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TAX ADMINISTRATION GOOD GOVERNMENT ACT

MAY 4, 2004.—Ordered to be printed

Mr. GRASSLEY, from the Committee on Finance, submitted the following

R E P O R T

[To accompany S. 882]

The Committee on Finance, to which was referred the bill (S. 882) to amend the Internal Revenue Code of 1986 to provide improvements in tax administration and taxpayer safeguards, and for other purposes, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill, as amended, do pass.

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I. LEGISLATIVE BACKGROUND

Overview

The Senate Committee on Finance marked up S. 882, the "Tax Administration Good Government Act," on February 2, 2004, and ordered the bill, with an amendment in the nature of a substitute, favorably reported by voice vote.

Hearings

During the 108th Congress, the Committee held hearings on various topics relating to the provisions of the bill, as follows:

• October 21, 2003, Tax Shelters: Who's Buying, Who's Selling and What's the Government Doing About It?

• May 20, 2003, Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, 2003.

• April 1, 2003, Taxpayer Alert: Choosing a Paid Preparer and the Pitfalls of Charitable Car Donation.

• February 13, 2003, Enron: The Joint Committee on Taxation's Investigative Report.

During the 107th Congress, the Committee held hearings on various topics relating to the provisions of the bill, as follows:

• May 14, 2002, Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, 2002.

• April 11, 2002, Schemes, Scams and Cons, Part II: The IRS Strikes Back.

• March 21, 2002, Corporate Tax Shelters: Looking Under the Roof.

• May 8, 2001, Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, 2001.

• April 5, 2001, Oversight of the Internal Revenue Service "Taxpayer Beware: Schemes, Scams and Cons."

TITLE I.—IMPROVEMENTS IN TAX ADMINISTRATION AND TAXPAYER SAFEGUARDS

A. Improve Efficiency and Safeguards in IRS Collection

1. Waiver of user fee for installment agreements using automated withdrawals (sec. 101 of the bill and sec. 6159 of the Code)

PRESENT LAW

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay

taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed (sec. 6159). An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

The IRS charges a $43 user fee if a request for an installment agreement is approved.[1]

REASONS FOR CHANGE

The Committee believes that it improves collection results if taxpayers utilize automated installment payment mechanisms. Automated installment payment mechanisms provide efficiencies in processing and promote timely payment. The Committee believes that waiving this user fee for taxpayers who utilize automated installment payment mechanisms will encourage more taxpayers to utilize them.

EXPLANATION OF PROVISION

The provision waives the user fee for installment agreements in which automated installment payments (such as automated debits from a bank account) are agreed to.

EFFECTIVE DATE

The provision is effective for agreements entered into on or after 180 days after the date of enactment.

2. Authorize IRS to enter into installment agreements that provide for partial payment (sec. 102 of the bill and sec. 6159 of the Code)

PRESENT LAW

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed (sec. 6159). An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

Prior to 1998, the IRS administratively entered into installment agreements that provided for partial payment (rather than full payment) of the total amount owed over the period of the agreement. In that year, the IRS Chief Counsel issued a memorandum concluding that partial payment installment agreements were not permitted.

REASONS FOR CHANGE

According to the Department of the Treasury, at the end of fiscal year 2003, the IRS had not pursued 2.25 million cases totaling more than $16.5 billion in delinquent taxes. The Committee be-

[1] See Form 9465; Treas. Reg. see. 300.1.

lieves that clarifying that the IRS is authorized to enter into installment agreements with taxpayers that do not provide for full payment of the taxpayer's liability over the life of the agreement will improve effective tax administration.

The Committee recognizes that some taxpayers are unable or unwilling to enter into a realistic offer-in-compromise. The Committee believes that these taxpayers should be encouraged to make partial payments toward resolving their tax liability, and that providing for partial payment installment agreements will help facilitate this. The Committee also believes, however, that the offer-in-compromise program should remain the sole avenue via which taxpayers fully resolve their tax liabilities and attain a fresh start.

EXPLANATION OF PROVISION

The provision clarifies that the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. The provision also requires the IRS to review partial payment installment agreements at least every two years. The primary purpose of this review is to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

EFFECTIVE DATE

The provision is effective for installment agreements entered into on or after the date of enactment.

3. Termination of installment agreements (sec. 103 of the bill and sec. 6159 of the Code)

PRESENT LAW

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments, if the IRS determines that doing so will facilitate collection of the amounts owed (sec. 6159). An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

Under present law, the IRS is permitted to terminate an installment agreement only[2] if: (1) the taxpayer fails to pay an installment at the time the payment is due; (2) the taxpayer fails to pay any other tax liability at the time when such liability is due; (3) the taxpayer fails to provide a financial condition update as required by the IRS; (4) the taxpayer provides inadequate or incomplete information when applying for an installment agreement; (5) there has been a significant change in the financial condition of the taxpayer; or (6) the collection of the tax is in jeopardy.[3]

[2] Sec. 6159(b)(1).
[3] Sec. 6159(b)(2), (3), and (4).

REASONS FOR CHANGE

The Committee believes that taxpayers who are permitted to pay their previous tax obligations through an installment agreement should also be required to remain current with their Federal tax obligations. The Committee believes that giving the IRS the authority to terminate installment agreements in additional circumstances will improve the operation of the installment agreement process and enhance tax compliance.

EXPLANATION OF PROVISION

The provision grants the IRS authority to terminate an installment agreement when a taxpayer fails to timely make a required Federal tax deposit[4] or fails to timely file a tax return (including extensions). The termination could occur even if the taxpayer remained current with payments under the installment agreement.

EFFECTIVE DATE

The provision is effective for failures occurring on or after the date of enactment.

4. Office of Chief Counsel review of offers-in-compromise (sec. 104 of the bill and sec. 7122 of the Code)

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 of $50,000 or more can only be accepted if the reasons for the acceptance are documented in detail and supported by a written opinion from the IRS Chief Counsel (sec. 7122).

REASONS FOR CHANGE

Many offers-in-compromise cases do not present any significant legal issues, and the required legal review for cases meeting the statutory threshold can delay the acceptance process under current administrative procedures. The Committee believes that eliminating this threshold requiring review will permit the IRS to focus its review resources on the most important cases, regardless of dollar value.

EXPLANATION OF PROVISION

The provision repeals the requirement that an offer-in-compromise of $50,000 or more must be supported by a written opinion from the Office of Chief Counsel. Written opinions must only be provided if the Secretary determines that an opinion is required with respect to a compromise.

[4] Failure to timely make a required Federal tax deposit is not considered to be a failure to pay any other tax liability at the time such liability is due under section 6159(b)(4)(B) because liability for tax generally does not accrue until the end of the taxable period, and deposits are required to be made prior to that date (sec. 6302).

EFFECTIVE DATE

The provision applies to offers-in-compromise submitted or pending on or after the date of enactment.

5. Permit the IRS to require increased electronic filing of returns prepared by paid return preparers (sec. 105 of the bill and sec. 6011 of the Code)

PRESENT LAW

The Code authorizes the IRS to issue regulations specifying which returns must be filed electronically.[5] There are several limitations on this authority. First, it can only apply to persons required to file at least 250 returns during the year.[6] Second, the IRS is prohibited from requiring that income tax returns of individuals, estates, and trusts be submitted in any format other than paper (although these returns may by choice be filed electronically).

REASONS FOR CHANGE

The Congress set a goal for the IRS to have 80 percent of tax returns filed electronically by 2007. The Committee understands that an overwhelming number of tax returns are already prepared electronically. Thus, the Committee believes that expanding the scope of returns that are prepared by paid return preparers and that are required to be filed electronically is necessary for the IRS to meet the 80 percent goal set by the Congress and will improve tax administration.

EXPLANATION OF PROVISION

The provision permits the IRS to expand the scope of returns that are prepared by paid return preparers and that are required to be filed electronically by removing the present-law restrictions relating to the types of tax returns required to be filed electronically and by lowering the number of returns that trigger the requirement to file electronically to five. The Committee expects the IRS to expand the types of forms and schedules that may be filed electronically to permit full implementation of this provision.

EFFECTIVE DATE

The provision is effective on the date of enactment.

6. Place threshold on tolling of statute of limitations during review by Taxpayer Advocate Service (sec. 106 of the bill and sec. 7811 of the Code)

PRESENT LAW

Taxpayers suffering significant hardship may request that the Office of the Taxpayer Advocate issue a Taxpayer Assistance Order, which requires the IRS to take (or refrain from taking) specified actions (sec. 7811). The statute of limitations is suspended for the period beginning on the date of the taxpayer's application and ending on the date of the decision by the National Taxpayer Advocate.

[5] Sec. 6011(e).
[6] Partnerships with more than 100 partners are required to file electronically.

REASONS FOR CHANGE

The Committee believes that the administration of this suspension of the statute of limitations adds unnecessary complexity to the Taxpayer Assistance Order process when the National Taxpayer Advocate renders a decision within a short period of time. The Committee believes the Taxpayer Assistance Order process would be improved by disregarding relatively short periods of review by the Taxpayer Advocate.

EXPLANATION OF PROVISION

The provision modifies this suspension of statute of limitations by applying it only if the date of the decision by the National Taxpayer Advocate is at least 7 days after the date of the taxpayer's application.

EFFECTIVE DATE

The provision is effective for applications filed after the date of enactment.

7. Increase in penalty for bad checks and money orders (sec. 107 of the bill and sec. 6657 of the Code)

PRESENT LAW

The Code[7] imposes a penalty for bad checks and money orders on the person who tendered it. The penalty is two percent of the amount of the bad check or money order. The minimum penalty is $15 (or, if less, the amount of the check), applicable to checks that are less than $750.

REASONS FOR CHANGE

The Committee believes that it is appropriate to increase the minimum amount of this penalty so that it is more consistent with amounts charged by the private sector for bad checks.

EXPLANATION OF PROVISION

The provision increases the minimum penalty to $25 (or, if less, the amount of the check), applicable to checks that are less than $1,250.

EFFECTIVE DATE

The provision applies to checks or money orders received after the date of enactment.

8. Extend time limit for contesting IRS levy (sec. 108 of the bill and sec. 6343 of the Code)

PRESENT LAW

The IRS is authorized to return property that has been wrongfully or mistakenly levied upon (sec. 6343). In general, monetary proceeds may be returned within 9 months of the date of the levy.

[7] Sec. 6657.

REASONS FOR CHANGE

The Committee understands that in many cases this 9-month period may be insufficient for taxpayers or third parties to discover a wrongful or mistaken levy and seek to remedy it. Accordingly, the Committee believes it is appropriate to provide for a longer period of time within which a person may contest a wrongful IRS levy.

EXPLANATION OF PROVISION

The provision extends this 9-month period to 2 years.

EFFECTIVE DATE

The provision is effective with respect to: (1) Levies made after the date of enactment; and (2) levies made on or before the date of enactment provided that the 9-month period has not expired as of the date of enactment.

9. Individuals held harmless on improper levy on individual retirement plan (sec. 109 of the bill and sec. 6343 of the Code)

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 distributed 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 59½ 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 an incorrect levy. For example, amounts withdrawn from an IRA pursuant to a levy are returned to the individual owning the IRA in the case of a wrongful levy or if the levy was not in accordance with IRS administrative procedures. In the case of a wrongful levy, the IRS is required to pay interest on the amount returned to the individual at the overpayment rate. The IRS is not required to pay interest if the levy was not in accordance with IRS administrative procedures.

Present law does not provide special rules to allow an individual to recontribute to an IRA amounts withdrawn from an IRA pursuant to a levy and later returned to the individual by the IRS (or interest thereon). Thus, if an individual wishes to contribute such returned amounts to an IRA, the contribution is subject to the normally applicable rules for IRA contributions.

REASONS FOR CHANGE

IRA assets provide an important source of retirement income for many Americans. Under present law, if the IRS improperly levies on an IRA, the individual owning the IRA may not be made whole,

even if the IRS returns the amount levied, with interest, because the individual may lose the opportunity to have those funds accumulate on a tax-favored basis until retirement. The Committee believes that improper levies should not reduce retirement income security for IRA owners. Thus, the Committee bill provides that IRA funds that are withdrawn pursuant to an improper IRS levy and returned by the IRS may be recontributed to the IRA.

EXPLANATION OF PROVISION

Under the provision, an individual is able to recontribute to an IRA amounts withdrawn pursuant to a levy and returned by the IRS (and any interest thereon) within 60 days of receipt by the individual, without regard to the normally applicable limits on IRA contributions and rollovers. The provision applies to levied amounts returned to the individual because the levy (1) was wrongful or (2) is determined to be premature or otherwise not in accordance with administrative procedures. The contribution has to be made to the same type of IRA from which the amounts were withdrawn.

Under the provision, the IRS is required to pay interest on amounts returned to the individual at the overpayment rate in the case of a levy that is determined to be premature or otherwise not in accordance with administrative procedures (as well as in the case of a wrongful levy under present law). Interest paid by the IRS on the amount returned to the individual and contributed to the IRA is treated as part of the distribution made from the IRA on account of the levy and is not includible in gross income. In addition, any tax attributable to an amount distributed from an IRA by reason of a levy is abated if the amount is recontributed to an IRA pursuant to the provision.

EFFECTIVE DATE

The provision is effective for levied amounts (and interest thereon) returned to individuals after December 31, 2004.

10. Allow the Financial Management Service to retain transaction fees from levied amounts (sec. 110 of the bill)

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, 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.

REASONS FOR CHANGE

The Committee believes that altering the bookkeeping structure of these costs will provide for cost savings to the government.

EXPLANATION OF PROVISION

The provision allows 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 provision is effective on the date of enactment.

11. Elimination on restriction on offsetting refunds from former residents (sec. 111 of the bill and sec. 6402 of the Code)

PRESENT LAW

Overpayments of Federal tax may be used to pay past-due child support and debts owed to Federal agencies, without the consent of the taxpayer.[8] Overpayments of Federal tax may also be used to pay specified past-due, legally enforceable State income tax debts, provided that the person making the Federal tax overpayment has shown on the Federal tax return for the taxable year of the overpayment an address that is within the State seeking the tax offset.

REASONS FOR CHANGE

The Committee understands that the current refund procedure has proven an effective collection tool for State governments. The Committee believes that eliminating unnecessary restrictions on this program will improve the ability of States to collect past-due, legally enforceable State income tax debts.

EXPLANATION OF PROVISION

The provision eliminates the requirement that the person making the Federal tax overpayment show on the Federal tax return for the taxable year of the overpayment an address that is within the State seeking the tax offset. Accordingly, States may seek to offset refunds from residents of their own State as well as any other State to collect specified past-due, legally enforceable State income tax debts.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Processing and Personnel

1. Information regarding statute of limitations (sec. 121 of the bill)

PRESENT LAW

In general, a taxpayer must file a refund claim within three years of the filing of the return or within two years of the payment of the tax, whichever period expires later (if no return is filed, the two-year limit applies). A refund claim that is not filed within these time periods is rejected as untimely.

A special rule applies during periods of disability. Equitable tolling of the statute of limitations for refund claims of an individual taxpayer applies during any period in which an individual is un-

[8] Sec. 6402.

able to manage his or her financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months. Equitable tolling does not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters.

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

REASONS FOR CHANGE

Some taxpayers who are due refunds fail to file tax returns by the due date. Several years later they realize that they owe additional taxes to the IRS for that later year and attempt to offset the amount that they owe against the refund that they were due for the earlier year. They are unable to do so, however, if their claim for the refund is filed beyond the statutorily specified deadline. The Committee recognizes that, in general, statutes of limitations promote important policy goals of repose and certainty. The Committee also believes that it is important that taxpayers be adequately informed of the operation of these provisions so that they are not inadvertently disadvantaged by consequences that they did not foresee.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The revisions to Publication 1 are required to be made as soon as practicable, but not later than 180 days after the date of enactment. The revisions to the Form 1040 instructional packages are required to be made for instructions for taxable years beginning after December 31, 2004.

2. Annual report on IRS performance measures (sec. 122 of the bill and sec. 7803 of the Code)

PRESENT LAW

There is no specific statutory requirement that the IRS Commissioner provide annual reports on performance measures.

REASONS FOR CHANGE

In the 2002 Report of the IRS Oversight Board: Assessment of the IRS and the Tax System, the IRS set forth the current state

of the IRS, the tax administration system, as well as the opportunities and challenges that the agency faces. The Committee believes that such a report provided on an annual basis will meet several needs, including: (1) it will assist Congress in holding the IRS and the IRS Commissioner accountable, (2) it will give senior management an opportunity to state publicly, and in concrete terms, the agency's performance goals, and (3) it will serve as a useful reference guide for IRS stakeholders. The Committee believes that requiring the IRS to report on performance measures, levels, and goals, will improve the administration of the tax system.

EXPLANATION OF PROVISION

The provision statutorily requires that the IRS Commissioner provide annual reports, on a fiscal year basis, to the IRS Oversight Board and to the Congress on performance measures. The report must include specific target performance goals (including volume projections) for a five-year period against which to measure the IRS's performance. For each performance goal, the report must include comparisons between the target performance level and the actual performance level. The report must include a narrative explaining how the IRS plans to meet each performance goal. If the IRS fails to meet a performance goal, the IRS must explain why. In general, the performance goals must cover the following areas: public evaluation of the IRS, customer service, compliance, and management initiatives. The report must also include a narrative regarding the level of the IRS workload and the resources available to IRS. The report is due by December 31 of each year, covering the preceding fiscal year.

EFFECTIVE DATE

The provision is effective for fiscal year 2004 and thereafter.

3. Disclosure of tax information to facilitate combined employment tax reporting (sec. 123 of the bill and sec. 6103 of the Code)

PRESENT LAW

Traditionally, Federal tax forms are filed with the Federal government and State tax forms are filed with individual States. This necessitates duplication of items common to both returns.

The Taxpayer Relief Act of 1997[9] permitted implementation of a demonstration project to assess the feasibility and desirability of expanding combined Federal and State reporting. There were several limitations on the demonstration project. First, it was limited to the sharing of information between the State of Montana and the IRS. Second, it was limited to employment tax reporting. Third, it was limited to disclosure of the name, address, TIN, and signature of the taxpayer, which is information common to both the Montana and Federal portions of the combined form. Fourth, it was limited to a period of five years.

The authority for the demonstration project expired on the date five years after the date of enactment (August 5, 2002).

[9] Sec. 976; P.L. 105–34; August 5, 1997.

REASONS FOR CHANGE

The Committee believes that combined employment tax reporting eliminates filing duplication, allowing for a more technologically efficient transmission of data, and reducing taxpayer burden. The Committee also believes that combined employment tax reporting will increase electronic filing.

EXPLANATION OF PROVISION

The provision amends the Code to provide permanent authority for any State to participate in a combined Federal and State employment tax reporting program, provided that the program has been approved by the Secretary.

EFFECTIVE DATE

The provision is effective on the date of enactment.

4. Extension of declaratory judgment procedures to non-501(c)(3) tax-exempt organizations (sec. 124 of the bill and sec. 7428 of the Code)

PRESENT LAW

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it generally must file an application for recognition of exemption with the IRS and receive a favorable determination of its status. Similarly, for most organizations, a charitable organization's eligibility to receive tax-deductible contributions is dependent upon its receipt of a favorable determination from the IRS. In general, a section 501(c)(3) organization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases in which an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS is authorized to revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

In situations in which the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on such application, or in which the IRS informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status, present law authorizes the organization to seek a declaratory judgment regarding its tax status (sec. 7428). Section 7428 provides a remedy in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3). A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization, although it also can include a proposed revocation of an organization's tax-exempt status or public charity classification. Section

7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS. An organization is deemed to have exhausted its administrative remedies at the expiration of 270 days after the date on which the request for a determination was made if the organization has taken, in a timely manner, all reasonable steps to secure such determination.

If an organization (other than a section 501(c)(3) organization) files an application for recognition of exemption and receives a favorable determination from the IRS, the determination of tax-exempt status is usually effective as of the date of formation of the organization if its purposes and activities during the period prior to the date of the determination letter were consistent with the requirements for exemption. However, if the organization files an application for recognition of exemption and later receives an adverse determination from the IRS, the IRS may assert that the organization is subject to tax on some or all of its income for open taxable years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

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

REASONS FOR CHANGE

The Committee believes that it is important to provide certainty for organizations that have sought a determination of their tax-exempt status. Thus, the Committee finds it appropriate to extend the present-law declaratory judgment procedures to all organizations that apply for tax-exempt status as organizations described in section 501(c) and (d).

DESCRIPTION OF PROVISION

The provision extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) and 501(d) determinations. The provision limits jurisdiction over controversies involving such other determinations to the United States Tax Court.[10]

EFFECTIVE DATE

The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations is effective for pleadings filed with respect to determinations (or requests for determinations) made after December 31, 2004.

[10] This limitation currently applies to declaratory judgments relating to tax qualification for certain employee retirement plans (sec. 7476).

5. Amendment to Treasury auction reforms (sec. 125 of the bill and sec. 202 of the Government Securities Act Amendments of 1993)

PRESENT LAW

Members of the Treasury Borrowing Advisory Committee are prohibited from disclosing anything relating to the securities to be auctioned in a midquarter refunding by the Secretary until the Secretary makes a public announcement of the refunding.

REASONS FOR CHANGE

The Committee believes that permitting disclosure upon the release by the Secretary of the minutes of the meeting accomplishes the goals of the present-law restrictions without needlessly hindering the members of the advisory committee.

EXPLANATION OF PROVISION

The provision permits earlier disclosure upon the release by the Secretary of the minutes of the meeting.

EFFECTIVE DATE

The provision applies to meetings held after the date of enactment.

6. Revisions relating to termination of employment of IRS employees for misconduct (sec. 126 of the bill and new sec. 7804A of the Code)

PRESENT LAW

Section 1203 of the IRS Restructuring and Reform Act of 1998 requires the IRS to terminate an employee for certain proven violations committed by the employee in connection with the performance of official duties. The violations include: (1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets; (2) providing a false statement under oath material to a matter involving a taxpayer; (3) with respect to a taxpayer, taxpayer representative, or other IRS employee, the violation of any right under the U.S. Constitution, or any civil right established under titles VI or VII of the Civil Rights Act of 1964, title IX of the Educational Amendments of 1972, the Age Discrimination in Employment Act of 1967, the Age Discrimination Act of 1975, sections 501 or 504 of the Rehabilitation Act of 1973 and title I of the Americans with Disabilities Act of 1990; (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or a taxpayer representative; (5) assault or battery on a taxpayer or other IRS employee, but only if there is a criminal conviction or a final judgment by a court in a civil case, with respect to the assault or battery; (6) violations of the Internal Revenue Code, Treasury Regulations, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating or harassing a taxpayer or other IRS employee; (7) willful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry; (8) willful failure to file any tax return re-

quired under the Code on or before the due date (including extensions) unless failure is due to reasonable cause; (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause; and (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

Section 1203 also provides non-delegable authority to the Commissioner to determine that mitigating factors exist, that, in the Commissioner's sole discretion, mitigate against terminating the employee. The Commissioner, in his sole discretion, may establish a procedure to determine whether an individual should be referred for such a determination by the Commissioner.

