taxpayer disposes of the timber with a retained economic interest, the gain is eligible for capital gain treatment (sec. 631(b)). Third, if the taxpayer cuts standing timber, the taxpayer may elect to treat the cutting as a sale or exchange eligible for capital gains treatment (sec. 631(a)).

### **Description of Proposal**

The proposal would provide that timber (within the meaning of section 631) sold by the taxpayer, if the taxpayer held the timber (and the land from which it is cut) for more than one year, will be treated as property used in the trade or business under section 1231(b)(2). Thus, the gain generally will be eligible for capital gains treatment. This treatment will apply whether or not the timber would otherwise be a capital asset or property held for sale to customers.

### **Effective Date**

The provision is effective for sales of timber after the date of enactment.