REASONS FOR CHANGE

The Committee understands that two of the violations under present law have resulted in unintended consequences. First, the Committee does not believe that an IRS employee due a tax refund should be terminated from employment for filing that return late. No other taxpayer faces a comparable penalty for the late filing of a return due a refund. Investigating and resolving issues related to the late filing by IRS employees of refund returns expends resources that could be better spent on other tax administration efforts.

Second, the Committee understands that employees are misusing the "employee versus employee" violation as retaliation against fellow employees. There are other administrative remedies that are more appropriate for resolving employee versus employee claims, such as Title V adverse action cases, as well as actions of the Merit Systems Protection Board.

The Committee believes that removing from the list of violations these two provisions that do not directly involve an IRS employee's interactions with taxpayers will improve the focus of the provision.

EXPLANATION OF PROVISION

The provision removes from the list of violations: (1) the late filing of refund returns; and (2) employee versus employee assault or battery. The provision also places the entire section in the Internal Revenue Code.

EFFECTIVE DATE

The provision is effective on the date of enactment.

7. Expand IRS Oversight Board authority (sec. 127 of the bill and sec. 7802 of the Code)

PRESENT LAW

The Code has established the IRS Oversight Board and has given that Board general oversight responsibilities for the IRS, as well as specific oversight responsibilities with respect to the IRS' strategic plans, operational plans, management, budget, and taxpayer protections.[11] Among these responsibilities, the Board is required to review the Commissioner's selection, evaluation, and compensation of IRS senior executives and to review and approve the IRS budget request (having ensured that the budget request supports the an-

[11] Sec. 7802(c) and (d).

nual and long-range strategic plans of the IRS). The Board must report annually to the Congress with respect to the conduct of its responsibilities.

REASONS FOR CHANGE

The Committee understands that the IRS Oversight Board, as established, is in a difficult position to exert meaningful authority and oversight over the IRS. Although the Board is under the Department of Treasury, Congress intended for the Board to provide balanced independent oversight over the IRS. The Committee understands that the Board's current authority to review the IRS Commissioner's selection, evaluation, and compensation of senior executives has been unclear and that the Board has not been actively engaged and consulted as Congress intended. The Committee believes that the Board should have a strong and active role in the IRS Commissioner's selection, evaluation, and compensation of senior executives. The Board should be included in the process before the IRS Commissioner acts with respect to the selection, evaluation, and compensation of senior executives. Furthermore, the Committee understands that the Board's ability to provide a thorough and independent analysis of the IRS's budget request is hindered by its organizational structure within the Executive Branch. The Committee believes that expanding the authority of the IRS Oversight Board will improve oversight and accountability of the IRS.

EXPLANATION OF PROVISION

Approval with respect to senior executives

The provision requires that the IRS Oversight Board approve the IRS Commissioner's selection, evaluation, and compensation of senior executives.

Reports

Budget

The provision requires that the budget for the IRS that the Board submits to the Secretary of the Treasury be detailed and contain analysis. The budget is to be submitted without any prior review or comment from the Commissioner, the Secretary of the Treasury, or any officer or employee of either the Department of the Treasury or the Office of Management and Budget.

Annual Report

The provision requires that the Board submit its annual report by March 1st of each year.

Continuity in office

The provision provides that an Oversight Board member whose term has expired shall continue to serve until his or her successor takes office (limited to one year after the expiration of the Board member's term).

Access to health benefits

The provision makes Oversight Board members eligible for coverage by the Federal Employees' Health Benefits Program on the same basis as Federal employees.

EFFECTIVE DATE

The provision is effective on the date of enactment.

8. IRS Oversight Board approval of use of critical pay authority (sec. 128 of the bill and sec. 7802 of the Code)

PRESENT LAW

The Secretary of the Treasury has the authority, subject to specified conditions, to increase the pay levels for critical positions at the IRS above the levels otherwise provided.[12]

The Code has established the IRS Oversight Board and has given that board general oversight responsibilities for the IRS, as well as specific oversight responsibilities with respect to the IRS' strategic plans, operational plans, management, budget, and taxpayer protections.[13]

REASONS FOR CHANGE

The Committee understands that some believe that the IRS may have used its critical pay authority for positions that do not necessarily meet the specified conditions required under present law. Critical pay authority gives the IRS the flexibility to compensate certain employees at levels that are more competitive with the private sector. Thus, such authority is intended to aid the IRS in hiring individuals with specific expertise. The Committee believes that requiring the IRS Oversight Board to review and approve each use of critical pay authority will improve the administration and utilization of this authority.

EXPLANATION OF PROVISION

The provision requires that the IRS Oversight Board review and approve each use of this critical pay authority.

EFFECTIVE DATE

The provision is effective for personnel hired after the date of enactment.

9. Low-income taxpayer clinics (sec. 129 of the bill and new sec. 7526A of the Code)

PRESENT LAW

The Code[14] provides that the Secretary is authorized to provide up to $6 million per year in matching grants to certain low-income taxpayer clinics. Eligible clinics are those that charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or provide tax information to individuals for whom English is a second language ("controversy clinics"). No clinic can receive more than $100,000 per year.

A "clinic" includes (1) a clinical program at an accredited law, business, or accounting school, in which students represent low-income taxpayers, or (2) an organization exempt from tax under Code

[12] 5 U.S.C. secs. 9502 and 9503.
[13] Sec. 7802(c) and (d).
[14] Sec. 7526.

section 501(c) which either represents low-income taxpayers or provides referral to qualified representatives.

REASONS FOR CHANGE

The Committee believes that low-income taxpayer clinics contribute to compliance with the Code by providing representation to taxpayers who might otherwise be uncertain about their rights and obligations under the Code. Accordingly, the Committee believes that the amount authorized to be appropriated for matching grants to them should be increased. The Committee also believes that the scope of the work that clinics seeking grants may do should be broadened to encompass return preparation.

EXPLANATION OF PROVISION

The provision authorizes $10 million in matching grants for low-income taxpayer return preparation clinics ("preparation clinics"). These clinics may provide routine tax return preparation and filing services to low-income taxpayers. The authorization of $6 million for low-income controversy clinics under present law is also increased to $10 million.

The provision expands the scope of clinics eligible to receive preparation clinic grants to encompass clinics at all educational institutions. The provision prohibits the use of grants for overhead expenses at both controversy clinics and preparation clinics. The provision also authorizes the IRS to use mass communications, referrals, and other means to promote the benefits and encourage the use of low-income controversy and preparation clinics.

EFFECTIVE DATE

The provision is effective for grants made after the date of enactment.

10. Taxpayer access to financial institutions (sec. 130 of the bill)

PRESENT LAW

A large number of individual taxpayers do not have bank accounts. Because of this, these taxpayers are unable to participate fully in electronic filing, because IRS cannot electronically transmit to them their tax refunds.

REASONS FOR CHANGE

The Committee believes that assisting unbanked taxpayers in establishing accounts in depository institutions in connection with preparing and filing their tax returns will increase the number of taxpayers able to participate fully in electronic filing.

EXPLANATION OF PROVISION

The provision authorizes the Secretary of the Treasury to award demonstration project grants (totaling up to $10 million) to eligible entities to provide tax preparation assistance in connection with establishing an account in a federally insured depositary institution for individuals that do not have such an account. Entities eligible to receive grants are: tax-exempt organizations described in section 501(c)(3), federally insured depositary institutions, State or local

governmental agencies, community development financial institutions, Indian tribal organizations, Alaska native corporations, native Hawaiian organizations, and labor organizations.

EFFECTIVE DATE

The provision is effective on the date of enactment.

11. Enrolled agents (sec. 131 of the bill and new sec. 7529 of the Code)

PRESENT LAW

Treasury Department Circular No. 230 provides rules relating to practice before the IRS by attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others.

REASONS FOR CHANGE

The Committee believes that individuals who meet the regulatory requirements established by the Secretary should be able to use the specified credentials or designation in any State or Federal jurisdiction.

EXPLANATION OF PROVISION

The bill adds a new section to the Code permitting the Secretary to prescribe regulations to regulate the conduct of enrolled agents in regard to their practice before the IRS and to permit enrolled agents meeting the Secretary's qualifications to use the credentials or designation "enrolled agent", "EA", or "E.A.".

EFFECTIVE DATE

The provision is effective on the date of enactment.

12. Establishment of disaster response team (sec. 132 of the bill and sec. 7803 of the Code)

PRESENT LAW

The Secretary of the Treasury may specify that certain deadlines are postponed for a period of up to one year in the case of a taxpayer determined to be affected by a Presidentially declared disaster or by a terroristic or military action.[15] The deadlines that may be postponed are the same as are postponed by reason of service in a combat zone.

REASONS FOR CHANGE

The Committee understands that the IRS is involved in responding to disasters. However, the Committee believes that the lack of an established Disaster Response Team within the IRS results in delaying the IRS' response to disasters and contributes to taxpayer burden when a taxpayer is affected by a Presidentially declared disaster. The Committee believes that it is important to improve the response of the IRS to Presidentially declared disasters.

[15] Section 7508A.

EXPLANATION OF PROVISION

The provision directs the Secretary to create in the IRS a permanent Disaster Response Team, which, in coordination with the Federal Emergency Management Agency, is to assist taxpayers in clarifying and resolving tax matters associated with a Presidentially declared disaster. The provision requires that the Disaster Response Team be staffed by personnel from the office of the Taxpayer Advocate as well as personnel from the national office of the IRS with relevant knowledge and experience. The provision also requires the IRS to provide a toll-free number dedicated to responding to taxpayers affected by a Presidentially declared disaster and to provide relevant information via the IRS website.

EFFECTIVE DATE

The provision is effective on the date of enactment.

13. Study of accelerated tax refunds (sec. 133 of the bill)

PRESENT LAW

Some States have established procedures to provide for accelerated tax refunds to taxpayers who maintain the same filing characteristics as in the previous year. The IRS does not have such a procedure.

REASONS FOR CHANGE

The Committee understands that States have realized efficiency gains and cost savings with electronic filing, automated deposits of tax refunds, and automated payments of tax liabilities. The Committee believes that requiring the Secretary of the Treasury to conduct a study of the implementation of an accelerated tax refund program for taxpayers who maintain the same filing characteristics as in the previous year and who elect to receive their refunds via direct deposit will provide the Committee with valuable information as to whether it is appropriate to implement such a system.

EXPLANATION OF PROVISION

The provision requires the Secretary of the Treasury to conduct a study of the implementation of an accelerated tax refund program for taxpayers who maintain the same filing characteristics as in the previous year and who elect to receive their refunds via direct deposit.

EFFECTIVE DATE

The Secretary is required to submit the report to the Congress not later than one year after the date of enactment.

14. Study of clarifying recordkeeping responsibilities (sec. 134 of the bill)

PRESENT LAW

Every person liable for Federal tax must keep records, provide statements, make returns, and comply with rules and regulations,

as prescribed by the Secretary.[16] In general, taxpayers are required to keep records for as long as the statute of limitations may be open.

REASONS FOR CHANGE

The Committee understands that the present-law recordkeeping requirements do not reflect advances in technology. Specifically, the storage requirements may require taxpayers to maintain outdated and cumbersome technologies. The Committee understands that there is a balance, however, between minimizing taxpayer burden and ensuring that taxpayers maintain appropriate recordkeeping for purposes of IRS enforcement. The Committee believes that requiring the Secretary of the Treasury to conduct a study of the recordkeeping requirements will provide the Committee with valuable information as to whether it is appropriate to modify these requirements.

EXPLANATION OF PROVISION

The provision requires the Secretary of the Treasury to study:

- The scope of the records required to be maintained by taxpayers;
- The utility of requiring taxpayers to maintain all records indefinitely;
- The effects of the necessity to upgrade technological storage for outdated records;
- The number of negotiated records retention agreements requested by taxpayers and the number entered into by the IRS; and
- Proposals regarding taxpayer recordkeeping.

EFFECTIVE DATE

The Secretary is required to submit the report to the Congress not later than one year after the date of enactment.

15. Streamline reporting process for National Taxpayer Advocate (sec. 135 of the bill and sec. 7803 of the Code)

PRESENT LAW

The Code requires the National Taxpayer Advocate to produce two reports for the Congress each year. The first, due by June 30, reports on the objectives for the office; the second, due by December 31, reports on the activities of the office and contains detailed data and recommendations in specified areas.

REASONS FOR CHANGE

The Committee believes that combining these reports will reduce burdens on the National Taxpayer Advocate. The Committee also believes that authorizing the National Taxpayer Advocate to report to the Congress at any time on any significant issues affecting taxpayer rights will improve the awareness of the Congress of these issues.

[16] Section 6001.

EXPLANATION OF PROVISION

The provision combines these two reports into one, due by December 31. The provision also provides that the National Taxpayer Advocate, in his or her sole discretion, may report to the Congress at any time on any significant issues affecting taxpayer rights.

EFFECTIVE DATE

The provision combining the reports is effective for reports in 2005 and thereafter. The provision authorizing reports on significant issues affecting taxpayer rights is effective on the date of enactment.

16. IRS Free File program (sec. 136 of the bill)

PRESENT LAW

The IRS has entered into cooperative relationships with commercial return preparation services to provide free electronic filing services to eligible low-income or elderly taxpayers. This program is called "Free File." IRS permits these commercial return preparation services to cross-market their other services and products to all participating taxpayers, except to those taxpayers who explicitly opt out of this cross-marketing.

REASONS FOR CHANGE

The Committee believes that functioning of the Free File program will be improved if cross-marketing is permitted only to taxpayers who explicitly give permission to receive it.

EXPLANATION OF PROVISION

The provision requires that, as a condition for participating in the Free File program, commercial return preparation services that choose to cross-market their other services and products to Free File taxpayers may only do so to taxpayers who explicitly choose this (opt in). The provision requires the IRS to ensure that this opt-in feature is clear, prominently displayed, and in large typeface.

EFFECTIVE DATE

The provision is effective with respect to returns filed after December 31, 2004.

17. Modification of TIGTA reporting requirements (sec. 137 of the bill and sec. 7803 of the Code)

PRESENT LAW

The Treasury Inspector General for Tax Administration (TIGTA) conducts audits and reviews of IRS operations. TIGTA also is statutorily required to report to the Congress (both annually and semi-annually) on a number of specific issues.

REASONS FOR CHANGE

The Committee understands that these reporting requirements utilize significant resources and that the IRS does not necessarily maintain the data required for these reports. The Committee also understands that the current frequency of reporting gives the IRS

a limited and, perhaps, insufficient amount of time to implement corrective actions before another review. The Committee believes that streamlining these TIGTA reporting requirements will yield a more meaningful picture of the IRS and its progress in meeting Congressional expectations.

EXPLANATION OF PROVISION

The provision repeals the statutory requirement that TIGTA issue the following reports:

- IRS compliance with the restrictions[17] on directly contacting taxpayers who have indicated that they prefer that their representatives be contacted.
- IRS compliance with the requirements relating to disclosure of collection information with respect to joint returns.
- IRS compliance with the fair debt collection provisions of the Code.
- The number of taxpayer complaints received during the reporting period.

In addition, the provision requires that all reports currently required to be made annually must be provided semi-annually.

EFFECTIVE DATE

The provision is effective on the date of enactment.

18. Study of IRS accounts receivable (sec. 138 of the bill)

PRESENT LAW

There is no statutory requirement of a study of IRS accounts receivables.

REASONS FOR CHANGE

The General Accounting Office has reported that it has received from the IRS the following information.[18] The gross accounts receivable for tax year 2003 is estimated at $246 billion. After a reduction for compliance assessments of $31 billion, write-offs of $126 billion, and allowance for doubtful accounts of $69 billion, the total net accounts receivable is $20 billion. The Committee believes that requiring the Secretary of the Treasury to conduct a study of IRS accounts receivable will provide the Committee with valuable information to assess the current problem and develop appropriate solutions to reduce the accounts receivable inventory.

EXPLANATION OF PROVISION

The provision requires the Department of the Treasury to conduct a study on the provisions of the Code, and the application of those provisions, regarding IRS collection procedures to determine whether impediments exist to the efficient and timely collection of tax debts. The study is also to include an examination of the accounts receivable inventory of the IRS.

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[17] Sec. 7521.

[18] GAO–04–126 IRS's Fiscal Years 2003 and 2002 Financial Statements, p.78.

EFFECTIVE DATE

The study must be completed within one year after the date of enactment.

19. Electronic commerce advisory group (sec. 139 of the bill and sec. 2001 of the Internal Revenue Service Restructuring and Reform Act of 1998)

PRESENT LAW

The IRS is statutorily required to convene an electronic commerce advisory group, including representatives from the small business community, from the tax practitioner, preparer, and computer tax processor communities and other representatives from the electronic filing industry.[19]

REASONS FOR CHANGE

The Committee believes that expanding the electronic commerce advisory group to include consumer advocate representation will ensure taxpayer representation and improve its functioning.

EXPLANATION OF PROVISION

The provision requires that the electronic commerce advisory group include at least two representatives from the consumer advocate community.

EFFECTIVE DATE

The initial appointment made in accordance with this provision must be made not later than 180 days after the date of enactment.

20. Study of modifications to Schedules L and M–1 (sec. 140 of the bill)

PRESENT LAW

The Code requires persons to file tax returns in accordance with the forms and regulations prescribed by the Secretary.[20] In general, corporations must file Form 1120. As part of that form, a corporation with more than $250,000 of gross receipts and total assets must complete Schedule M–1, which reconciles book income (or loss) with income (or loss) reported on the tax return.

REASONS FOR CHANGE

The Committee understands that high-profile cases involving profitable corporations (1) reporting little or no taxable income, (2) engaging in transactions that increased their financial income without affecting their current tax liabilities, or (3) engaging in transactions that decreased their taxable income without affecting their book income, have drawn attention to the sources and magnitudes of differences between tax and book income. IRS data shows that the dollar amount of the book-tax difference grew from $92.5 billion in 1996 to more than $159.0 billion in 1998, an increase of nearly 72 percent.

[19] Pub. L. 105–206 (112 Stat. 723, July 22, 1998), sec. 2001(b)(2).
[20] Sec. 6011(a).

The Committee believes that a lack of historical data makes it difficult to determine whether this is only a recent phenomenon or the continuation of a long-term trend. Current reporting of book tax differences via the Schedule M–1 makes broad analysis of the sources of these differences extremely difficult. In light of this, the Committee believes it is appropriate to consider revisions to the relevant tax forms.

EXPLANATION OF PROVISION

The provision requires the Secretary of the Treasury to report to the Senate Committee on Finance and the House Committee on Ways and Means on proposals to expand Schedules L and M–1 to include additional information, such as the following:

- The names and identification numbers of the parent companies for both book and tax purposes.
- A reconciliation of the consolidated book assets reported in public financial disclosure statements to the reported assets in the consolidated tax return.
- Worldwide net income as reported in public financial disclosure statements.
- The components of tax expense recorded in financial statement tax footnotes.
- A reconciliation of the book and tax income of entities included in the consolidated financial statement with book income as reported on the consolidated tax return.
- The adjustment for book income from domestic and foreign entities excluded from financial reporting but included for tax purposes.
- The book income of U.S. entities included in the consolidated return.
- Taxable income due to actual or deemed dividends from foreign subsidiaries.
- A reconciliation to reflect pretax book income of the U.S. consolidated tax return group plus taxable deemed or actual foreign repatriations.
- The differences in the reporting of income and expense between book and tax reporting, including specific reporting on pension expense, stock options, and the amortization of goodwill.
- Consistency in reporting of any additional items not specifically listed above.

In addition, the proposal requires the Securities and Exchange Commission and the Commissioner of Internal Revenue to report to the Senate Committee on Finance and the House Committee on Ways and Means on proposals to expand the public availability and clarity of information relating to book and tax differences and Federal tax liability with respect to corporations.

EFFECTIVE DATE

The report on modifying Schedules L and M–1 must be provided within 6 months after the date of enactment. The reports on information to be made public must be provided within one year after the date of enactment.

21. Regulation of Federal income tax return preparers and refund anticipation loan providers (sec. 141 of the bill and new sec. 7530 of the Code)

PRESENT LAW

Federal income tax return preparers

The Secretary of the Treasury is authorized to regulate the practice of representatives of persons before the Department of the Treasury.[21] The Secretary is also authorized to suspend or disbar from practice before the Department a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Department, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this provision are contained in Circular 230. In general, the preparation and filing of tax returns (absent further involvement) has not been considered within the scope of these Circular 230 provisions.

Refund anticipation loan providers

Taxpayers may choose to obtain a loan in the amount of their anticipated tax refund (a "refund anticipation loan"). In general, these loans are provided in connection with the filing of the taxpayer's return. In general, these loans are for relatively short periods of time (as little as several weeks, if the taxpayer files electronically).

REASONS FOR CHANGE

In her annual report to the Congress, the National Taxpayer Advocate noted that over 55 percent of the 130 million U.S. individual taxpayers paid a return preparer to prepare their 2001 Federal income tax returns and of the 1.2 million known tax return preparers, one-quarter to one-half are not regulated by any licensing entity or subject to minimum competency requirements. The Committee also understands that 57 percent of the earned income credit overclaims were attributable to returns prepared by paid preparers. The Committee believes that Federal income tax return preparers play an important role in the tax system. While those preparers authorized to practice before the IRS are already subject to oversight, many preparers are not. Those preparers should accordingly have greater oversight.

The Committee believes that requiring regulation of both Federal income tax return preparers and refund anticipation loan providers and increasing the information that must be disclosed in connection with a refund anticipation loan will improve the fairness and administration of the tax system.

EXPLANATION OF PROVISION

Federal income tax return preparers

The provision requires the annual registration of Federal income tax return preparers with the IRS. Any person who is paid to prepare five or more returns in a year is required to register, except that this provision does not apply to a qualified representative

[21] 31 U.S.C. 330.

(whether or not an attorney) who is authorized to practice before the IRS or an applicable court. Preparers are required to pass an annual examination and meet standards of conduct in order to register. The IRS may charge reasonable fees to defray the costs of administering this program. The provision imposes penalties for noncompliance with this provision. The provision requires the Secretary to conduct a public awareness campaign with respect to this requirement and to maintain a public list of registered preparers. The provision permits the Secretary to use any funds specifically appropriated for earned income credit compliance to improve compliance with this provision.

Refund anticipation loan providers

The provision requires the Secretary of the Treasury to establish a program to require the registration with the IRS of all providers of refund anticipation loans to individual taxpayers. The Secretary must also specify the type of information that must be disclosed to taxpayers by refund anticipation loan providers (such as the fees charged in connection with the loan) and the manner and timing of the disclosure. The provision permits the imposition of sanctions for violations of these provisions.

EFFECTIVE DATE

The provision is effective on the date of enactment.

C. Other Provisions

1. Penalty for failure to report interests in foreign financial accounts (sec. 151 of the bill and sec. 5321 of Title 31, United States Code)

PRESENT LAW

The Secretary of the Treasury requires citizens, residents, or persons doing business in the United States to keep records and file reports when that person makes a transaction or maintains an account with a foreign financial entity.[22] In general, individuals must fulfill this requirement by answering questions regarding foreign accounts or foreign trusts that are contained in Part III of Schedule B of the IRS Form 1040. Taxpayers who answer "yes" in response to the question regarding foreign accounts must then file Treasury Department Form TD F 90–22.1. This form must be filed with the Department of the Treasury, and not as part of the tax return that is filed with the IRS.

The Secretary of the Treasury may impose a civil penalty on any person who willfully violates this reporting requirement. The civil penalty is the amount of the transaction or the value of the account, up to a maximum of $100,000; the minimum amount of the penalty is $25,000.[23] In addition, any person who willfully violates this reporting requirement is subject to a criminal penalty. The criminal penalty is a fine of not more than $250,000 or imprisonment for not more than five years (or both); if the violation is part of a pattern of illegal activity, the maximum amount of the fine is

[22] The Secretary must impose these requirements pursuant to 31 U.S.C. 5314.
[23] 31 U.S.C. 5321(a)(5).

increased to $500,000 and the maximum length of imprisonment is increased to 10 years.[24]

On April 26, 2002, the Secretary of the Treasury submitted to the Congress a report on these reporting requirements.[25] This report, which was statutorily required,[26] studies methods for improving compliance with these reporting requirements. It makes several administrative recommendations, but no legislative recommendations. A further report was required to be submitted by the Secretary of the Treasury to the Congress by October 26, 2002.

REASONS FOR CHANGE

The Committee understands that the number of individuals involved in using offshore bank accounts to engage in abusive tax scams has grown significantly in recent years. For one scheme alone, the IRS estimates that there may be hundreds of thousands of taxpayers with offshore bank accounts attempting to conceal income from the IRS. The Committee is concerned about this activity and believes that improving compliance with this reporting requirement is vitally important to sound tax administration, to combating terrorism, and to preventing the use of abusive tax schemes and scams. Adding a new civil penalty that applies without regard to willfulness will improve compliance with this reporting requirement.

EXPLANATION OF PROVISION

The provision adds an additional civil penalty that may be imposed on any person who violates this reporting requirement (without regard to willfulness). This new civil penalty is up to $5,000. The penalty may be waived if any income from the account was properly reported on the income tax return and there was reasonable cause for the failure to report.

EFFECTIVE DATE

The provision generally is effective for violations occurring after the date of enactment.

2. Repeal of application of below-market loan rules to amounts paid to certain continuing care facilities (sec. 152 of the bill and sec. 7872 of the Code)

PRESENT LAW

Certain loans that bear interest at a below-market interest rate are treated as loans bearing interest at the market rate accompanied by a payment or payments from the lender to the borrower which are characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.) (sec. 7872). The market rate of interest for purposes of the below-market loan rules is assumed to be 100 percent of the applicable Federal rate ("AFR") at the time the loan is made in the case of a term loan

[24] 31 U.S.C. 5322.

[25] A Report to Congress in Accordance with Sec. 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, April 26, 2002.

[26] Sec. 361(b) of the USA PATRIOT Act of 2001 (Pub. L. 107–56).

or, in the case of a demand loan, 100 percent of the AFR in effect over the time that the loan is outstanding.

In general, the below-market loan rules apply to (1) loans where the foregone (i.e., below-market) interest is in the nature of a gift, (2) loans between an employee and an employer or between an independent contractor and one for whom the independent contractor provides services, (3) loans between a corporation and a shareholder of the corporation, (4) loans of which one of the principal purposes of the interest arrangement is the avoidance of Federal tax, (5) to the extent provided in Treasury regulations, any other below-market loans if the interest arrangement of such loan has a significant effect on any Federal tax liability of either the lender or borrower, and (6) loans to any qualified continuing care facility pursuant to a continuing care contract.

In the case of loans made to qualified continuing care facilities,[27] an exception from the below-market loan rules is provided for any loan as of the calendar year in which the lender has attained age 65, provided the loan is made by the lender to the qualified continuing care facility pursuant to a continuing care contract.[28] However, the exception applies only to the extent that the principal amount of the loan, when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility, does not exceed $90,000. This amount is indexed for inflation, and the amount for calendar year 2004 is $154,500.[29]

With regard to continuing care facilities that are not qualified continuing care facilities, the IRS takes the position that loans made to such facilities by residents are not subject to the below-market loan rules until and unless Treasury regulations are issued that treat such loans as having a significant effect on any Federal tax liability of either the facility or the resident.[30]

REASONS FOR CHANGE

In 1985, Congress enacted a limited exception from the below-market loan rules for qualified continuing care facilities with the expectation that Treasury would issue regulations applying such rules to non-qualified continuing care facilities based upon the general application of the rules to loans the interest arrangements of which have a significant effect on the Federal tax liability of either the lender or the borrower. The Committee understands that the absence of such regulations during the ensuing 20 years has created an anomalous situation in which contracts with qualified continuing care facilities are not subject to the below-market loan

[27] A "qualified continuing care facility" is defined as one or more facilities (1) which are designed to provide services under continuing care contracts, and (2) substantially all of the residents of which are covered by continuing care contracts. However, a facility is not a qualified continuing care facility unless substantially all facilities which are used to provide services that are required to be provided under a continuing care contract are owned or operated by the borrower. In addition, nursing homes do not constitute continuing care facilities (sec. 7872(g)(4)).

[28] A "continuing care contract" is defined as a written contract between an individual and a qualified continuing care facility under which (1) the individual or indvidual's spouse may use a qualified continuing care facility for their life or lives, (2) the individual or individual's spouse (a) will first reside in a separate, independent living unit with additional facilities outside such unit for the providing of means and other personal care, and (b) then will be provided long-term and skilled nursing care as the health of such individual or individual's spouse requires, and (3) no additional substantial payment is required if such individual or individual's spouse requires increased personal care services or long-term and skilled nursing care.

[29] Rev. Rul. 2003–118, 2003–47 I.R.B. 1095.

[30] Tech. Adv. Mem. 9521001 (Dec. 7, 1994).

rules only if they do not exceed the dollar threshold, while contracts with non-qualified continuing care facilities are not subject to such rules without limitation. The Committee believes that this has resulted in the unintended consequence that the present-law rules actually disadvantage qualified continuing care facilities and encourage continuing care facilities to intentionally fail to satisfy the present-law definition of a qualified continuing care facility in order to avoid the dollar threshold and the application of the below-market loan rules altogether.

The Committee recognizes that the modifications made by this provision merely equalize the treatment of qualified continuing care facilities and non-qualified continuing care facilities, whereas it is intended that contracts with non-qualified continuing care facilities be subject to the below-market loan rules if the treatment of such contracts as below-market loans has a significant effect on the Federal tax liability of either the resident or the facility. Thus, the Committee encourages Treasury issue regulations that provide for the application of the below-market loan rules to non-qualified continuing care facilities.

The Committee also believes that certain changes should be made to the definitions of a qualified continuing care facility and a continuing care contract in order to better reflect the current business practices of such facilities.

EXPLANATION OF PROVISION

The provision repeals the application of the below-market loan rules to loans that are made to any qualified continuing care facility pursuant to a continuing care contract, without regard to the principal amount of the loan (including the aggregate outstanding amount of any other previous loans between the resident or resident's spouse and any qualified continuing care facility). The provision also clarifies that the determination of whether a facility is a qualified continuing care facility is to be made on an annual basis at the end of each calendar year, rather than only when the continuing care contract is entered into. In addition, the provision modifies the definition of a continuing care contract to (1) not exclude contracts that require additional substantial payment for increased personal care services required by the resident or resident's spouse, and (2) provide authority for the Treasury to issue guidance that limits such definition to contracts that provide to the resident or resident's spouse only facilities, care and services that are customarily offered by continuing care facilities. The provision also clarifies that the definition of a qualified continuing care facility requires substantially all of the independent living unit residents of the facility to be covered by continuing care contracts.

The provision does not affect the present-law application of the below-market loan rules to loans made to any continuing care facility that is not a qualified continuing care facility.

EFFECTIVE DATE

The provision applies to calendar years beginning after December 31, 2004.

TITLE II.—REFORM OF PENALTY AND INTEREST

A. INDIVIDUAL ESTIMATED TAX

(Sec. 201 of the bill and sec. 6654 of the Code)

1. Increase estimated tax threshold

PRESENT LAW

The Federal income tax system is designed to ensure that taxpayers pay taxes throughout the year based on their income earned and deductions. To the extent that tax is not collected through withholding, taxpayers are required to make quarterly estimated payments of tax. If an individual fails to make the required estimated tax payments under the rules, a penalty is imposed under section 6654. The amount of the penalty is determined by applying the underpayment interest rate to the amount of the underpayment for the period of the underpayment. The amount of the underpayment is the excess of the required payment over the amount (if any) of the installment paid on or before the due date of the installment. The period of the underpayment runs from the due date of the installment to the earlier of (1) the 15th day of the fourth month following the close of the taxable year or (2) the date on which each portion of the underpayment is made. The penalty for failure to pay estimated tax is the equivalent of interest, which is based on the time value of money.

Taxpayers are not liable for a penalty for the failure to pay estimated tax when the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by withholding, is less than $1,000. This safe harbor does not apply, however, when a taxpayer has paid tax throughout the year solely through estimated tax payments. For such taxpayers, any tax shown on the return for the taxable year, net of estimated tax paid, could subject the taxpayer to the penalty for failure to pay estimated tax (unless another safe harbor applies).

REASONS FOR CHANGE

Some taxpayers are required to complete Form 2210 (Underpayment of Estimated Tax by Individuals, Estates, and Trusts) and attach it to their tax return to show that they qualify for an exception that can lower or eliminate the penalty for underpayment of estimated tax. The computations required to determine the amount of the individual estimated tax penalty are complex and difficult to administer. The Committee believes that by increasing the estimated tax payment threshold, fewer taxpayers will be required to make estimated tax payments.

EXPLANATION OF PROVISION

The threshold is increased to $2,000.

EFFECTIVE DATE

The provision is effective for estimated tax payments made for taxable years beginning after December 31, 2004.

2. Apply one interest rate per estimated tax underpayment period for individuals, estates, and trusts

PRESENT LAW

The present-law penalty for failure to pay estimated tax is equal to the underpayment interest rate multiplied by the number of days the underpayment is outstanding, which is the number of days between when the taxpayer should have made the estimated payment and the earlier of (1) the 15th day of the fourth month following the close of the taxable year or (2) the date on which each portion of the underpayment is made. The interest rate, which equals the Federal short-term rate plus three percentage points, is subject to change on the first day of each quarter, which is January 1, April 1, July 1, and October 1.

If interest rates change while an underpayment of estimated tax is outstanding, then taxpayers are required to make separate calculations for the periods before and after the interest rate change. Such calculations generally are needed to cover 15-day periods. For example, the July 1 interest rate occurs 15 days after the June 15 payment date (for calendar-year taxpayers). A change in interest rates, which occurs on the first day of each calendar quarter, would require the use of different interest rates during one estimated tax underpayment period and would increase the number of calculations that a taxpayer must make in calculating a penalty for failure to pay estimated tax.

REASONS FOR CHANGE

The adjustment of the interest rate for underpayments greatly complicates the computation of interest. When interest rates change during an underpayment period, taxpayers must perform multiple calculations to account for the change in interest rate. Thus, the Committee finds that, if only one interest rate applied per underpayment period, complexity would be reduced because there generally would be only one interest calculation required per underpayment period.

EXPLANATION OF PROVISION

The interest rates are aligned so that, for any given estimated tax underpayment period, only one interest rate will apply. The underpayment interest rate in effect on the first day of the quarter in which the pertinent estimated payment due date arises is the interest rate that will apply during an entire underpayment period.

EFFECTIVE DATE

The provision is effective for estimated tax payments made for taxable years beginning after December 31, 2004.

3. Provide that underpayment balances are cumulative

PRESENT LAW

Section 6654(b)(1) defines "underpayment" as the amount of an installment due over the amount of any installment paid (including withholding) on or before the due date of the installment. In determining an underpayment penalty for a calendar year taxpayer, the

period of underpayment runs for each underpayment from the payment's due date through the earlier of the date on which any portion of the payment is made or the 15th day of the fourth month following the close of the taxable year. Underpayment balances are not cumulative and must be tracked separately for each estimated tax underpayment period.

REASONS FOR CHANGE

Tracking underpayments separately results in additional complexity in calculating interest on underpayments of estimated tax. The Committee thus finds that the calculation of interest on underpayments of estimated tax would be simplified by providing that underpayment balances would roll into the next estimated tax period so that interest would be calculated once per cumulative underpayment, per period.

EXPLANATION OF PROVISION

The definition of "underpayment" is changed to allow existing underpayment balances to be used in underpayment calculations for succeeding estimated payment periods. Taxpayers will now calculate a cumulative underpayment at the end of each underpayment period.

EFFECTIVE DATE

The provision is effective for estimated tax payments made for taxable years beginning after December 31, 2004.

4. Require 365-day year for all estimated tax interest calculations for individuals, estates, and trusts

PRESENT LAW

Under current IRS procedures, taxpayers with outstanding underpayment balances that extend from a leap year through a non-leap year are required to make separate calculations solely to account for the different number of days in the two different years. For example, if a taxpayer has an underpayment outstanding from September 15, 2004, through January 15, 2005, then the taxpayer must account for the period from September 15, 2004, through December 31, 2004, by using a 366-day formula.[31] The taxpayer then must account for the period from January 1, 2005, through January 15, 2005, under a 365-day formula. This calculation is required regardless of whether the interest rate changes on January 1, 2005.

REASONS FOR CHANGE

The Committee finds that complexity in calculating interest on underpayments of estimated tax would be reduced by eliminating the extra calculation that is required for underpayment balances that extend from a leap year to a non-leap year or from a non-leap year to a leap year.

[31] The year 2004 is a leap year, the year 2005 is not.

EXPLANATION OF PROVISION

A 365-day year is used for all individual, estate, and trust estimated tax interest calculations.

EFFECTIVE DATE

The provision is effective for estimated tax payments made for taxable years beginning after December 31, 2004.

B. Corporate Estimated Tax

(Sec. 202 of the bill and sec. 6655 of the Code)

PRESENT LAW

In general, corporations are required to make quarterly estimated tax payments of their income tax liability (sec. 6655). An exception to this requirement applies if the amount of tax for the taxable year is less than $500.

REASONS FOR CHANGE

The Committee believes that increasing the value of this exception will reduce taxpayer burden and simplify administration of the tax laws.

EXPLANATION OF PROVISION

The provision increases the value of this exception to amounts of tax that are less than $1,000.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2004.

C. Increase in Large Corporation Threshold for Estimated Tax Payments

(Sec. 203 of the bill and sec. 6655 of the Code)

PRESENT LAW

In general, corporations are required to make quarterly estimated tax payments of their income tax liability (sec. 6655). In general, annual payments must total either 100 percent of the current year's tax or 100 percent of the previous year's tax. Large corporations may not base their payments on the previous year's tax. A large corporation has taxable income of $1 million or more for any taxable year in the preceding three taxable years.

REASONS FOR CHANGE

The Committee believes that increasing this threshold will reduce taxpayer burden and simplify administration of the tax laws.

EXPLANATION OF PROVISION

The provision increases this $1 million threshold defining large corporations by $50,000 every year beginning after 2004 until it reaches $1.5 million.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2004.

D. Abatement of Interest

(Sec. 204 of the bill and sec. 6404 of the Code)

PRESENT LAW

In general

The Secretary of the Treasury can abate or suspend the accrual of interest in a number of situations. In general, the Secretary is authorized to abate interest that is not owed by the taxpayer, either because the interest was erroneously or illegally assessed, or because the interest was assessed after the expiration of the period of limitations. The Secretary also may abate interest that is attributable to certain unreasonable errors and delays by the Internal Revenue Service. The Secretary may abate interest where, in his judgment, the administration and collection costs involved do not warrant the collection of the amount due.

The Secretary is required to abate interest in the case of a declared disaster or certain erroneous refunds attributable solely to errors made by the IRS. The Secretary is required to suspend the accrual of interest if the IRS fails to contact the taxpayer in a timely manner and in the case of taxpayers serving in a combat zone.

Interest that is abated is not owed by the taxpayer and does not accrue additional interest through compounding or result in any additional penalties. If the accrual of interest is suspended for a period, then that period is not taken into account in determining the interest owed on an underpayment.

Most abatements of interest are a result of adjustments to the underlying tax liability. Underpayment interest is assessed any time an underpayment is assessed. If the underlying tax liability is later adjusted, resulting in a reduction in the amount of the underpayment, the portion of the interest attributable to such adjustment must be abated.

Abatement of interest attributable to unreasonable IRS errors or delays

The Secretary is permitted to abate interest on any deficiency attributable in whole or in part to any unreasonable error or delay by an IRS employee in performing a ministerial or managerial act.

Abatement of penalties and additions to tax attributable to erroneous written advice given by the IRS

The Secretary is required to abate any portion of any penalty or addition to tax attributable to erroneous advice furnished to the taxpayer in writing by an officer or employee of the IRS acting in his or her official capacity. The abatement applies only if (1) the advice is given in response to a specific written request made by the taxpayer, (2) the taxpayer reasonably relied on the advice, and (3) the taxpayer provided adequate and accurate information.

Only penalties and additions to tax that are attributable to erroneous written advice given by the IRS are abated under this rule.

Interest is abated only to the extent that it is attributable to abated penalties and additions to tax. Interest attributable to an underpayment of tax, where such underpayment is the result of the taxpayer's proper reliance on written advice of the IRS, is not eligible for abatement.

Procedures for the abatement of interest

Taxpayers may apply for the abatement of interest by filing a claim on Form 843 with the Internal Revenue Service Center that has assessed the interest the taxpayer seeks to have abated.

Typically, interest is abated when the amount of tax assessed is reduced. Thus, any procedure that may result in the reduction of assessed tax may also result in an abatement of interest.

REASONS FOR CHANGE

The Committee believes that the narrow definition of ministerial and managerial act prevents the abatement of interest in certain situations where there are errors or delays. Further, the abatement of interest does not apply to employment taxes and certain excise taxes. As with other types of taxes, errors and delays occur in the administration of employment and excise taxes. The Committee believes that there are additional situations in which it is not appropriate for the Secretary to collect interest on an underpayment of tax to promote efficiency in administration of the tax laws and fairness to taxpayers.

EXPLANATION OF PROVISION

Expand abatement of interest for unreasonable IRS errors or delays

The provision expands the scope of interest that may be abated by removing the requirement that the error or delay occur in performing a ministerial or managerial act and by applying it to interest for all types of taxes.

Allow the abatement of interest to the extent the interest is attributable to taxpayer reliance on written statements of the IRS

The provision requires the Secretary to abate interest on an underpayment where the underpayment is attributable to erroneous advice furnished to the taxpayer in writing by an officer or employee of the IRS acting in his or her official capacity. It is anticipated that the abatement would apply to interest attributable to the period of time from the issuance of the erroneous advice through the day that is 21 days (10 days in the case of an underpayment in excess of $100,000) after the day the IRS gives written notice that its advice was erroneous. The proposal does not eliminate the taxpayer's obligation to satisfy any underpayment of tax attributable to such erroneous advice.

EFFECTIVE DATE

The changes made by these provisions are effective with respect to interest accruing on or after the date of enactment.

E. Deposits Made To Suspend the Running of Interest on Potential Underpayments

(Sec. 205 of the bill and new sec. 6603 of the Code)

PRESENT LAW

Generally, interest on underpayments and overpayments continues to accrue during the period that a taxpayer and the IRS dispute a liability. The accrual of interest on an underpayment is suspended if the IRS fails to notify an individual taxpayer in a timely manner, but interest will begin to accrue once the taxpayer is properly notified. No similar suspension is available for other taxpayers.

A taxpayer that wants to limit its exposure to underpayment interest has a limited number of options. The taxpayer can continue to dispute the amount owed and risk paying a significant amount of interest. If the taxpayer continues to dispute the amount and ultimately loses, the taxpayer will be required to pay interest on the underpayment from the original due date of the return until the date of payment.

In order to avoid the accrual of underpayment interest, the taxpayer may choose to pay the disputed amount and immediately file a claim for refund. Payment of the disputed amount will prevent further interest from accruing if the taxpayer loses (since there is no longer any underpayment) and the taxpayer will earn interest on the resultant overpayment if the taxpayer wins. However, the taxpayer will generally lose access to the Tax Court if it follows this alternative. Amounts paid generally cannot be recovered by the taxpayer on demand, but must await final determination of the taxpayer's liability. Even if an overpayment is ultimately determined, overpaid amounts may not be refunded if they are eligible to be offset against other liabilities of the taxpayer.

The taxpayer may also make a deposit in the nature of a cash bond. The procedures for making a deposit in the nature of a cash bond are provided in Rev. Proc. 84–58.

A deposit in the nature of a cash bond will stop the running of interest on an amount of underpayment equal to the deposit, but the deposit does not itself earn interest. A deposit in the nature of a cash bond is not a payment of tax and is not subject to a claim for credit or refund. A deposit in the nature of a cash bond may be made for all or part of the disputed liability and generally may be recovered by the taxpayer prior to a final determination. However, a deposit in the nature of a cash bond need not be refunded to the extent the Secretary determines that the assessment or collection of the tax determined would be in jeopardy, or that the deposit should be applied against another liability of the taxpayer in the same manner as an overpayment of tax. If the taxpayer recovers the deposit prior to final determination and a deficiency is later determined, the taxpayer will not receive credit for the period in which the funds were held as a deposit. The taxable year to which the deposit in the nature of a cash bond relates must be designated, but the taxpayer may request that the deposit be applied to a different year under certain circumstances.

REASONS FOR CHANGE

The Committee believes that taxpayers should be able to limit their underpayment interest exposure in a tax dispute. An improved deposit system will help taxpayers better manage their exposure to underpayment interest without requiring them to surrender access to their funds or requiring them to make a potentially indefinite-term investment in a non-interest bearing account. The Committee believes that an improved deposit system that allows for the payment of interest on amounts that are not ultimately needed to offset tax liability when the taxpayer's position is upheld, as well as allowing for the offset of tax liability when the taxpayer's position fails, will provide an effective way for taxpayers to manage their exposure to underpayment interest. However, the Committee believes that such an improved deposit system should be reserved for the issues that are known to both parties, either through IRS examination or voluntary taxpayer disclosure.

EXPLANATION OF PROVISION

In general

The provision allows a taxpayer to deposit cash with the IRS that may subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes. Interest will not be charged on the portion of the underpayment that is deposited for the period that the amount is on deposit. Generally, deposited amounts that have not been used to pay a tax may be withdrawn at any time if the taxpayer so requests in writing. The withdrawn amounts will earn interest at the applicable Federal rate to the extent they are attributable to a disputable tax.

The Secretary may issue rules relating to the making, use, and return of the deposits.

Use of a deposit to offset underpayments of tax

Any amount on deposit may be used to pay an underpayment of tax that is ultimately assessed. If an underpayment is paid in this manner, the taxpayer will not be charged underpayment interest on the portion of the underpayment that is so paid for the period the funds were on deposit.

For example, assume a calendar year individual taxpayer deposits $20,000 on May 15, 2005, with respect to a disputable item on its 2004 income tax return. On April 15, 2007, an examination of the taxpayer's year 2004 income tax return is completed, and the taxpayer and the IRS agree that the taxable year 2004 taxes were underpaid by $25,000. The $20,000 on deposit is used to pay $20,000 of the underpayment, and the taxpayer also pays the remaining $5,000. In this case, the taxpayer will owe underpayment interest from April 15, 2005 (the original due date of the return) to the date of payment (April 15, 2007) only with respect to the $5,000 of the underpayment that is not paid by the deposit. The taxpayer will owe underpayment interest on the remaining $20,000 of the underpayment only from April 15, 2005, to May 15, 2005, the date the $20,000 was deposited.

Withdrawal of amounts

A taxpayer may request the withdrawal of any amount of deposit at any time. The Secretary must comply with the withdrawal request unless the amount has already been used to pay tax or the Secretary properly determines that collection of tax is in jeopardy. Interest will be paid on deposited amounts that are withdrawn at a rate equal to the short-term applicable Federal rate for the period from the date of deposit to a date not more than 30 days preceding the date of the check paying the withdrawal. Interest is not payable to the extent the deposit was not attributable to a disputable tax.

For example, assume a calendar year individual taxpayer receives a 30-day letter showing a deficiency of $20,000 for taxable year 2004 and deposits $20,000 on May 15, 2006. On April 15, 2007, an administrative appeal is completed, and the taxpayer and the IRS agree that the 2004 taxes were underpaid by $15,000. $15,000 of the deposit is used to pay the underpayment. In this case, the taxpayer will owe underpayment interest from April 15, 2005 (the original due date of the return) to May 15, 2006, the date the $20,000 was deposited. Simultaneously with the use of the $15,000 to offset the underpayment, the taxpayer requests the return of the remaining amount of the deposit (after reduction for the underpayment interest owed by the taxpayer from April 15, 2005, to May 15, 2006). This amount must be returned to the taxpayer with interest determined at the short-term applicable Federal rate from the May 15, 2006, to a date not more than 30 days preceding the date of the check repaying the deposit to the taxpayer.

Limitation on amounts for which interest may be allowed

Interest on a deposit that is returned to a taxpayer shall be allowed for any period only to the extent attributable to a disputable item for that period. A disputable item is any item for which the taxpayer (1) has a reasonable basis for the treatment used on its return and (2) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer's treatment of such item.

All items included in a 30-day letter to a taxpayer are deemed disputable for this purpose. Thus, once a 30-day letter has been issued, the disputable amount cannot be less than the amount of the deficiency shown in the 30-day letter. A 30-day letter is the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

Deposits are not payments of tax

A deposit is not a payment of tax prior to the time the deposited amount is used to pay a tax. Similarly, withdrawal of a deposit will not establish a period for which interest was allowable at the short-term applicable Federal rate for the purpose of establishing a net zero interest rate on a similar amount of underpayment for the same period.

EFFECTIVE DATE

The provision applies to deposits made after one year after the date of enactment. Amounts already on deposit as of the date of enactment are treated as deposited (for purposes of applying this provision) on the date (after one year after the date of enactment) the taxpayer identifies the amount as a deposit made pursuant to this provision.

F. Freeze of Provision Regarding Suspension of Interest Where Secretary Fails To Contact Taxpayer

(Sec. 206 of the bill and sec. 6404 of the Code)

PRESENT LAW

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was aware that there was tax due. The Code suspends the accrual of certain penalties and interest after 1 year if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period.[32] With respect to taxable years beginning before January 1, 2004, the one-year period is increased to 18 months. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension only applies to taxpayers who file a timely tax return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties.

REASONS FOR CHANGE

The volume and complexity of the IRS workload has significantly increased. The Committee believes that, in light of current IRS capabilities, staffing levels, and resource constraints the one-year period is too short and that the 18-month period should be made the permanent rule.

EXPLANATION OF PROVISION

The provision makes the 18-month rule the permanent rule. The provision also adds gross misstatements[33] to the list of provisions to which the suspension of interest rules do not apply.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2003.[34]

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[32] Sec. 6404(g). This provision was added to the Code by sec. 3305 of the IRS Restructuring and Reform Act of 1998 (Pub. L. No. 105–206, July 22,1998).

[33] This includes any substantial omission of items to which the six-year statute of limitations applies (sec. 6051(e), gross valuation misstatements (sec. 6662(h)), and similar provisions.

[34] It is intended that this proposal apply retroactively to the period beginning January 1, 2004 and ending on the date of enactment.

G. Clarification of Application of Federal Tax Deposit Penalty

(Sec. 207 of the bill)

PRESENT LAW

In many instances, taxpayers are required to make deposits of Federal taxes (sec. 6302). Failure to do so is subject to a penalty (sec. 6656). The amount of that penalty depends on the length of time that the deposit was not made. The penalty is 2 percent of the underpayment if the failure to deposit is for not more than 5 days, 5 percent for 6 through 15 days, and 10 percent for more than 15 days. The IRS has stated its position that the 10 percent penalty rate automatically applies if a deposit is not made in the manner required.

REASONS FOR CHANGE

The Committee believes that the position of the IRS does not reflect the intent of the Congress in enacting this penalty, that the rate of the penalty vary depending on the time of the failure, whether the failure being penalized is a failure to make a deposit in the manner required or a failure to make a deposit at all. The Committee considers it anomalous that the IRS would interpret this penalty so that individuals who make the correct deposit but not in the manner required are penalized at a higher rate than those that do not make a deposit at all until several days after the due date. The Committee believes it is more appropriate to penalize taxpayers in similar situations similarly.

EXPLANATION OF PROVISION

The application of the Federal tax deposit penalty is clarified so that the 10 percent penalty rate only applies in cases where the failure to deposit extends for more than 15 days. Thus, a taxpayer who makes a deposit on time but not in the manner required will be subject to a penalty of 2 percent.

EFFECTIVE DATE

The provision is effective on the date of enactment.

H. Frivolous Tax Returns and Submissions

(Sec. 208 of the bill and sec. 6702 of the Code)

PRESENT LAW

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of $500 imposed by the IRS (sec. 6702). The Code also permits the Tax Court to impose a penalty of up to $25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in the proceeding is frivolous or groundless (sec. 6673(a)).

REASONS FOR CHANGE

The Committee believes that frivolous returns and submissions consume resources at the IRS and in the courts that can better be utilized in resolving legitimate disputes with taxpayers. Expanding

the scope of the penalty to cover all taxpayers and tax returns promotes fairness in the tax system. The Committee believes that adopting this provision will improve effective tax administration.

EXPLANATION OF PROVISION

The provision modifies this IRS-imposed penalty by increasing the amount of the penalty to up to $5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The provision also modifies present law with respect to certain submissions that raise frivolous arguments. The submissions to which this provision applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. The proposal permits the IRS to impose a penalty of up to $5,000 for such requests, unless the taxpayer withdraws the request promptly after being given an opportunity to do so.

The provision requires the IRS to publish a list of positions, arguments, requests, and proposals determined to be frivolous for purposes of these provisions.

EFFECTIVE DATE

The provision is effective for submissions made and issues raised after the date on which the Secretary first prescribes the required list.

I. Extension of Notice Requirements With Respect to Interest and Penalty Calculations

(Sec. 209 of the bill and secs. 3306 and 3308 of the Internal Revenue Service Restructuring and Reform Act of 1998)

PRESENT LAW

The Code requires that the IRS include in every notice to an individual taxpayer requiring the payment of interest a computation of the interest and information regarding the provision of the Code under which interest is imposed.[35] A similar requirement generally applies with respect to notices imposing penalties.[36] In the case of notices issued after June 30, 2001, and before July 1, 2003, these requirements were treated as met if the notice contained a telephone number for the IRS from whom the taxpayer could request the relevant information.

REASONS FOR CHANGE

In light of IRS resources and technology constraints, the Committee believes that the application of this special telephone number rule should be extended for several years.

EXPLANATION OF PROVISION

The provision extends the application of this special telephone number rule.

[35] Sec. 6631.
[36] Sec. 6751.

EFFECTIVE DATE

The provision is effective for notices issued before July 1, 2006.

J. Expansion of Interest Netting

(Sec. 210 of the bill and sec. 6621 of the Code)

PRESENT LAW

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

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

For example, on July 1, 2017, a deficiency of $1,500 is determined with respect to a taxpayer's 2014 Federal income tax return, which the taxpayer pays within 21 days. In the meantime, the taxpayer has filed returns for 2015 and 2016, showing a refund due to overwithholding each year of $1,000. The IRS issues the appropriate refund checks on May 15 of each year, within 45 days of the due date of the return. Thus, interest is not allowable to the taxpayer with respect to either 2015 or 2016. In this case, the taxpayer owes interest on the $1,500 year 2014 underpayment from the original due date of the return (April 15, 2015) until the underpayment is satisfied. Although, there are offsetting periods of overpayment (April 15, 2016 to May 15, 2016 and April 15, 2017 to May 15, 2017), there is no offsetting period for which interest is allowable on an overpayment.

REASONS FOR CHANGE

Interest represents the time value of money. The Committee believes that allowing taxpayers to consider the period of time the Secretary is allowed to process a refund in determining a net interest rate reflects this principle by recognizing that the government had use of the taxpayer's overpayment even though such overpayment was not allowable (i.e., periods of mutual indebtedness).

EXPLANATION OF PROVISION

In the case of any taxpayer (whether an individual or corporation or other), the interest netting rules are applied without regard to the 45-day period in which the Secretary may refund an overpayment of tax without the payment of interest under section 6611(e). Solely for the purpose of the interest netting computation, the portion of the 45-day period before repayment of the overpayment is considered as a period for which overpayment interest was allow-

able at a zero rate. The provision does not modify the period for which interest is payable or allowable for any other purpose.

In the example discussed as part of present law, above, a net interest rate of zero would be applied to $1,000 of the taxpayer's year 2014 underpayment for the periods between the due date of the 2015 and 2016 returns and the dates on which the refunds are made. The taxpayer in the example would owe interest at the underpayment rate for the periods from April 16, 2015, to April 15, 2016; May 16, 2016 to April 15, 2017; and from May 16, 2017 to July 1, 2017. For the periods April 15, 2016, to May 15, 2016 and April 15, 2017 to May 15, 2017, a zero net interest rate will apply.

EFFECTIVE DATE

The provision is effective for interest accrued after December 31, 2010.

TITLE III.—UNITED STATES TAX COURT MODERNIZATION

A. Consolidate Review of Collection Due Process Cases in the Tax Court

(Sec. 301 of the bill and sec. 6330 of the Code)

PRESENT LAW

In general, the Internal Revenue Service ("IRS") is required to notify taxpayers that they have a right to a fair and impartial hearing before levy may be made on any property or right to property.[37] Similar rules apply with respect to liens.[38] The hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. The appeal must be brought to the Tax Court, unless the Tax Court does not have jurisdiction over the underlying tax liability. If that is the case, then the appeal must be brought in the district court of the United States.[39] If a court determines that an appeal was not made to the correct court, the taxpayer has 30 days after such determination to file with the correct court.

The Tax Court is established under Article I of the United States Constitution[40] and is a court of limited jurisdiction.[41] Thus, the Tax Court may not have jurisdiction over the underlying tax liability with respect to an appeal of a due process hearing relating to a collections matter. As a practical matter, many cases involving such appeals (whether within the jurisdiction of the Tax Court or a district court) do not involve the underlying tax liability.

REASONS FOR CHANGE

The Tax Court does not have jurisdiction over all of the tax issues underlying collection due process cases (such as issues involving most excise taxes). The judicial appeals structure of present law was designed in recognition of these jurisdictional limitations;

[37] Sec. 6330(a).
[38] Sec. 6320.
[39] Sec. 6330(d).
[40] Sec. 7441.
[41] Sec. 7442.

however, in many cases the underlying taxes are not involved in determining the due process issue. The present-law structure can lead to confusion over which court is the proper court in which to file an appeal. Some believe that this confusion may also be used by some taxpayers seeking to delay the collection process. Accordingly, the Committee believes that the Tax Court should have jurisdiction over all appeals of collection due process determinations. The simplification provided will both benefit the taxpayers involved and the IRS by eliminating confusion over which court is the proper venue for appeal and will reduce the period of time before judicial review. This provision will also eliminate the opportunity to use the present-law rules in unintended ways to delay or defeat the collection process.

EXPLANATION OF PROVISION

The provision modifies the jurisdiction of the Tax Court by providing that all appeals of collection due process determinations are to be made to the United States Tax Court.

EFFECTIVE DATE

The provision applies to determinations made by the IRS after the date of enactment.

B. Extend Authority for Special Trial Judges To Hear and Decide Certain Employment Status Cases

(Sec. 302 of the bill and sec. 7443A of the Code)

PRESENT LAW

In connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (1) one or more individuals performing services for that person are employees of that person or (2) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court has jurisdiction to determine whether the IRS is correct and the proper amount of employment tax under such determination.[42] Any redetermination by the Tax Court has the force and effect of a decision of the Tax Court and is reviewable.

An election may be made by the taxpayer for small case procedures if the amount of the employment taxes in dispute is $50,000 or less for each calendar quarter involved.[43] The decision entered under the small case procedure is not reviewable in any other court and should not be cited as authority.

The chief judge of the Tax Court may assign proceedings to special trial judges. The Code enumerates certain types of proceedings that may be so assigned and may be decided by a special trial judge. In addition, the chief judge may designate any other proceeding to be heard by a special trial judge.[44]

REASONS FOR CHANGE

The Committee believes that clarifying that special trial judges may decide proceedings involving a determination of employment

[42] Sec. 7436.
[43] Sec. 7436(c).
[44] Sec. 7443A.

status in which the amount of employment taxes in dispute is $50,000 or less for each calendar quarter involved will improve the operations and internal functioning of the Tax Court.

EXPLANATION OF PROVISION

The provision clarifies that the chief judge of the Tax Court may assign to special trial judges any employment tax cases that are subject to the small case procedure and may authorize special trial judges to decide such small tax cases.

EFFECTIVE DATE

The provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

C. Confirmation of Tax Court Authority To Apply Equitable Recoupment

(Sec. 303 of the bill and sec. 6214 of the Code)

PRESENT LAW

Equitable recoupment is a common-law equitable principle that permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[45] In *Estate of Mueller* v. *Commissioner,*[46] the Court of Appeals for the Sixth Circuit held that the Tax Court may not apply the doctrine of equitable recoupment. More recently, the Court of Appeals for the Ninth Circuit, in *Branson* v. *Commissioner,*[47] held that the Tax Court may apply the doctrine of equitable recoupment.

REASONS FOR CHANGE

The Committee believes that it is important to resolve the conflict among the circuit courts by eliminating the uncertainty or confusion of differing results in differing circuits. The Committee also believes that the provision will provide simplification benefits to both taxpayers and the IRS.

EXPLANATION OF PROVISION

The provision confirms that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the U.S. District Courts or the U.S. Court of Claims. No implication is intended as to whether the Tax Court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

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[45] See *Stone* v. *White,* 301 U.S. 532 (1937); *Bull* v. *United States,* 295 U.S. 247 (1935).
[46] 153 F.3d 302 (6th Cir.), cert. den., 525 U.S. 1140 (1999).
[47] 264 F.3d 904 (9th Cir.), cert. den., 2002 U.S. LEXIS 1545 (U.S. Mar. 18, 2002).

EFFECTIVE DATE

The provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

D. Tax Court Filing Fee

(Sec. 304 of the bill and sec. 7451 of the Code)

PRESENT LAW

The Tax Court is authorized to impose a fee of up to $60 for the filing of any petition for the redetermination of a deficiency or for declaratory judgments relating to the status and classification of 501(c)(3) organizations, the judicial review of final partnership administrative adjustments, and the judicial review of partnership items if an administrative adjustment request is not allowed in full.[48] The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest or for failure to award administrative costs and other areas of jurisdiction for which a petition may be filed. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[49]

REASONS FOR CHANGE

The Committee believes it is appropriate to clarify that the Tax Court filing fee applies to any case commenced by the filing of a petition.

EXPLANATION OF PROVISION

The provision provides that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Appointment of Tax Court Employees

(Sec. 305 of the bill and sec. 7471(a) of the Code)

PRESENT LAW

The Tax Court is a legislative court established by the Congress pursuant to Article I of the U.S. Constitution (an "Article I" court).[50] The Tax Court is authorized to appoint employees, subject to the rules applicable to employment with the Executive Branch of the Federal Government (generally referred to as "competitive service"), as administered by the Office of Personnel Management.[51]

Employment with the Federal Executive Branch is governed by certain general statutory principles, such as recruitment of qualified individuals, fair and equitable treatment of employees and ap-

[48] Sec. 7451.
[49] See Rule 20(a) of the Tax Court Rules of Practice and Procedure.
[50] Sec. 7441.
[51] Sec. 7471.

plicants, maintenance of high standards of employee conduct, and protection of employees against arbitrary action. The rules for employment in the Federal Executive Branch address various aspects of such employment, including: (1) procedures for the appointment of employees in the competitive service, including preferences for certain individuals (e.g., veterans); (2) compensation, benefits, and leave programs for employees; (3) appraisals of employee performance; (4) disciplinary actions; and (5) employee rights, including appeal rights. In addition, employees are protected from certain personnel practices (referred to as "prohibited personnel practices"), such as discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition.

REASONS FOR CHANGE

The Tax Court was established as an Article I court in part because of its need for independence from the Executive Branch and its responsibility for reviewing determinations of a Federal Executive Branch agency (i.e., the Internal Revenue Service).[52] Accordingly, the Committee believes that the Tax Court should have the authority to establish its own personnel system, rather than being subject to the rules administered by the Federal Executive Branch. Similar authority has previously been provided to other Article I courts and to courts established under Article III of the U.S. Constitution. The Committee also believes that a personnel system established by the Tax Court should be consistent with the general principles that govern other employment with the Federal Government and should provide certain protections to employees.

EXPLANATION OF PROVISION

The provision extends to the Tax Court authority to establish its own personnel management system. Any personnel management system adopted by the Tax Court must: (1) include the merit system principles that govern employment with the Federal Executive Branch; (2) prohibit personnel practices that are prohibited in the Federal Executive Branch; and (3) in the case of an individual eligible for preference for employment in the Federal Executive Branch, provide preference for that individual in a manner and to an extent consistent with preference in the Federal Executive Branch.

The provision requires the Tax Court to prohibit discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition. The Tax Court is also required to promulgate procedures for resolving complaints of discrimination by employees and applicants for employment.

The provision allows the Tax Court to appoint a clerk without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, the clerk serves at the pleasure of the Tax Court.

The provision also allows the Tax Court to appoint other necessary employees without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, these employees are subject to removal by the Tax Court.

[52] See, e.g., S. Rep. No. 91–552, at 302 (1969).

The provision allows judges and special trial judges of the Tax Court to appoint law clerks and secretaries, in such numbers as the Tax Court may approve, without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, a law clerk or secretary serves at the pleasure of the appointing judge.

The provision exempts law clerks from the sick leave and annual leave provisions applicable to employees of the Federal Executive Branch. Any unused sick or annual leave to the credit of a law clerk as of the effective date of the provision remains credited to the individual and is available to the individual upon separation from the Federal Government, or upon transfer to a position subject to such sick leave and annual leave provisions.

The provision allows the Tax Court to fix and adjust the compensation of the clerk and other employees without regard to the Federal Executive Branch rules regarding employee classifications and pay rates. To the maximum extent feasible, Tax Court employees are to be compensated at rates consistent with those of employees holding comparable positions in the Federal Judicial Branch. The Tax Court may also establish programs for employee evaluations, premium pay, and resolution of employee grievances.

In the case of an individual who is an employee of the Tax Court on the day before the effective date of the provision, the provision preserves certain rights that the employee is entitled to as of that day. The provision preserves the right to: (1) appeal a reduction in grade or removal; (2) appeal an adverse action; (3) appeal a prohibited personnel practice; (4) make an allegation of a prohibited personnel practice; or (5) file an employment discrimination appeal. These rights are preserved for as long as the individual remains an employee of the Tax Court.

Under the provision, a Tax Court employee who completes at least one year of continuous service under a nontemporary appointment with the Tax Court acquires competitive service status for appointment to any position in the Federal Executive Branch competitive service for which the employee possesses the required qualifications.

The provision also allows the Tax Court to procure the services of experts and consultants in accordance with Federal Executive Branch rules.

EFFECTIVE DATE

The provision is effective on the date that the Tax Court adopts a personnel management system after date of enactment of the provision.

F. Use of Practitioner Fee

(Sec. 306 of the bill and sec. 7475 of the Code)

PRESENT LAW

The Tax Court is authorized to impose on practitioners admitted to practice before the Tax Court a fee of up to $30 per year.[53]

[53] Sec. 7475.

These fees are to be used to employ independent counsel to pursue disciplinary matters.

REASONS FOR CHANGE

The Committee understands that many pro se taxpayers are not familiar with Tax Court procedures and applicable legal requirements. The Committee believes it is beneficial for Tax Court fees imposed on practitioners also to be available to provide services to pro se taxpayers.

EXPLANATION OF PROVISION

The provision provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers.

EFFECTIVE DATE

The provision is effective on the date of enactment.

G. Tax Court Pension and Compensation

1. Judges of the Tax Court (secs. 311–317 and 323 of the bill and secs. 7443, 7447, 7448, and 7472 of the Code)

PRESENT LAW

The Tax Court is established by the Congress pursuant to Article I of the U.S. Constitution.[54] The salary of a Tax Court judge is the same salary as received by a United States District Court judge.[55] Present law also provides Tax Court judges with some benefits that correspond to benefits provided to United States District Court judges, including specific retirement and survivor benefit programs for Tax Court judges.[56]

Under the retirement program, a Tax Court judge may elect to receive retirement pay from the Tax Court in lieu of benefits under another Federal retirement program. A Tax Court judge may also elect to participate in a plan providing annuity benefits for the judge's surviving spouse and dependent children (the "survivors' annuity plan"). Generally, benefits under the survivors' annuity plan are payable only if the judge has performed at least five years of service. Cost-of-living increases in benefits under the survivors' annuity plan are generally based on increases in pay for active judges.

Tax Court judges participate in the Federal Employees Group Life Insurance program (the "FEGLI" program). Retired Tax Court judges are eligible to participate in the FEGLI program as the result of an administrative determination of their eligibility, rather than a specific statutory provision.

Tax Court judges are not covered by the leave system for Federal Executive Branch employees. As a result, an individual who works in the Federal Executive Branch before being appointed to the Tax Court does not continue to accrue annual leave under the same leave program and may not use leave accrued prior to his or her appointment to the Tax Court.

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[54] Sec. 7441.
[55] Sec. 7443(c).
[56] Secs. 7447 and 7448.

Tax Court judges are not eligible to participate in the Thrift Savings Plan.

Tax Court judges are subject to limitations on outside earned income under the Ethics in Government Act of 1978.

REASONS FOR CHANGE

Tax Court judges receive compensation at the same rate as United States District Court judges. In addition, the benefit programs for Tax Court judges are intended to accord with similar programs applicable to District Court judges.[57] However, subsequent legislative changes in the benefits provided to District Court judges have not applied to Tax Court judges, thus creating disparities between the treatment of Tax Court judges and the treatment of District Court judges. The Committee believes that parity should exist between the benefits provided to Tax Court judges and those provided to District Court judges.

EXPLANATION OF PROVISION

Survivor annuities for assassinated judges

Under the provision, benefits under the survivors' annuity plan are payable if a Tax Court judge is assassinated before the judge has performed five years of service.

Cost-of-living adjustments for survivor annuities

The provision provides that cost-of-living increases in benefits under the survivors' annuity plan are generally based on cost-of-living increases in benefits paid under the Civil Service Retirement System.

Life insurance coverage

Under the provision, a judge or retired judge of the Tax Court is deemed to be an employee continuing in active employment for purposes of participation in the Federal Employees Group Life Insurance program. In addition, in the case of a Tax Court judge age 65 or over, the Tax Court is authorized to pay on behalf of the judge any increase in employee premiums under the FEGLI program that occur after April 24, 1999,[58] including expenses generated by such payment, as authorized by the chief judge of the Tax Court in a manner consistent with payments authorized by the Judicial Conference of the United States (i.e., the body with policy-making authority over the administration of the courts of the Federal Judicial Branch).

Accrued annual leave

Under the provision, in the case of a judge who is employed by the Federal Executive Branch before appointment to the Tax Court, the judge is entitled to receive a lump-sum payment for the balance of his or her accrued annual leave on appointment to the Tax Court.

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[57] See, e.g., S. Rep. No. 91–552, at 303 (1969).

[58] This date relates to changes in the FEGLI program, including changes to premium rates to reflect employees' ages.

Thrift Savings Plan participation

Under the provision, Tax Court judges are permitted to participate in the Thrift Savings Plan. A Tax Court judge is not eligible for agency contributions to the Thrift Savings Plan.

Exemption for teaching compensation from outside earned income limitations

Under the provision, compensation earned by a retired Tax Court judge for teaching is not treated as outside earned income for purposes of limitations under the Ethics in Government Act of 1978.

EFFECTIVE DATE

The provisions are effective on the date of enactment, except that: (1) the provision relating to cost-of-living increases in benefits under the survivors' annuity plan applies with respect to increases in Civil Service Retirement benefits taking effect after the date of enactment; (2) the provision relating to payment of accrued annual leave applies to any Tax Court judge with an outstanding leave balance as of the date of enactment and to any individual appointed to serve as a Tax Court judge after such date; (3) the provision relating to participation by Tax Court judges in the Thrift Savings Plan applies as of the next open season; and (4) the provision relating to teaching compensation of a retired Tax Court judge applies to any individual serving as a retired Tax Court judge on or after the date of enactment.

2. Special trial judges of the Tax Court (secs. 318–323 of the bill and sec. 7448 and new secs. 7443A, 7443B, and 7443C of the Code)

PRESENT LAW

The Tax Court is established by the Congress pursuant to Article I of the U.S. Constitution.[59] The chief judge of the Tax Court may appoint special trial judges to handle certain cases.[60] Special trial judges serve for an indefinite term. Special trial judges receive a salary of 90 percent of the salary of a Tax Court judge and are generally covered by the benefit programs that apply to Federal Executive Branch employees, including the Civil Service Retirement System or the Federal Employees' Retirement System.

REASONS FOR CHANGE

Special trial judges of the Tax Court perform a role similar to that of magistrate judges in courts established under Article III of the U.S. Constitution ("Article III" courts). However, disparities exist between the positions of magistrate judges of Article III courts and special trial judges of the Tax Court. For example, magistrate judges of Article III courts are appointed for a specific term, are subject to removal only in limited circumstances, and are eligible for coverage under special retirement and survivor benefit programs. The Committee believes that special trial judges of the Tax Court and magistrate judges of Article III courts should receive

[59] Sec. 7441.
[60] Sec. 7443A.

comparable treatment as to the status of the position, salary, and benefits.

EXPLANATION OF PROVISION

Magistrate judges of the Tax Court

Under the provision, the position of special trial judge of the Tax Court is renamed as magistrate judge of the Tax Court. Magistrate judges are appointed (or reappointed) to serve for eight-year terms and are subject to removal in limited circumstances.

Under the provision, a magistrate judge receives a salary of 92 percent of the salary of a Tax Court judge.

The provision exempts magistrate judges from the leave program that applies to employees of the Federal Executive Branch and provides rules for individuals who are subject to such leave program before becoming exempt.

Survivors' annuity plan

Under the provision, magistrate judges of the Tax Court may elect to participate in the survivors' annuity plan for Tax Court judges. An election to participate in the survivors' annuity plan must be filed not later than the latest of six months after: (1) the date of enactment of the provision; (2) the date the judge takes office; or (3) the date the judge marries.

Retirement annuity program for magistrate judges

The provision establishes a new retirement annuity program for magistrate judges of the Tax Court, under which a magistrate judge may elect to receive a retirement annuity from the Tax Court in lieu of benefits under another Federal retirement program. A magistrate judge may elect to be covered by the retirement program within five years of appointment or five years of date of enactment. A magistrate judge who elects to be covered by the retirement program generally receives a refund of contributions (with interest) made to the Civil Service Retirement System or the Federal Employees' Retirement System.

A magistrate judge may retire at age 65 with 14 years of service and receive an annuity equal to his or her salary at the time of retirement. For this purpose, service may include service performed as a special trial judge or a magistrate judge, provided the service is performed no earlier than 9½ years before the date of enactment of the provision. The provision also provides for payment of a reduced annuity in the case a magistrate judge with at least eight years of service or in the case of disability or failure to be reappointed.

A magistrate judge receiving a retirement annuity is entitled to cost-of-living increases based on cost-of-living increases in benefits paid under the Civil Service Retirement System. However, such an increase cannot cause the retirement annuity to exceed the current salary of a magistrate judge.

Contributions of one percent of salary are withheld from the salary of a magistrate judge who elects to participate in the retirement annuity program. Such contributions must be made also with respect to prior service for which the magistrate judge elects credit under the retirement annuity program. No contributions are re-

quired after 14 years of service. A lump sum refund of the magistrate judge's contributions (with interest) is made if no annuity is payable, for example, if the magistrate judge dies before retirement.

A magistrate judge's right to a retirement annuity is generally suspended or reduced in the case of employment outside the Tax Court.

The provision includes rules under which annuity payments may be made to a person other than the magistrate judge in certain circumstances, such as divorce or legal separation, under a court decree, a court order, or court-approved property settlement.

The provision establishes the Tax Court Judicial Officers' Retirement Fund (the "Fund"). Amounts in the Fund are authorized to be appropriated for the payment of annuities, refunds, and other payments under the retirement annuity program. Contributions withheld from a magistrate judge's salary are deposited in the Fund. In addition, the provision authorizes to be appropriated to the Fund amounts required to reduce the Fund's unfunded liability to zero. For this purpose, the Fund's unfunded liability means the estimated excess, actuarially determined on an annual basis, of the present value of benefits payable from the Fund over the sum of (1) the present value of contributions to be withheld from the future salary of the magistrate judges and (2) the balance in the Fund as of the date the unfunded liability is determined.

Under the provision, a magistrate judge who elects to participate in the retirement annuity program is also permitted to participate in the Thrift Savings Plan. Such a magistrate judge is not eligible for agency contributions to the Thrift Savings Plan.

Retirement annuity rule for incumbent magistrate judges

The provision provides a transition rule for magistrate judges in active service on the date of enactment of the provision. Under the transition rule, such a magistrate judge is entitled to an annuity under the Civil Service Retirement System or the Federal Employees' Retirement System based on prior service that is not credited under the magistrate judges' retirement annuity program. If the magistrate judge made contributions to the Civil Service Retirement System or the Federal Employees' Retirement System with respect to service that is credited under the magistrate judges' retirement annuity program, such contributions are refunded (with interest).

A magistrate judge who elects the transition rule is also entitled to the annuity payable under the magistrate judges' retirement program in the case of retirement with at least eight years of service or on failure to be reappointed. This annuity is based on service as a magistrate judge or special trial judge of the Tax Court that is performed no earlier than 9½ years before the date of enactment of the provision and for which the magistrate judge makes contributions of one percent of salary.

Recall of retired magistrate judges

The provision provides rules under which a retired magistrate judge may be recalled to perform services for a limited period.

EFFECTIVE DATE

The provisions are effective on date of enactment.

TITLE IV.—CONFIDENTIALITY AND DISCLOSURE

A. Clarification of Definition of Church Tax Inquiry

(Sec. 401 of the bill and sec. 7611 of the Code)

PRESENT LAW

Under present law, the IRS may begin a church tax inquiry only if an appropriate high-level Treasury official reasonably believes, on the basis of the facts and circumstances recorded in writing, that an organization (1) may not qualify for tax exemption as a church, (2) may be carrying on an unrelated trade or business, or (3) otherwise may be engaged in taxable activities.[61] A church tax inquiry is defined as any inquiry to a church (other than an examination) that serves as a basis for determining whether the organization qualified for tax exemption as a church or whether it is carrying on an unrelated trade or business or otherwise is engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records, other than routine requests for information or inquiries regarding matters that do not primarily concern the tax status or liability of the church itself.

REASONS FOR CHANGE

The Committee believes that the present-law church tax inquiry procedures provide important safeguards against the IRS engaging in unnecessary and intrusive examinations of churches. However, the church tax inquiry procedures also have the effect of hampering IRS efforts to educate churches with respect to actions that are not permissible under section 501(c)(3). The Committee believes that a clarification of the scope of the church tax inquiry procedures to make it clear that the IRS may undertake educational outreach efforts with respect to specific churches (e.g., initiating meetings with representatives of a particular church to discuss the rules that apply to such church) will improve compliance with the law by churches.

DESCRIPTION OF PROVISION

The provision clarifies that the church tax inquiry procedures do not apply to contacts made by the IRS for the purpose of educating churches with respect to the federal income tax law governing tax-exempt organizations. For example, the IRS does not violate the church tax inquiry procedures when written materials are provided to a church or churches for the purpose of educating such church or churches with respect to the types of activities that are not permissible under section 501(c)(3).

EFFECTIVE DATE

The provision is effective on the date of enactment.

[61] Sec. 7611.

B. Collection Activities With Respect to a Joint Return Disclosable to Either Spouse Based on Oral Request

(Sec. 402 of the bill and sec. 6103 of the Code)

PRESENT LAW

Section 6103(e) concerns disclosures to persons with a material interest. section 6103(e)(1)(B) requires, upon written request, the IRS to allow the inspection or disclosure of a joint return to either of the individuals with respect to whom the return is filed. Section 6103(e)(7) permits the IRS to disclose return information to the same persons who may have access to a return under the other provisions of section 6103(e). Requests for information pursuant to section 6103(e)(7) do not have to be in writing. Pursuant to section 6103(e)(7) and section 6103(e)(1)(B), either spouse may obtain return information regarding a joint return, including collection information without making a written request.

In response to concerns that former spouses were not able to obtain information regarding collection activities relating to a joint return, the Taxpayer Bill of Rights 2 added section 6103(e)(8).[62] When a deficiency is assessed with respect to a joint return and the individuals are no longer married or no longer reside in the same household, upon request in writing by either of such individuals, the IRS is required to disclose: (1) whether the IRS has attempted to collect such deficiency from the other individual; (2) the general nature of such collection activities; and (3) the amount collected.[63]

The Treasury Inspector General for Tax Administration conducts semiannual reports involving a review and certification of whether the Secretary is complying with the requirements of disclosing information to an individual filing a joint return on collection activity involving the other individual filing the return.[64]

REASONS FOR CHANGE

The Committee believes that former spouses should be able to receive collection information with respect to a joint return in the same manner as if they were current spouses. Thus, a former spouse should not be required to make a written request because if the spouses were still married, a written request would not be required.

EXPLANATION OF PROVISION

The provision eliminates the requirement for former spouses to make a written request for disclosure of collection activities with respect to a joint return. The provision also eliminates the Treasury Inspector General for Tax Administration's reporting requirement associated with the disclosure of collection activities with respect to a joint return.

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[62] "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." Joint Committee on Taxation, General Explanation of Taxation Legislation Enacted in the 104th Congress (JCS–12–96), December 18, 1996 at 29.

[63] Sec. 6103(e)(8).

[64] Sec. 7803(d)(1)(B).

EFFECTIVE DATE

The provision is effective for requests and reports made after the date of enactment.

C. Taxpayer Representatives Not Subject to Examination on Sole Basis of Representation of Taxpayers

(Sec. 403 of the bill and sec. 6103 of the Code)

PRESENT LAW

Under section 6103(h)(1), returns and return information are, without written request, open to inspection by or disclosure to officers and employees of the Department of the Treasury, including IRS employees, whose official duties require such inspection or disclosure for tax administration purposes. The Office of Chief Counsel issued an opinion stating that it was appropriate for a local IRS employee to examine tax records to determine whether taxpayer representatives who submit Form 2848 (Power of Attorney) are current in their tax obligations.[65] The opinion concluded that section 6103(h)(1) permits local IRS employees to access the Integrated Data Retrieval System[66] to determine whether a taxpayer's representative is current in his or her tax obligations.

REASONS FOR CHANGE

The Committee believes that the official duties of the IRS employee examining a taxpayer concern the tax affairs of the taxpayer, not the taxpayer's representative. The taxpayer is under audit, not the taxpayer's representative. Whether the representative has filed his or her returns ordinarily has no bearing on the IRS's determination of the liability of the taxpayer. An IRS employee should make a referral to the Director of Practice, if the employee has reason to believe the taxpayer's representative has engaged in inappropriate behavior.

EXPLANATION OF PROVISION

The provision clarifies that an IRS employee conducting an examination of a taxpayer is not authorized to inspect a taxpayer representative's return or return information solely on the basis of the representative's relationship to the taxpayer. Under the provision, the supervisor of an IRS employee is required to approve such inspection after making a determination that other grounds justify such an inspection. The provision does not affect the ability of employees of the IRS Director of Practice, or other employees whose assigned duties concern the regulation of practice before the IRS, to access returns and return information of a representative.

EFFECTIVE DATE

The provision is effective after the date of enactment.

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[65] Internal Revenue Service, IRS Legal Memorandum ILM 199941038 (August 19, 1999).

[66] The Integrated Data Retrieval System (commonly referred to as "IDRS") is the IRS's primary computer database for return information.

D. Prohibition of Disclosure of Taxpayer Identification Information With Respect To Disclosure of Accepted Offers-in-Compromise

(Sec. 404 of the bill and sec. 6103 of the Code)

PRESENT LAW

Section 6103 permits the IRS to disclose return information to members of the general public to permit inspection of accepted offers in compromise.[67] For one year after the date of execution, a copy of the Form 7249, "Offer Acceptance Report," for each accepted offer in compromise with respect to any liability for a tax imposed by Title 26 is made available for inspection and copying in the location designated by the Compliance Area Director or Compliance Services Field Director within the Small Business and Self-Employed Division of the taxpayer's geographic area of residence.[68] Currently, this form contains the taxpayer identification number of the taxpayer, e.g., the social security number in the case of an individual taxpayer, along with the taxpayer's name and full address.

REASONS FOR CHANGE

The IRS's determination to accept an offer-in-compromise is based on decisions relating to analysis of the individual taxpayer's facts and circumstances and financial situation. Summaries of accepted offers-in-compromise, Form 7249—Offer Acceptance Report, are available for public inspection in the IRS district offices. Currently, this form contains the taxpayer identification number of the taxpayer, e.g., the social security number in the case of an individual taxpayer, along with the taxpayer's name and full address. The Committee believes that if disclosure is warranted, such disclosure should be limited to the least amount of information necessary. The Committee believes that the disclosure of a taxpayer's taxpayer identification number is unnecessary and an unwarranted invasion of privacy. In addition, the Committee believes such disclosure provides an opportunity for identity fraud and abuse.

EXPLANATION OF PROVISION

The provision prohibits the disclosure of the taxpayer's taxpayer identification number as part of the publicly available summaries of accepted offers-in-compromise.

EFFECTIVE DATE

The provision applies to disclosures made after the date of enactment.

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[67] Sec. 6103(k)(l).
[68] Treas. Reg. sec. 601.702(d)(8).

E. Compliance by Contractors With Confidentiality Safeguards

(Sec. 405 of the bill and sec. 6103 of the Code)

PRESENT LAW

Section 6103 permits the disclosure of returns and return information to State agencies, as well as to other Federal agencies for specified purposes. Section 6103(p)(4) requires, as conditions of receiving returns and return information, that State agencies (and others) provide safeguards as prescribed by the Secretary of the Treasury by regulation to be necessary or appropriate to protect the confidentiality of returns or return information.[69] It also requires that a report be furnished to the Secretary at such time and containing such information as prescribed by the Secretary regarding the procedures established and utilized for ensuring the confidentiality of returns and return information.[70] After an administrative review, the Secretary may take such actions as are necessary to ensure these requirements are met, including the refusal to disclose returns and return information.[71]

Under present law, employees of a State tax agency may disclose returns and return information to contractors for tax administration purposes.[72] These disclosures can be made only to the extent necessary to procure contractually equipment, other property, or the providing of services, related to tax administration.[73]

The contractors can make redisclosures of returns and return information to their employees as necessary to accomplish the tax administration purposes of the contract, but only to contractor personnel whose duties require disclosure.[74] Treasury regulations prohibit redisclosure to anyone other than contractor personnel without the written approval of the IRS.[75]

By regulation, all contracts must provide that the contractor will comply with all applicable restrictions and conditions for protecting confidentiality prescribed by regulation, published rules or procedures, or written communication to the contractor.[76] Failure to comply with such restrictions or conditions may cause the IRS to terminate or suspend the duties under the contract or the disclosures of returns and return information to the contractor.[77] In addition, the IRS can suspend disclosures to the State tax agency until the IRS determines that the conditions are or will be satis-

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[69] Sec. 6103(p)(4)(D).

[70] Sec. 6103(p)(4)(E).

[71] Sec. 6103(p)(4) (flush language) and (7); Treas. Reg. sec. 301.6103(p)(7)–1.

[72] Sec. 6103(n) and Treas. Reg. sec. 301.6103(n)–1(a). "Tax administration" includes "the administration, management, conduct, direction, and supervision of the execution and application of internal revenue laws or related statutes (or equivalent laws and statutes of a State) * * *" Sec. 6103(b)(4).

[73] Treas. Reg. sec. 301.6013(n)–1(a). Such services include the processing, storage, transmission or reproduction of such returns or return information, the programming, maintenance, repair, or testing of equipment or other property, or the providing of other services for purposes of tax administration.

[74] Treas. Reg. sec. 301.6103(n)–1(a) and (b). A disclosure is necessary if such procurement or the performance of such services cannot otherwise be reasonably, properly, or economically accomplished without such disclosure. Treas. Reg. sec. 301.6103(n)–1(b). The regulations limit the quantity of information to that needed to perform the contract.

[75] Treas. Reg. sec. 301.6103(n)–1(a).

[76] Treas. Reg. sec. 301.6103(n)–1(d).

[77] Treas. Reg. sec. 301.6103(n)–1(d)(1).

fied.[78] The IRS may take such other actions as deemed necessary to ensure that such conditions or requirements are or will be satisfied.[79]

REASONS FOR CHANGE

The Committee notes the increasing use of contractors by government agencies to perform the work of the government. In the Committee's view, the IRS has insufficient resources to monitor the compliance of every contractor in addition to its other duties. Further, the Committee finds that it is appropriate to require that Federal, State and local agency recipients of tax information monitor and certify that their contractors and other agents have in place adequate safeguards to protect this information.

EXPLANATION OF PROVISION

The provision requires that a State, local, or Federal agency conduct on-site reviews every three years of all of its contractors or other agents receiving Federal returns and return information. If the duration of the contract or agreement is less than one year, a review is required at the mid-point of the contract. The purpose of the review is to assess the contractor's efforts to safeguard Federal returns and return information. This review is intended to cover secure storage, restricting access, computer security, and other safeguards deemed appropriate by the Secretary. Under the provision, the State, local or Federal agency is required to submit a report of its findings to the IRS and certify annually that such contractors and other agents are in compliance with the requirements to safeguard the confidentiality of Federal returns and return information. The certification is required to include the name and address of each contractor or other agent with the agency, the duration of the contract, and a description of the contract or agreement with the State, local, or Federal agency.

The provision does not apply to contracts for purposes of Federal tax administration.

This provision does not alter or affect in any way the right of the IRS to conduct safeguard reviews of State, local, or Federal agency contractors or other agents. It also does not affect the right of the IRS to initially approve the safeguard language in the contract or agreement and the safeguards in place prior to any disclosures made in connection with such contracts or agreements.

EFFECTIVE DATE

The provision is effective for disclosures made after the date of enactment. The first certification is required to be made with respect to the portion of calendar year 2004 following the date of enactment.

[78] Treas. Reg. sec. 301.6103(n)–1(d)(2).
[79] Treas. Reg. sec. 301.6103(n)–1(d).

F. Higher Standards for Requests for and Consents to Disclosure

(Sec. 406 of the bill and sec. 6103 of the Code)

PRESENT LAW

In general

As a general rule, returns and return information are confidential and cannot be disclosed unless authorized by Title 26.[80] Under section 6103(c), a taxpayer may designate in a request or consent to the disclosure by the IRS of his or her return or return information to a third party. Treasury regulations set forth the requirements for such consent.[81] The request or consent may be written or nonwritten form. The Treasury regulations require that the taxpayer sign and date a written consent. At the time the consent is signed and dated by the taxpayer, the written document must indicate (1) the taxpayer's taxpayer identity information; (2) the identity of the person to whom disclosure is to be made; (3) the type of return (or specified portion of the return) or return information (and the particular data) that is to be disclosed; and (4) the taxable year covered by the return or return information. The regulations also require that the consent be submitted within 60 days of the date signed and dated, however, at the time of submission, the IRS generally is unaware of whether a consent form was completed or dated after the taxpayer signs it. Present law does not require that a recipient receiving returns or return information by consent maintain the confidentiality of the information received. Under present law, the recipient is also free to use the information for purposes other than for which the information was solicited from the taxpayer.

Section 6103(c) consents are often used in connection with mortgage loan applications. Mortgage originators qualify loan applicants as meeting or not meeting the requirements for loan approval. This process involves the verification and investigation of information and conditions. If the loan is granted, the mortgage originator may use its own money to fund the loan. Alternatively, another entity, an "investor," may buy the loan and provide the money. Investors typically perform a re-investigation of loans received for funding. Such re-investigations may include verification through the IRS of the tax return provided by the taxpayer to the mortgage originator.

Usually the mortgage originator does not know which investor will ultimately fund the loan. Thus, at the time of application, the originator asks the borrower/taxpayer to sign a consent (Form 4506) designating the originator as the third party to receive the taxpayer's returns. Subsequently, at closing, the investor may request that the originator obtain another Form 4506 naming the investor as the third party to receive the taxpayer's return.

Ostensibly to avoid confusion over why the taxpayer would be authorizing a party other than the originator to receive his tax return, the taxpayer may be asked to sign a blank Form 4506 at closing. In some cases, mortgage originators ask taxpayers not to date the Form 4506. This allows the form to be submitted to the IRS

[80] Sec. 6103(a).
[81] Treas. Reg. sec. 301.6103(c)–1.

at a later date, often months or years later, for purposes of mortgage resale.

Criminal penalties

Under section 7206, it is a felony to willfully make and subscribe any document that contains or is verified by a written declaration that it is made under penalties of perjury and which such person does not believe to be true and correct as to every material matter.[82] Upon conviction, such person may be fined up to $100,000 ($500,000 in the case of a corporation) or imprisoned up to 3 years, or both, together with the costs of prosecution.

Under section 7213, criminal penalties apply to: (1) willful unauthorized disclosures of returns and return information by Federal and State employees and other persons; (2) the offering of any item of material value in exchange for a return or return information and the receipt of such information pursuant to such an offer; and (3) the unauthorized disclosure of return information received by certain shareholders under the material interest provision of section 6103. Under section 7213, a court can impose a fine up to $5,000, up to five years imprisonment, or both, together with the costs of prosecution. If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

The willful and unauthorized inspection of returns and return information can subject Federal and State employees and others to a maximum fine of $1,000, up to a year in prison, or both, in addition to the costs of prosecution. If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

Civil damage remedies for unauthorized disclosure or inspection

If a Federal employee makes an unauthorized disclosure or inspection, a taxpayer can bring suit against the United States in Federal district court. If a person other than a Federal employee makes an unauthorized disclosure or inspection, suit may be brought directly against such person. No liability results from a disclosure based on a good faith, but erroneous, interpretation of section 6103. A disclosure or inspection made at the request of the taxpayer will also relieve liability.

Upon a finding of liability, a taxpayer can recover the greater of $1,000 per act of unauthorized disclosure (or inspection), or the sum of actual damages plus, in the case of an inspection or disclosure that was willful or the result of gross negligence, punitive damages. The taxpayer may also recover the costs of the action and, if found to be a prevailing party, reasonable attorney fees.

The taxpayer has two years from the date of the discovery of the unauthorized inspection or disclosure to bring suit. The IRS is required to notify a taxpayer of an unauthorized inspection or disclosure as soon as practicable after any person is criminally charged by indictment or information for unlawful inspection or disclosure.

[82] Sec. 7206(1).

REASONS FOR CHANGE

The Committee does not believe that the practice of asking taxpayers to sign blank or undated consent forms is appropriate. While recognizing that investors may want to minimize their risks in buying a loan, the Committee finds that these practices can abuse the taxpayer consent process. It is doubtful that a taxpayer is aware that by not dating the form, it could be used months or years after the date it is executed. Taxpayers may be unaware that a blank consent form which does not designate a recipient can be used for purposes other than those related to the transaction under which the request for consent arose.

In addition, the IRS does not have the resources to verify that the return information was used solely for the stated purpose. The IRS estimates that it receives annually more than 800,000 requests from taxpayers directing that their returns or return information be sent to a third party. Examples of third party entities to which the IRS provides information include financial institutions (including the mortgage banking industry), colleges and universities, and Federal, State, and local governmental entities.

The Committee believes that to preserve the integrity of the consent process, a penalty must be placed on the third party soliciting a taxpayer to sign an undated or otherwise incomplete consent. Consistent with a taxpayer's reasonable expectation of privacy, the Committee believes that limitations should be placed on the use of returns and return information obtained by consent.

EXPLANATION OF PROVISION

The provision requires the consent form prescribed by the IRS to contain a warning, prominently displayed, informing the taxpayer that he or she should not sign the form unless it is complete. The provision requires the consent form to state that if the taxpayer believes there is an attempt to coerce him to sign an incomplete or blank form, the taxpayer should report the matter to the Treasury Inspector General for Tax Administration. The telephone number and address for the Treasury Inspector General for Tax Administration must be included on the form. The returns and return information of any taxpayer disclosed to a designee of the taxpayer for a purpose specified in writing, electronically, or orally may be disclosed or used by such persons only for the purpose of, and to the extent necessary in, accomplishing the purpose for the disclosure specified and cannot not be disclosed or used for any other purpose. The provision makes a violation of these requirements, or use or disclosure of information obtained by consent for purposes not permitted by section 6103, punishable by a civil penalty.

The Secretary of Treasury is required to submit a report to Congress on compliance with the designation and certification requirements no later than 18 months after the date of enactment. Such report must evaluate (on the basis of random sampling) whether the provision is achieving its purpose, whether requesters and submitters are continuing to evade the purpose of the provision, whether the sanctions are adequate, and such recommendations as considered necessary or appropriate to better achieve the purposes of the provision.

Any request for or consent to disclose any return or return information under section 6103(c) made before the date of enactment of the provision remains in effect until the earlier of the date such request or consent is otherwise terminated or the date three years after the date of enactment.

EFFECTIVE DATE

The provision applies to requests and consents made after three months after the date of enactment.

G. Civil Damage Remedies for Unauthorized Disclosure or Inspection

(Sec. 407 of the bill and sec. 7431 of the Code)

PRESENT LAW

If a Federal employee makes an unauthorized disclosure or inspection, a taxpayer can bring suit against the United States in Federal district court. If a person other than a Federal employee makes an unauthorized disclosure or inspection, suit may be brought directly against such person. No liability results from a disclosure based on a good faith, but erroneous, interpretation of section 6103. A disclosure or inspection made at the request of the taxpayer will also relieve liability.

Upon a finding of liability, a taxpayer can recover the greater of $1,000 per act of unauthorized disclosure (or inspection), or the sum of actual damages plus, in the case of an inspection or disclosure that was willful or the result of gross negligence, punitive damages. The taxpayer may also recover the costs of the action and, if found to be a prevailing party, reasonable attorney fees.

The taxpayer has two years from the date of the discovery of the unauthorized inspection or disclosure to bring suit. The IRS is required to notify a taxpayer of an unauthorized inspection or disclosure as soon as practicable after any person is criminally charged by indictment or information for unlawful inspection or disclosure.

REASONS FOR CHANGE

Currently, the IRS is not required to notify a taxpayer that an unlawful disclosure or inspection of the taxpayer's return or return information has occurred until the offender has been charged by criminal indictment or information. Accordingly, the Committee believes that the IRS should provide notice to taxpayers if an administrative determination is made as to any disciplinary or adverse action against an IRS employee when returns or return information have been unlawfully accessed or disclosed. The Committee also believes that it is important that such notice include the date of inspection or disclosure and the rights of the affected taxpayer.

The Committee believes that a taxpayer should exhaust all administrative remedies within the IRS prior to receiving an award of damages.

The Committee believes that the Secretary of Treasury should report annually to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives when damage claim payments are made from the United States Judgment Fund.

The Committee also believes that the IRS should provide as part of its public annual report information on unauthorized disclosures or inspections of return and return information. The Committee believes such information will allow review of the enforcement efforts in this area and the extent to which taxpayer privacy is being protected.

EXPLANATION OF PROVISION

The provision requires the Secretary to notify a taxpayer if the IRS or, upon notice to the Secretary by a Federal or State agency, if such Federal or State agency, proposes an administrative determination as to disciplinary or adverse action against an employee arising from the employee's unauthorized inspection or disclosure of the taxpayer's return or return information. The provision requires the notice to include the date of the inspection or disclosure and the rights of the taxpayer as a result of such administrative determination.

Under the provision, in action for civil damages for unauthorized disclosure or inspection, any person who made the inspection or disclosure bears the burden of proving the existence of a good faith interpretation of section 6103 to avoid liability.

The provision adds a new exhaustion of administrative remedies requirement. A judgment for damages will not be awarded unless the court determines that the plaintiff has exhausted the administrative remedies available. The provision also clarifies that unauthorized disclosure or inspection damage claims are payable out of funds appropriated under section 1304 of title 31 of the United States Code (relating to the United States Judgment Fund). Both administrative settlements and settlements of judicial proceedings are paid out of this fund. The Secretary of the Treasury will report annually to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives regarding damage claim payments made from the United States Judgment Fund.

As part of its public report on disclosures, the provision requires the Secretary to furnish information regarding the willful unauthorized disclosure and inspection of returns and return information. Such information includes the number, status, and results of: (1) administrative investigations, (2) civil lawsuits brought under section 7431 (including the amounts for which such lawsuits were settled and the amounts of damages awarded), and (3) criminal prosecutions.

EFFECTIVE DATE

The provision is effective: (1) for determinations made after 180 days after the date of enactment with respect to the taxpayer notice requirement; (2) for inspections and disclosures occurring on and after 180 days after the date of enactment with respect to the provisions relating to the exhaustion of administrative remedies and burden of proof; (3) 180 days after the date of enactment with respect to the payment authority; and (4) for calendar years ending after 180 days after the date of enactment with respect to the reporting requirements.

H. Expanded Disclosure in Emergency Circumstances

(Sec. 408 of the bill and sec. 6103 of the Code)

PRESENT LAW

Section 6103(i)(3)(B) permits the IRS to disclose return information to the extent necessary to apprise Federal or State law enforcement officials of circumstances involving an imminent danger of death or physical injury to an individual. Recipients of such information are required to adhere to certain recordkeeping, reporting, and safeguard requirements as a condition of receiving such information (sec. 6103(p)(4)). Upon completion of use of such information, the Code requires the recipient to return the information to the IRS or make the information undisclosable and furnish a report to the IRS as to the manner in which the information was made undisclosable ("destruction requirements") (sec. 6103(p)(4)(F)(i)).

REASONS FOR CHANGE

Local law enforcement officials need to receive information regarding exigent circumstances in the same manner that Federal and State law enforcement officials receive such information. The Committee believes that expanding this provision to permit disclosure to local law enforcement authorities will permit more rapid response to these situations.

EXPLANATION OF PROVISION

The provision expands present law to permit disclosure of return information to local law enforcement authorities to apprise them of circumstances involving imminent danger of death or physical injury to an individual. The provision eliminates the recordkeeping, safeguard and destruction requirements for all such disclosures to Federal, State or local law enforcement officials.

EFFECTIVE DATE

The provision is effective on the date of enactment.

I. Disclosure of Taxpayer Identity for Tax Refund Purposes

(Sec. 409 of the bill and sec. 6103 of the Code)

PRESENT LAW

When the IRS is unable to find a taxpayer due a refund, present law provides that the IRS may use "the press or other media" to notify the taxpayer of the refund.[83] Section 6103(m) allows the IRS to give the press taxpayer identity information for this purpose.[84] Taxpayer identity includes name, mailing address, taxpayer identification number or combination thereof.

The IRS believes that the current statutory framework of "press and other media" does not permit disclosures via the Internet. The

[83] Sec. 6103(m)(1). This section provides:

The Secretary may disclose taxpayer identity information to the press or other media for purposes of notifying persons entitled to tax refunds when the Secretary, after reasonable effort and lapse of time, has been unable to locate such persons.

[84] Sec. 6103(m)(1), and (b)(6) (definition of "taxpayer identity").

legislative history of the present-law provision does not address the meaning of "press and other media." At the time of the statute's enactment in 1976, the press (newspapers and periodicals) and other traditional media were the only means available for the IRS to distribute undelivered refund information to the public. Thus, the IRS interprets the term "other media" to exclude the Internet.

REASONS FOR CHANGE

In November 2002, the IRS announced that the U.S. Postal Service returned more than 96,792 refund checks as undeliverable.[85] These checks totaled over $80 million.[86] It is the understanding of the Committee that the current method of notification, by newspaper, is ineffective. The Committee believes that the IRS should be able to use any method of mass communication, including the Internet, to reach a taxpayer who is due a refund.

EXPLANATION OF PROVISION

The provision allows the IRS to use any means of "mass communication," including the Internet, to notify the taxpayer of an undelivered refund. It limits the amount of return information that may be disclosed to a taxpayer's name, and the city, State, and zip code of the taxpayer's mailing address.

EFFECTIVE DATE

The provision is effective upon date of enactment.

J. Disclosure to State Officials of Proposed Actions Related to Section 501(c) Organizations

(Sec. 410 of the bill and sec. 6104 of the Code)

PRESENT LAW

In the case of organizations that are described in section 501(c)(3) and exempt from tax under section 501(a) or that have applied for exemption as an organization so described, present law (sec. 6104(c)) requires the Secretary to notify the appropriate State officer of (1) a refusal to recognize such organization as an organization described in section 501(c)(3), (2) a revocation of a section 501(c)(3) organization's tax-exempt status, and (3) the mailing of a notice of deficiency for any tax imposed under section 507, chapter 41, or chapter 42.[87] In addition, at the request of such appropriate State officer, the Secretary is required to make available for inspection and copying, such returns, filed statements, records, reports, and other information relating to the above-described disclosures, as are relevant to any State law determination. An appropriate State officer is the State attorney general, State tax officer, or any

[85] Internal Revenue Service, Information Release IR–2002–121 (November 13, 2002).
[86] Id.
[87] The applicable taxes include the termination tax on private foundations; taxes on public charities for certain excess lobbying expenses; taxes on a private foundation's net investment income, self-dealing activities, undistributed income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures (some of these taxes also apply to certain non-exempt trusts); taxes on the political expenditures and excess benefit transactions of section 501(c)(3) organizations; and certain taxes on black lung benefit trusts and foreign organizations.

State official charged with overseeing organizations of the type described in section 501(c)(3).

In general, return and return information (as such terms are defined in sec. 6103(b)) is confidential and may not be disclosed or inspected unless expressly provided by law.[88] Present law requires the Secretary to keep records of disclosures and requests for inspection[89] and requires that persons authorized to receive return and return information maintain various safeguards to protect such information against unauthorized disclosure.[90] Willful unauthorized disclosure or inspection of return or return information is subject to a fine and/or imprisonment.[91] The knowing or negligent unauthorized inspection or disclosure of returns or return information gives the taxpayer a right to bring a civil suit.[92] Such present-law protections against unauthorized disclosure or inspection of return and return information do not apply to the disclosures or inspections, described above, that are authorized by section 6104(c).

REASONS FOR CHANGE

The Committee believes that State officials that are charged with oversight of certain organizations described in section 501(c) have an important and legitimate interest in receiving certain information about such organizations' tax-exempt status and tax filings, in some cases before the IRS has made a final determination with respect to an organization's tax-exempt status or liability for tax. By providing appropriate State officials with earlier access to information about the activities of certain section 501(c) organizations, State officials will be able to monitor such organizations more effectively and better protect the public's interest in assuring that organizations that have been given the benefit of tax-exemption operate consistently with their exempt purposes.[93]

The Committee stresses the importance of maintaining the confidentiality of taxpayer return and return information and believes it is important to extend existing protections against unauthorized disclosure or inspection of return and return information to disclosures made or inspections allowed by the Secretary of return and return information regarding such section 501(c) organizations.

EXPLANATION OF PROVISION

The provision provides that upon written request by an appropriate State officer, the Secretary may disclose: (1) a notice of proposed refusal to recognize an organization as a section 501(c)(3) organization; (2) a notice of proposed revocation of tax-exemption of a section 501(c)(3) organization; (3) the issuance of a proposed deficiency of tax imposed under section 507, chapter 41, or chapter 42; (4) the names, addresses, and taxpayer identification numbers of organizations that have applied for recognition as section 501(c)(3)

[88] Sec. 6103(a).
[89] Sec. 6103(p)(3).
[90] Sec. 6103(p)(4).
[91] Secs. 7213 and 7213A.
[92] Sec. 7431.
[93] The staff of the Joint Committee on Taxation recommended the adoption of a similar provision. Joint Committee on Taxation, Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Volume II: Study of Disclosure Provisions Relating to Tax-Exempt Organizations (JCS–1–00), January 28, 2000 at 101–105.

organizations; and (5) returns and return information of organizations with respect to which information has been disclosed under (1) through (4) above.[94] Disclosure or inspection is permitted for the purpose of, and only to the extent necessary in, the administration of State laws regulating section 501(c)(3) organizations, such as laws regulating tax-exempt status, charitable trusts, charitable solicitation, and fraud. Disclosure or inspection may be made only to or by designated representatives of the appropriate State officer, which does not include any contractor or agent. The Secretary also is permitted to disclose or open to inspection the return and return information of an organization that is recognized as tax-exempt under section 501(c)(3), or that has applied for such recognition, to an appropriate State officer if the Secretary determines that disclosure or inspection may facilitate the resolution of Federal or State issues relating to the tax-exempt status of the organization. For this purpose, appropriate State officer means the State attorney general or any other State official charged with overseeing organizations of the type described in section 501(c)(3).

In addition, the provision provides that upon the written request by an appropriate State officer, the Secretary may make available for inspection or disclosure returns and return information of an organization described in section 501(c)(2) (certain title holding companies), 501(c)(4) (certain social welfare organizations), 501(c)(6) (certain business leagues and similar organizations), 501(c)(7) (certain recreational clubs), 501(c)(8) (certain fraternal organizations), 501(c)(10) (certain domestic fraternal organizations operating under the lodge system), and 501(c)(13) (certain cemetery companies). Such return and return information is available for inspection or disclosure only for the purpose of, and to the extent necessary in, the administration of State laws regulating the solicitation or administration of the charitable funds or charitable assets of such organizations. Disclosure or inspection may be made only to or by designated representatives of the appropriate State officer, which does not include any contractor or agent. For this purpose, appropriate State officer means the State attorney general and the head of an agency designated by the State attorney general as having primary responsibility for overseeing the solicitation of funds for charitable purposes of such organizations.

In addition, the provision provides that any return and return information disclosed under section 6104(c) may be disclosed in civil administrative and civil judicial proceedings pertaining to the enforcement of State laws regulating the applicable tax-exempt organization in a manner prescribed by the Secretary. Returns and return information are not to be disclosed under section 6104(c), or in such an administrative or judicial proceeding, to the extent that the Secretary determines that such disclosure would seriously impair Federal tax administration. The provision makes disclosures of returns and return information under section 6104(c) subject to the disclosure, recordkeeping, and safeguard provisions of section 6103, including the requirements that such information remain confidential (sec. 6103(a)(2)), that the Secretary maintain a permanent system of records of requests for disclosure (sec. 6103(p)(3)), and that

[94] Such returns and return information also may be open to inspection by an appropriate State officer.

the appropriate State officer maintain various safeguards that protect against unauthorized disclosure (sec. 6103(p)(4)). The provision provides that the willful unauthorized disclosure of returns or return information described in section 6104(c) is a felony subject to a fine of up to $5,000 and/or imprisonment of up to five years (sec. 7213(a)(2)), the willful unauthorized inspection of returns or return information described in section 6104(c) is subject to a fine of up to $1,000 and/or imprisonment of up to one year (sec. 7213A), and provides the taxpayer the right to bring a civil action for damages in the case of knowing or negligent unauthorized disclosure or inspection of such information (sec. 7431(a)(2)).

EFFECTIVE DATE

The provision is effective on the date of enactment but does not apply to requests made before such date.

K. Treatment of Public Records

(Sec. 411 of the bill and sec. 6103 of the Code)

PRESENT LAW

Section 6103 provides that "returns and return information shall be confidential and except as authorized by this title * * * [none of the identified persons] shall disclose any return or return information obtained by him * * *"[95] A taxpayer can sue the United States government for the unauthorized disclosure and/or inspection of returns and return information.[96] Section 6103 does not expressly address the disclosure of returns and return information made a part of the public record.

Returns and return information become part of the public record in many ways. For example, returns and return information introduced in judicial proceedings constitutes publicly available court records.[97] As another example, notices of Federal tax lien filed with the county recorder alert the public of the IRS's interest in a taxpayer's property.[98]

The courts are divided on whether section 6103 applies to publicly disclosed returns and return information. Some courts have strictly interpreted section 6103, applying it despite the information's public availability. Other courts have found that returns and return information found in the public record loses its confidential status so that a person disclosing it does not violate section 6103. Still other courts have looked to the source of the information being disclosed. These courts find that section 6103 does not protect returns and return information taken directly from a public source, while information taken directly from IRS records remains protected.

REASONS FOR CHANGE

The Committee believes that Congress sought to prohibit only the disclosure of confidential tax return information. Once tax return information is made a part of the public domain, the taxpayer

[95] Sec. 6103(a).
[96] Sec. 7431.
[97] See, e.g., sec. 7461 regarding the publicity of U.S. Tax Court proceedings.
[98] See sec. 6323(f) regarding where to file notices of Federal tax lien.

may no longer claim a right of privacy in that information. The Committee believes that, in general, it is inappropriate to treat information that has properly been made part of the public record as continuing to be subject to the general rules of confidentiality contained in the Code.

EXPLANATION OF PROVISION

Under the provision, the general confidentiality restrictions do not apply to returns and return information disclosed: (1) in the course of any judicial or administrative proceeding or pursuant to tax administration activities, and (2) properly made part of the public record. In a situation in which a third-party is seeking to have the IRS divulge information that would otherwise be protected by section 6103, the Committee expects the third party to initially point to specific information in the public record that appears to duplicate that being withheld. For example, if a third party makes a Freedom of Information Act request for a record that is contained both in a publicly available court file and also in an IRS administrative file, the requester would need to provide to the IRS evidence that the information sought from the IRS is also in the court file.

EFFECTIVE DATE

The provision is effective before, on, and after the date of enactment.

L. Employee Identity Disclosures

(Sec. 412 of the bill and sec. 6103 of the Code)

PRESENT LAW

In such manner as prescribed by regulation, IRS and Treasury Inspector General for Tax Administration personnel may disclose return information in connection with their official duties relating to any audit, collection activity, or civil or criminal tax investigation, or any offense under the internal revenue laws.[99] Such disclosure may only be made to the extent necessary in obtaining information not otherwise reasonably available with respect to the correct determination of tax, liability for tax, or the amount collected or with respect to the enforcement of any other provision of the Code.

IRS special agents are investigating agents of the IRS Criminal Investigation ("CI"). These agents investigate tax crimes. In unauthorized disclosure litigation, taxpayers have asserted that CI special agents, by various means, wrongfully disclosed the criminal nature of the investigation of the taxpayers in the course of conducting third party witness interviews or inquiries.[100] For example, in *Gandy* v. *United States*,[101] the court held that a special agent made an unauthorized disclosure of return information when the

[99] Sec. 6103(k)(6).

[100] See, e.g., *Comyns* v. *United States*, 155 F. Supp. 2d 1344 (S.D. Fla. 2001), aff'd, 287 F.3d 1034 (11th Cir. 2002); *Payne* v. *United States*, 91 F. Supp. 2d 1014 (S.D. Tex. 1999), rev'd, 289 F.3d 377 (5th Cir. 2002); *Gandy* v. *United States*, 99–1 U.S. Tax Cas. (CCH) 50,237 (E.D. Tex. 1999), aff'd, 234 F.3d 281 (5th Cir. 2000); *Rhodes* v. *United States*, 903 F. Supp. 819 (M.D. Pa. 1995); *Diamond* v. *United States*, 944 F.2d 431 (8th Cir. 1991).

[101] 243 F.3d 281 (2000).

agent identified himself as such during interviews of third parties. The court found that the agent by identifying himself disclosed the fact of a criminal investigation. The fact of a criminal investigation is return information protected by section 6103 and the court found that such disclosure was not necessary to obtain information from the third parties.

On July 10, 2003, the Department of Treasury issued temporary regulations, effective on that date, which allow internal revenue employees to identify themselves and their organizational affiliation, and the nature of their investigation when making contact with a third party witness:

> (3) Internal revenue and [Treasury Inspector General for Tax Administration ("TIGTA")] employees may identify themselves, their organizational affiliation with the Internal Revenue Service (IRS) (e.g., Criminal Investigation (CI)) or TIGTA (e.g., Office of Investigations (OI)), and the nature of their investigation, when making an oral, written, or electronic contact with a third party witness through the use and presentation of any identification media (including, but not limited to, an IRS or TIGTA badge, credential, or business card) or through the use of an information document request, summons, or correspondence on IRS or TIGTA letterhead or which bears a return address or signature block that reveals affiliation with the IRS or TIGTA.[102]

REASONS FOR CHANGE

Department of Treasury agents are specifically authorized[103] to disclose return information to the extent necessary to gather data that may be relevant to an investigation. Situations in which special agents may have to make such disclosures in order to perform their duties arise on a daily basis. For example, this occurs whenever they contact third parties believed to have information pertinent to a tax investigation. The Committee believes that it is appropriate to permit Department of Treasury agents (in connection with their official duties) to disclose return information to the extent necessary to obtain information relating to such official duties or to properly accomplish any activity connected with such official duties.

EXPLANATION OF PROVISION

The provision amends section 6103 to provide that nothing in section 6103 may be construed to prohibit agents of the Department of Treasury from identifying themselves, their organizational affiliation, and the nature of an investigation when contacting third parties in writing or in person.

EFFECTIVE DATE

The provision is effective on the date of enactment.

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[102] Treas. Reg. sec. 301.6103(k)(6)–1T(a)(3). It is not clear whether the regulations permit an IRS employee to disclose their organizational affiliation orally, for example, as part of a telephone conversation.

[103] Sec. 6103(k)(6).

M. Taxpayer Identification Number Matching

(Sec. 413 of the bill and sec. 6103 of the Code)

PRESENT LAW

A taxpayer identification number (TIN) is an identification number used by the IRS for purposes of tax administration. A TIN must be furnished on all returns, statements, or other tax related documents.[104] The Code imposes information reporting requirements upon payors of income. The Code provides that a person (the payor) required to make a return with respect to another person (the payee) must ask the payee for the identifying number prescribed for securing the proper identification of the payee and include that number in the return.[105] Typically, if there is an error with the name/TIN combination furnished by the payee, the disclosure of such error to the payor is permitted when the reportable payment is already subject to backup withholding.[106]

REASONS FOR CHANGE

The Committee is concerned with the number of information returns that the IRS receives each year containing missing or incorrect name and TIN information. Therefore, the Committee believes that compliance will be greatly enhanced if payors have the ability to verify with the IRS payee TINs prior to filing information returns for reportable payments on behalf of such payees.

EXPLANATION OF PROVISION

The provision permits the IRS to disclose to any person required to provide a taxpayer identifying number to the IRS whether such information matches records maintained by the IRS. This will allow a payor to verify the TIN furnished by a payee prior to filing information returns for reportable payments on behalf of the payee. Under the provision, the IRS informs the payor whether there is an error with the name/TIN combination furnished by the payee. The verification is limited to whether the information provided by the payor matches the records of the IRS. The IRS will not disclose correct TINs if an error arises, as it will be the responsibility of the payor to obtain the correct TIN from the payee.

EFFECTIVE DATE

The provision is effective on the date of enactment.

N. Form 8300 Disclosures

(Sec. 414 of the bill and sec. 6103 of the Code)

PRESENT LAW

Under the Code, any person engaged in a trade or business who receives more than $10,000 in cash in one transaction (or in two or more related transactions) is required to report the receipt of cash to the IRS and the Financial Crimes Enforcement Network (FinCEN) on Form 8300 (Report of Cash Payments Over $10,000

[104] Sec. 6109(a)(1).
[105] Sec. 6109(a)(3).
[106] Sec. 3406.

Received in a Trade or Business).[107] Any Federal agency, State or local government agency, or foreign government agency may have access, upon written request, to the information contained in returns filed under section 6050I. The Code provides that disclosures of information from Form 8300 be made on the same basis and subject to the same conditions as apply to disclosures of information filed on Currency Transaction Reports under the Bank Secrecy Act.[108] This provision however, cannot be used to obtain disclosures for tax administration purposes. The general safeguard requirements of the Code apply to such disclosures.[109] For example, as a condition of disclosure, requesting agencies must file with the IRS a report describing the procedures established and utilized by the agency for ensuring the confidentiality of return information.

REASONS FOR CHANGE

Form 8300 is similar to a Currency Transaction Report, which is required to be filed by financial institutions in connection with currency transactions of more than $10,000. Both Form 8300 and Currency Transaction Reports are filed with the IRS; however, Title 31 governs Currency Transaction Reports. The USA Patriot Act (Pub. L. No. 107–56) imposed a duplicate reporting requirement for Form 8300 information under Title 31 of the U.S. Code, in part to facilitate law enforcement's access to such information. The Code's safeguard requirements for return information were perceived to be cumbersome in comparison to the disclosure rules imposed on similar information governed by Title 31, such as Currency Transaction Reports. Because the Code envisions that Form 8300 information will be disclosed on the same basis and subject to the same conditions as Currency Transaction Reports, and a duplicate report of the same information is required under Title 31, the Committee believes it is appropriate to conform treatment and remove the specific Title 26 safeguards with respect to these information reports.

EXPLANATION OF PROVISION

The provision repeals the safeguard requirements applicable to the disclosure of returns filed reflecting cash receipts of more than $10,000 received in a trade or business.

EFFECTIVE DATE

The provision is effective on the date of enactment.

O. Disclosure to Law Enforcement Agencies Regarding Terrorist Activities

(Sec. 415 of the bill and sec. 6103 of the Code)

PRESENT LAW

Return information includes a taxpayer's identity.[110] The IRS may disclose return information, other than taxpayer return information, to officers and employees of Federal law enforcement upon a written request. The request must be made by the head of the

[107] Sec. 6050I and 31 U.S.C. sec. 5331.
[108] 31 U.S.C. sec. 5313.
[109] Sec. 6103(p)(4).
[110] Sec. 6103(b)(2)(A).

Federal law enforcement agency (or his delegate) involved in the response to or investigation of terrorist incidents, threats, or activities, and set forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity. The information is to be disclosed to officers and employees of the Federal law enforcement agency who would be personally and directly involved in the response to or investigation of terrorist incidents, threats, or activities. The information is to be used by such officers and employees solely for such response or investigation.[111]

The Federal law enforcement agency may redisclose the information to officers and employees of State and local law enforcement personally and directly engaged in the response to or investigation of the terrorist incident, threat, or activity. The State or local law enforcement agency must be part of an investigative or response team with the Federal law enforcement agency for these disclosures to be made.[112] No disclosures may be made under this provision after December 31, 2003.

If a taxpayer's identity is taken from a return or other information filed with or furnished to the IRS by or on behalf of the taxpayer, it is taxpayer return information. Since taxpayer return information is not covered by this disclosure authorization, taxpayer identity so obtained cannot be disclosed and thus associated with the other information being provided.

REASONS FOR CHANGE

The Committee understands the importance of law enforcement efforts investigating terrorist activities. Therefore, the Committee believes that it is appropriate for the IRS to disclose to officers and employees of a Federal law enforcement agency a taxpayer's identity to the extent necessary to assist in the investigation of terrorist incidents, threats, or activities.

EXPLANATION OF PROVISION

The provision makes a technical change to clarify that a taxpayer's identity is not treated as taxpayer return information for purposes of disclosures to law enforcement agencies regarding terrorist activities.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE V.—SIMPLIFICATION

A. Establish Uniform Definition of a Qualifying Child

(Secs. 501 through 508 of the bill and secs. 2, 21, 24, 32, 151, and 152 of the Code)

PRESENT LAW

In general

Present law contains five commonly used provisions that provide benefits to taxpayers with children: (1) the dependency exemption;

[111] Sec. 6103(i)(7)(A).
[112] Sec. 6103(i)(7)(A)(ii).

(2) the child credit; (3) the earned income credit; (4) the dependent care credit; and (5) head of household filing status. Each provision has separate criteria for determining whether the taxpayer qualifies for the applicable tax benefit with respect to a particular child. The separate criteria include factors such as the relationship (if any) the child must bear to the taxpayer, the age of the child, and whether the child must live with the taxpayer. Thus, a taxpayer is required to apply different definitions to the same individual when determining eligibility for these provisions, and an individual who qualifies a taxpayer for one provision does not automatically qualify the taxpayer for another provision.

Dependency exemption [113]

In general

Taxpayers are entitled to a personal exemption deduction for the taxpayer, his or her spouse, and each dependent. For 2003, the amount deductible for each personal exemption is $3,050. The deduction for personal exemptions is phased out for taxpayers with incomes above certain thresholds.[114]

In general, a taxpayer is entitled to a dependency exemption for an individual if the individual: (1) satisfies a relationship test or is a member of the taxpayer's household for the entire taxable year; (2) satisfies a support test; (3) satisfies a gross income test or is a child of the taxpayer under a certain age; (4) is a citizen or resident of the U.S. or resident of Canada or Mexico;[115] and (5) did not file a joint return with his or her spouse for the year.[116] In addition, the taxpayer identification number of the individual must be included on the taxpayer's return.

Relationship or member of household test

Relationship test.—The relationship test is satisfied if an individual is the taxpayer's (1) son or daughter or a descendant of either (e.g., grandchild or great-grandchild); (2) stepson or stepdaughter; (3) brother or sister (including half brother, half sister, stepbrother, or stepsister); (4) parent, grandparent, or other direct ancestor (but not foster parent); (5) stepfather or stepmother; (6) brother or sister of the taxpayer's father or mother; (7) son or daughter of the taxpayer's brother or sister; or (8) the taxpayer's father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law.

An adopted child (or a child who is a member of the taxpayer's household and who has been placed with the taxpayer for adoption)

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[113] Secs. 151 and 152. Under the statutory structure, section 151 provides for the deduction for personal exemptions with respect to "dependents." The term "dependent" is defined in section 152. Most of the requirements regarding dependents are contained in section 152; section 151 contains additional requirements that must be satisfied in order to obtain a dependency exemption with respect to a dependent (as so defined). In particular, section 151 contains the gross income test, the rules relating to married dependents filing a joint return, and the requirement for a taxpayer identification number. The other rules discussed here are contained in section 151.

[114] Sec. 151(d)(3).

[115] A legally adopted child who does not satisfy the residency or citizenship requirement may nevertheless qualify as a dependent (provided other applicable requirements are met) if (1) the child's principal place of abode is the taxpayer's home and (2) the taxpayer is a citizen or national of the United States. Sec. 152(b)(3).

[116] This restriction does not apply if the return was filed solely to obtain a refund and no tax liability would exist for either spouse if they filed separate returns. Rev. Rul. 54–567, 1954–2 C.B. 108.

is treated as a child of the taxpayer. A foster child is treated as a child of the taxpayer if the foster child is a member of the taxpayer's household for the entire taxable year.

Member of household test.—If the relationship test is not satisfied, then the individual may be considered the dependent of the taxpayer if the individual is a member of the taxpayer's household for the entire year. Thus, a taxpayer may be eligible to claim a dependency exemption with respect to an unrelated child who lives with the taxpayer for the entire year.

For the member of household test to be satisfied, the taxpayer must both maintain the household and occupy the household with the individual.[117] A taxpayer or other individual does not fail to be considered a member of a household because of "temporary" absences due to special circumstances, including absences due to illness, education, business, vacation, and military service.[118] Similarly, an individual does not fail to be considered a member of the taxpayer's household due to a custody agreement under which the individual is absent for less than six months.[119] Indefinite absences that last for more than the taxable year may be considered "temporary." For example, the IRS has ruled that an elderly woman who was indefinitely confined to a nursing home was temporarily absent from a taxpayer's household. Under the facts of the ruling, the woman had been an occupant of the household before being confined to a nursing home, the confinement had extended for several years, and it was possible that the woman would die before becoming well enough to return to the taxpayer's household. There was no intent on the part of the taxpayer or the woman to change her principal place of abode.[120]

Support test

In general.—The support test is satisfied if the taxpayer provides over one half of the support of the individual for the taxable year. To determine whether a taxpayer has provided more than one half of an individual's support, the amount the taxpayer contributed to the individual's support is compared with the entire amount of support the individual received from all sources, including the individual's own funds.[121] Governmental payments and subsidies (e.g., Temporary Assistance to Needy Families, food stamps, and housing) generally are treated as support provided by a third party. Expenses that are not directly related to any one member of a household, such as the cost of food for the household, must be divided among the members of the household. If any person furnishes support in kind (e.g., in the form of housing), then the fair market value of that support must be determined.

Multiple support agreements.—In some cases, no one taxpayer provides more than one half of the support of a individual. Instead, two or more taxpayers, each of whom would be able to claim a dependency exemption but for the support test, together provide more than one half of the individual's support. If this occurs, the taxpayers may agree to designate that one of the taxpayers who indi-

[117] Treas. Reg. sec. 1.152–1(b).
[118] Id.
[119] Id.
[120] Rev. Rul. 66–28, 1966–1 C.B. 31.
[121] In the case of a son, daughter, stepson, or stepdaughter of the taxpayer who is a full-time student, scholarships are not taken into account for purpose of the support test. Sec. 152(d).

vidually provides more than 10 percent of the individual's support can claim a dependency exemption for the child. Each of the others must sign a written statement agreeing not to claim the exemption for that year. The statements must be filed with the income tax return of the taxpayer who claims the exemption.

Special rules for divorced or legally separated parents.—Special rules apply in the case of a child of divorced or legally separated parents (or parents who live apart at all times during the last six months of the year) who provide over one half the child's support during the calendar year.[122] If such a child is in the custody of one or both of the parents for more than one half of the year, then the parent having custody for the greater portion of the year is deemed to satisfy the support test; however, the custodial parent may release the dependency exemption to the noncustodial parent by filing a written declaration with the IRS.[123]

Gross income test

In general, an individual may not be claimed as a dependent of a taxpayer if the individual has gross income that is at least equal to the personal exemption amount for the taxable year.[124] If the individual is the child of the taxpayer and under age 19 (or under age 24, if a full-time student), the gross income test does not apply.[125] For purposes of this rule, a "child" means a son, daughter, stepson, or stepdaughter (including an adopted child of the taxpayer, a foster child who resides with the taxpayer for the entire year, or a child placed with the taxpayer for adoption by an authorized adoption agency).

Earned income credit [126]

In general

In general, the earned income credit is a refundable credit for low-income workers. The amount of the credit depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no "qualifying children." In order to be a qualifying child for the earned income credit, an individual must satisfy a relationship test, a residency test, and an age test. In addition, the name, age, and taxpayer identification number of the qualifying child must be included on the return.

Relationship test

An individual satisfies the relationship test under the earned income credit if the individual is the taxpayer's: (1) son, daughter, stepson, or stepdaughter, or a descendant of any such individual;[127] (2) brother, sister, stepbrother, or stepsister, or a descendant of any such individual, who the taxpayer cares for as the taxpayer's own child; or (3) eligible foster child. An eligible foster

[122] For purposes of this rule, a "child" means a son, daughter, stepson, or stepdaughter (including an adopted child or foster child, or child placed with the taxpayer for adoption). Sec. 152(e)(1)(A).

[123] Special support rules also apply in the case of certain pre-1985 agreements between divorced or legally separated parents. Sec. 152(e)(4).

[124] Certain income from sheltered workshops is not taken into account in determining the gross income of permanently and totally disabled individuals. Sec. 151(c)(5).

[125] Sec. 151(c).

[126] Sec. 32.

[127] A child who is legally adopted or placed with the taxpayer for adoption by an authorized adoption agency is treated as the taxpayer's own child. Sec. 32(c)(3)(B)(iv).

child is an individual (1) who is placed with the taxpayer by an authorized placement agency, and (2) who the taxpayer cares for as her or his own child. A married child of the taxpayer is not treated as meeting the relationship test unless the taxpayer is entitled to a dependency exemption with respect to the married child (e.g., the support test is satisfied) or would be entitled to the exemption if the taxpayer had not waived the exemption to the noncustodial parent.[128]

Residency test

The residency test is satisfied if the individual has the same principal place of abode as the taxpayer for more than one half of the taxable year. The residence must be in the United States.[129] As under the dependency exemption (and head of household filing status), temporary absences due to special circumstances, including absences due to illness, education, business, vacation, and military service are not treated as absences for purposes of determining whether the residency test is satisfied.[130] Under the earned income credit, there is no requirement that the taxpayer maintain the household in which the taxpayer and the qualifying individual reside.

Age test

In general, the age test is satisfied if the individual has not attained age 19 as of the close of the calendar year. In the case of a full-time student, the age test is satisfied if the individual has not attained age 24 as of the close of the calendar year. In the case of an individual who is permanently and totally disabled, no age limit applies.

Child credit [131]

Taxpayers with incomes below certain amounts are eligible for a child credit for each qualifying child of the taxpayer. The amount of the child credit is up to $600, in the case of taxable years beginning in 2003 or 2004. The child credit increases to $700 for taxable years beginning in 2005 through 2008, $800 for taxable years beginning in 2009, and $1,000 for taxable years beginning in 2010. The credit declines to $500 in taxable year 2011.[132] For purposes of this credit, a qualifying child is an individual: (1) with respect to whom the taxpayer is entitled to a dependency exemption for the year; (2) who satisfies the same relationship test applicable to the earned income credit; and (3) who has not attained age 17 as of the close of the calendar year. In addition, the child must be a citizen

[128] Sec. 32(c)(3)(B)(ii).

[129] The principal place of abode of a member of the Armed Services is treated as in the United States during any period during which the individual is stationed outside the United States on active duty. Sec. 32(c)(4).

[130] IRS Publication 596, Earned Income Credit (EIC), at 13. H. Rep. 101–964 (October 27, 1990), at 1037.

[131] Sec. 24.

[132] Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), Pub. L. No. 107–16, sec. 901(a) (2001) (making, by way of the EGTRRA sunset provision, the increase in the child credit inapplicable to taxable years beginning after December 31, 2010).

or resident of the United States.[133] A portion of the child credit is refundable under certain circumstances.[134]

Dependent care credit [135]

The dependent care credit may be claimed by a taxpayer who maintains a household that includes one or more qualifying individuals and who has employment-related expenses. A qualifying individual means (1) a dependent of the taxpayer under age 13 for whom the taxpayer is entitled to a dependency exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself,[136] or (3) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself. In addition, a taxpayer identification number for the qualifying individual must be included on the return.

A taxpayer is considered to maintain a household for a period if over one half the cost of maintaining the household for the period is furnished by the taxpayer (or, if married, the taxpayer and his or her spouse). Costs of maintaining the household include expenses such as rent, mortgage interest (but not principal), real estate taxes, insurance on the home, repairs (but not home improvements), utilities, and food eaten in the home.

A special rule applies in the case of a child who is under age 13 or is physically or mentally incapable of caring for himself or herself if the custodial parent has waived his or her dependency exemption to the noncustodial parent.[137] For the dependent care credit, the child is treated as a qualifying individual with respect to the custodial parent, not the parent entitled to claim the dependency exemption.

Head of household filing status [138]

A taxpayer may claim head of household filing status if the taxpayer is unmarried (and not a surviving spouse) and pays more than one half of the cost of maintaining as his or her home a household which is the principal place of abode for more than one half of the year of (1) an unmarried son, daughter, stepson or stepdaughter of the taxpayer or an unmarried descendant of the taxpayer's son or daughter, (2) an individual described in (1) who is married, if the taxpayer may claim a dependency exemption with respect to the individual (or could claim the exemption if the taxpayer had not waived the exemption to the noncustodial parent), or (3) a relative with respect to whom the taxpayer may claim a

[133] The child credit does not apply with respect to a child who is a resident of Canada or Mexico and is not a U.S. citizen, even if a dependency exemption is available with respect to the child. Sec. 24(c)(2). The child credit is, however, available with respect to a child dependent who is not a resident or citizen of the United States if: (1) the child has been legally adopted by the taxpayer; (2) the child's principal place of abode is the taxpayer's home; and (3) the taxpayer is a U.S. citizen or national. See sec. 24(c)(2) and sec. 152(b)(3).

[134] Sec. 24(d).

[135] Sec. 21.

[136] Although such an individual must be a dependent of the taxpayer as defined in section 152, it is not required that the taxpayer be entitled to a dependency exemption with respect to the individual under section 151. Thus, such an individual may be a qualifying individual for purposes of the dependent care credit, even though the taxpayer is not entitled to a dependency exemption because the individual does not meet the gross income test.

[137] Sec. 21(e)(5).

[138] Sec. 2(b).

dependency exemption.[139] If certain other requirements are satisfied, head of household filing status also may be claimed if the taxpayer is entitled to a dependency exemption with respect to one of the taxpayer's parents.

REASONS FOR CHANGE

Present law contains five commonly used provisions that provide benefits to taxpayers with children: (1) the dependency exemption; (2) the child credit; (3) the earned income credit; (4) the dependent care credit; and (5) head of household filing status. Each provision has separate criteria for determining whether the taxpayer qualifies for the applicable tax benefit with respect to a particular child. The separate criteria include factors such as the relationship (if any) the child must bear to the taxpayer, the age of the child, and whether the child must live with the taxpayer. Thus, a taxpayer is required to apply different definitions to the same individual when determining eligibility for these provisions, and an individual who qualifies a taxpayer for one provision does not automatically qualify the taxpayer for another provision. The use of different tests to determine whether a taxpayer may claim one or more of these tax benefits with respect to a child causes complexity for taxpayers and the IRS. The different tests relating to qualifying children are a source of errors for taxpayers both because the rules for each provision are different and because of the complexity of particular rules. The variety of rules cause taxpayers inadvertently to claim tax benefits for which they do not qualify, as well as to fail to claim tax benefits for which they do qualify. Adopting a uniform definition of qualifying child for five commonly used provisions (the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status) would achieve simplification by making it easier for taxpayers to determine whether they qualify for the various tax benefits relating to children, would reduce inadvertent taxpayer errors arising from confusion due to differing rules, and would make the applicable provisions easier for the IRS to administer.

EXPLANATION OF PROVISION

General description of provision

In general

The provision establishes a uniform definition of qualifying child for purposes of the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. A taxpayer generally may claim an individual who does not meet the uniform definition of qualifying child (with respect to any taxpayer) as a dependent if the present-law dependency requirements are satisfied. The provision generally does not modify other parameters of each tax benefit (e.g., the earned income requirements of the earned income credit) or the rules for determining whether individuals other than children qualify for each tax benefit.

[139] Sec. 2(b)(1)(A)(ii), as qualified by sec. 2(b)(3)(B). An individual for whom the taxpayer is entitled to claim a dependency exemption by reason of a multiple support agreement does not qualify the taxpayer for head of household filing status.

Under the uniform definition, in general, a child is a qualifying child of a taxpayer if the child satisfies each of three tests: (1) the child has the same principal place of abode as the taxpayer for more than one half the taxable year; (2) the child has a specified relationship to the taxpayer; and (3) the child has not yet attained a specified age. A tie-breaking rule applies if more than one taxpayer claims a child as a qualifying child.

Under the provision, the present-law support and gross income tests for determining whether an individual is a dependent generally do not apply to a child who meets the requirements of the uniform definition of qualifying child.

Residency test

Under the uniform definition's residency test, a child must have the same principal place of abode as the taxpayer for more than one half of the taxable year. It is intended that, as is the case under present law, temporary absences due to special circumstances, including absences due to illness, education, business, vacation, or military service, would not be treated as absences.

Relationship test

In order to be a qualifying child under the provision, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any such individual. A legally adopted individual of the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer, is treated as a child of such taxpayer by blood. A foster child who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction is treated as the taxpayer's child.[140]

Age test

Under the provision, the age test varies depending upon the tax benefit involved. In general, a child must be under age 19 (or under age 24 in the case of a full-time student) in order to be a qualifying child.[141] In general, no age limit applies with respect to individuals who are totally and permanently disabled within the meaning of section 22(e)(3) at any time during the calendar year. The provision retains the present-law requirements that a child must be under age 13 (if he or she is not disabled) for purposes of the dependent care credit, and under age 17 (whether or not disabled) for purposes of the child credit.

Children who support themselves

Under the provision, a child who provides over one half of his or her own support generally is not considered a qualifying child of another taxpayer. The provision retains the present-law rule, however, that a child who provides over one half of his or her own support may constitute a qualifying child of another taxpayer for purposes of the earned income credit.

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[140] The provision eliminates the present-law rule requiring that if a child is the taxpayer's sibling or stepsibling or a descendant of any such individual, the taxpayer must care for the child as if the child were his or her own child.

[141] The provision retains the present-law definition of full-time student set forth in section 151(c)(4).

Tie-breaking rules

If a child would be a qualifying child with respect to more than one individual (e.g., a child lives with his or her mother and grandmother in the same residence) and more than one person claims a benefit with respect to that child, then the following "tie-breaking" rules apply. First, if only one of the individuals claiming the child as a qualifying child is the child's parent, the child is deemed the qualifying child of the parent. Second, if both parents claim the child and the parents do not file a joint return, then the child is deemed a qualifying child first with respect to the parent with whom the child resides for the longest period of time, and second with respect to the parent with the highest adjusted gross income. Third, if the child's parents do not claim the child, then the child is deemed a qualifying child with respect to the claimant with the highest adjusted gross income.

Interaction with present-law rules

Taxpayers generally may claim an individual who does not meet the uniform definition of qualifying child with respect to any taxpayer as a dependent if the present-law dependency requirements (including the gross income and support tests) are satisfied.[142] Thus, for example, a taxpayer may claim a parent as a dependent if the taxpayer provides more than one half of the support of the parent and the parent's gross income is less than the exemption amount.

Children who are U.S. citizens living abroad or non-U.S. citizens living in Canada or Mexico may qualify as a qualifying child, as is the case under the present-law dependency tests. A legally adopted child who does not satisfy the residency or citizenship requirement may nevertheless qualify as a qualifying child (provided other applicable requirements are met) if (1) the child's principal place of abode is the taxpayer's home and (2) the taxpayer is a citizen or national of the United States.

Children of divorced or legally separated parents

The provision generally retains the present-law rule that allows a custodial parent to release the claim to a dependency exemption and the child credit to a noncustodial parent. Thus, the provision generally grandfathers those custodial waivers that are in place and effective on the date of enactment, and generally retains the custodial waiver rule for purposes of the dependency exemption and the child credit for decrees of divorce or separate maintenance or written separation agreements that become effective after the date of enactment. Under the provision, the custodial waiver rules do not affect eligibility with respect to children of divorced or legally separated parents for purposes of the earned income credit, the dependent care credit, and head of household filing status.

Other provisions

The provision retains the applicable present-law requirements that a taxpayer identification number for a child be provided on the taxpayer's return. For purposes of the earned income credit, a

[142] Individuals who satisfy the present-law dependency tests and who are not qualifying children are referred to as "qualifying relatives" under the provision.

qualifying child is required to have a social security number that is valid for employment in the United States (that is, the child must be a U.S. citizen, permanent resident, or have a certain type of temporary visa).

Effect of provision on particular tax benefits

Dependency exemption

For purposes of the dependency exemption, the provision defines a dependent as a qualifying child or a qualifying relative. The qualifying child test eliminates the support test (other than in the case of a child who provides more than one half of his or her own support), and replaces it with the residency requirement described above. Further, the present-law gross income test does not apply to a qualifying child. The rules relating to multiple support agreements do not apply with respect to qualifying children because the support test does not apply to them. Special tie-breaking rules (described above) apply if more than one taxpayer claims a qualifying child under the provision. These tie-breaking rules do not apply if a child constitutes a qualifying child with respect to multiple taxpayers, but only one eligible taxpayer actually claims the qualifying child.

The provision generally permits taxpayers to continue to apply the present-law dependency exemption rules to claim a dependency exemption for a qualifying relative who does not satisfy the qualifying child definition. In such cases, the present-law gross income and support tests, including the special rules for multiple support agreements, the special rules relating to income of handicapped dependents, and the special support test in case of students, continue to apply for purposes of the dependency exemption.

As is the case under present law, a child who provides over half of his or her own support is not considered a dependent of another taxpayer under the provision. Further, an individual shall not be treated as a dependent of any taxpayer if such individual has filed a joint return with the individual's spouse for the taxable year.

Earned income credit

In general, the provision adopts a definition of qualifying child that is similar to the present-law definition under the earned income credit. The present-law requirement that a foster child and certain other children be cared for as the taxpayer's own child is eliminated. The present-law tie-breaker rule applicable to the earned income credit is used for purposes of the uniform definition of qualifying child. The provision retains the present-law requirement that the taxpayer's principal place of abode must be in the United States.

Child credit

The present-law child credit generally uses the same relationships to define an eligible child as the uniform definition. The present-law requirement that a foster child and certain other children be cared for as the taxpayer's own child is eliminated. The age limitation under the provision retains the present-law requirement that the child must be under age 17, regardless of whether the child is disabled.

Dependent care credit

The present-law requirement that a taxpayer maintain a household in order to claim the dependent care credit is eliminated. Thus, if other applicable requirements are satisfied, a taxpayer may claim the dependent care credit with respect to a child who lives with the taxpayer for more than one half the year, even if the taxpayer does not provide more than one half of the cost of maintaining the household.

The rules for determining eligibility for the credit with respect to an individual who is physically or mentally incapable of caring for himself or herself are amended to include a requirement that the taxpayer and the dependent have the same principal place of abode for more than one half the taxable year.

Head of household filing status

Under the provision, a taxpayer qualifies for head of household filing status with respect to a child who is a qualifying child as defined under the provision. An individual who is not a qualifying child will qualify the taxpayer for head of household status only if, as is the case under present law, the individual is a dependent of the taxpayer and the taxpayer is entitled to a dependency exemption for such individual, or the individual is the taxpayer's father or mother and certain other requirements are satisfied. Thus, under the provision a taxpayer is eligible for head of household filing status only with respect to a qualifying child or an individual for whom the taxpayer is entitled to a dependency exemption.

The provision retains the present-law requirement that the taxpayer provide over one half the cost of maintaining the household.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2004.

B. Simplification Through Elimination of Inoperative Provisions

(Sec. 511 of the bill)

PRESENT LAW

The Internal Revenue Code of 1986 contains provisions that are no longer used in computing current taxes or are little used or of minor importance. These provisions are popularly referred to as "deadwood".

REASONS FOR CHANGE

The provision simplifies the Code by deleting "deadwood" without making substantive changes in the tax law.

EXPLANATION OF PROVISION

The provision contains numerous amendments to the Code repealing obsolete provisions to the Internal Revenue Code of 1986. No substantive changes are intended by the amendments.

EFFECTIVE DATE

The provision takes effect on the date of enactment.

TITLE VI.—REVENUE RAISERS

A. Provisions Designed To Curtail Tax Shelters

1. Penalty for failing to disclose reportable transaction (Sec. 601 of the bill and sec. 6707A of the Code)

PRESENT LAW

Regulations under section 6011 require a taxpayer to disclose with its tax return certain information with respect to each "reportable transaction" in which the taxpayer participates.[143]

There are six categories of reportable transactions. The first category is any transaction that is the same as (or substantially similar to)[144] a transaction that is specified by the Treasury Department as a tax avoidance transaction whose tax benefits are subject to disallowance under present law (referred to as a "listed transaction").[145]

The second category is any transaction that is offered under conditions of confidentiality. In general, a transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid a minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies (irrespective if such terms are legally binding).[146]

The third category of reportable transactions is any transaction for which (1) the taxpayer has the right to a full or partial refund of fees if the intended tax consequences from the transaction are not sustained or, (2) the fees are contingent on the intended tax consequences from the transaction being sustained.[147]

The fourth category of reportable transactions relates to any transaction resulting in a taxpayer claiming a loss (under section 165) of at least (1) $10 million in any single year or $20 million in any combination of years by a corporate taxpayer or a partnership with only corporate partners; (2) $2 million in any single year or $4 million in any combination of years by all other partnerships, S corporations, trusts, and individuals; or (3) $50,000 in any single year for individuals or trusts if the loss arises with respect to foreign currency translation losses.[148]

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[143] On February 27, 2003, the Treasury Department and the IRS released final regulations regarding the disclosure of reportable transactions. In general, the regulations are effective for transactions entered into on or after February 28, 2003.

The discussion of present law refers to the new regulations. The rules that apply with respect to transactions entered into on or before February 28, 2003, are contained in Treas. Reg. sec. 1.6011–4T in effect on the date the transaction was entered into.

[144] The regulations clarify that the term "substantially similar" includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Further, the term must be broadly construed in favor of disclosure. Treas. Reg. sec. 1–6011–4(c)(4).

[145] Treas. Reg. sec. 1.6011–4(b)(2).

[146] Treas. Reg. sec. 1.6011–4(b)(3).

[147] Treas. Reg. sec. 1.6011–4(b)(4).

[148] Treas. Reg. sec. 1.6011–4(b)(5). IRS Rev. Proc. 2003–24, 2003–11 I.R.B. 599, exempts certain types of losses from this reportable transaction category.

The fifth category of reportable transactions refers to any transaction done by certain taxpayers[149] in which the tax treatment of the transaction differs (or is expected to differ) by more than $10 million from its treatment for book purposes (using generally accepted accounting principles) in any year.[150]

The final category of reportable transactions is any transaction that results in a tax credit exceeding $250,000 (including a foreign tax credit) if the taxpayer holds the underlying asset for less than 45 days.[151]

Under present law, there is no specific penalty for failing to disclose a reportable transaction; however, such a failure can jeopardize a taxpayer's ability to claim that any income tax understatement attributable to such undisclosed transaction is due to reasonable cause, and that the taxpayer acted in good faith.[152]

REASONS FOR CHANGE

The Committee is aware that individuals and corporations are increasingly using sophisticated transactions to avoid or evade Federal income tax.[153] Such a phenomenon could pose a serious threat to the efficacy of the tax system because of both the potential loss of revenue and the potential threat to the integrity of the self-assessment system.

The Committee over three years ago began working on legislation to address this significant compliance problem. In addition, the Treasury Department, using the tools available, issued regulations requiring disclosure of certain transactions and requiring organizers and promoters of tax-engineered transactions to maintain customer lists and make these lists available to the IRS. Nevertheless, the Committee believes that additional legislation is needed to provide the Treasury Department with additional tools to assist its efforts to curtail abusive transactions. Moreover, the Committee believes that a penalty for failing to make the required disclosures, when the imposition of such penalty is not dependent on the tax treatment of the underlying transaction ultimately being sustained, will provide an additional incentive for taxpayers to satisfy their reporting obligations under the new disclosure provisions.

EXPLANATION OF PROVISION

In general

The provision creates a new penalty for any person who fails to include with any return or statement any required information

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[149] The significant book-tax category applies only to taxpayers that are reporting companies under the Securities Exchange Act of 1934 or business entities that have $250 million or more in gross assets.

[150] Treas. Reg. sec. 1.6011–4(b)(6). IRS Rev. Proc. 2003–25, 2003–11 I.R.B. 601, exempts certain types of transactions from this reportable transaction category.

[151] Treas. Reg. sec. 1.6011–4(b)(7).

[152] Section 6664(c) provides that a taxpayer can avoid the imposition of a section 6662 accuracy-related penalty in cases where the taxpayer can demonstrate that there was reasonable cause for the underpayment and that the taxpayer acted in good faith. Regulations under sections 6662 and 6664 provide that a taxpayer's failure to disclose a reportable transaction is a strong indication that the taxpayer failed to act in good faith, which would bar relief under section 6664(c).

[153] In this regard, the Committee has concerns with the outcomes and rationales used by courts in some recent decisions involving tax-motivated transactions. For a more detailed discussion of recent court decisions and other developments regarding tax shelters, *see* Joint Committee on Taxation, *Background and Present Law Relating to Tax Shelters* (JCX 19–02), March 19, 2002.

with respect to a reportable transaction. The new penalty applies without regard to whether the transaction ultimately results in an understatement of tax, and applies in addition to any accuracy-related penalty that may be imposed.

Transactions to be disclosed

The provision does not define the terms "listed transaction"[154] or "reportable transaction," nor does the provision explain the type of information that must be disclosed in order to avoid the imposition of a penalty. Rather, the provision authorizes the Treasury Department to define a "listed transaction" and a "reportable transaction" under section 6011.

Penalty rate

The penalty for failing to disclose a reportable transaction is $50,000. The amount is increased to $100,000 if the failure is with respect to a listed transaction. For large entities and high net worth individuals, the penalty amount is doubled (i.e., $100,000 for a reportable transaction and $200,000 for a listed transaction). The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only if: (1) the taxpayer on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the IRS Commissioner personally or the head of the Office of Tax Shelter Analysis. Thus, the penalty cannot be rescinded by a revenue agent, an Appeals officer, or any other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no taxpayer right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this provision and the reasons for the rescission.

A "large entity" is defined as any entity with gross receipts in excess of $10 million in the year of the transaction or in the preceding year. A "high net worth individual" is defined as any individual whose net worth exceeds $2 million, based on the fair market value of the individual's assets and liabilities immediately before entering into the transaction.

A public entity that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction or a non-disclosed reportable avoidance transaction)[155] must disclose the impo-

[154] The provision states that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011. For this purpose, it is expected that the definition of "substantially similar" will be the definition used in Treas. Reg. sec. 1.6011–4(c)(4). However, the Secretary may modify this definition (as well as the definitions of "listed transaction" and "reportable transactions") as appropriate.

[155] A reportable avoidance transaction is a reportable transaction with a significant tax avoidance purpose.

sition of the penalty in reports to the Securities and Exchange Commission for such period as the Secretary shall specify. The provision applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and treats any failure to disclose a transaction in such reports as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the Securities and Exchange Commission once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

EFFECTIVE DATE

The provision is effective for returns and statements the due date for which is after the date of enactment.

2. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose (Sec. 602 of the bill and sec. 6662A of the Code)

PRESENT LAW

The accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[156] The amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[157]

Special rules apply with respect to tax shelters.[158] For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

The understatement penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[159] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] * * * unambiguously concludes that there is a greater than 50-per-

[156] Sec. 6662.
[157] Sec. 6662(d)(2)(B).
[158] Sec. 6662(d)(2)(C).
[159] Sec. 6664(c).

cent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[160]

REASONS FOR CHANGE

Because the Treasury shelter initiative emphasizes combating abusive tax avoidance transactions by requiring increased disclosure of such transactions by all parties involved, the Committee believes that taxpayers should be subject to a strict liability penalty on an understatement of tax that is attributable to non-disclosed listed transactions or non-disclosed reportable transactions that have a significant purpose of tax avoidance. Furthermore, in order to deter taxpayers from entering into tax avoidance transactions, the Committee believes that a more meaningful (but less stringent) accuracy-related penalty should apply to such transactions even when disclosed.

EXPLANATION OF PROVISION

In general

The provision modifies the present-law accuracy related penalty by replacing the rules applicable to tax shelters with a new accuracy-related penalty that applies to listed transactions and reportable transactions with a significant tax avoidance purpose (hereinafter referred to as a "reportable avoidance transaction").[161] The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction. The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty applies), and the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement.

In addition, a public entity that is required to pay the 30-percent penalty must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed

[160] Treas. Reg. sec. 1.6662–4(g)(4)(i)(B); Treas. Reg. sec. 1.6664–4(c).

[161] The terms "reportable transaction" and "listed transaction" have the same meanings as used for purposes of the penalty for failing to disclose reportable transactions.

transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Once the 30-percent penalty has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this provision and the reasons for the compromise.

Determination of the understatement amount

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return)[162], and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

Strengthened reasonable cause exception

A penalty is not imposed under the provision with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011,[163] (2) that there is or was substantial authority for such treatment, and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief (1) is based on the facts and law that exist at the time the tax return that includes the item is filed, and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the

[162] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

[163] See the previous discussion regarding the penalty for failing to disclose a reportable transaction.

tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor," or (2) is a "disqualified opinion."

Disqualified tax advisor

A disqualified tax advisor is any advisor who (1) is a material advisor[164] and who participates in the organization, management, promotion or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates, (2) is compensated directly or indirectly[165] by a material advisor with respect to the transaction, (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained, or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents (1) establishing a structure used in connection with the transaction (such as a partnership agreement), (2) describing the transaction (such as an offering memorandum or other statement describing the transaction), or (3) relating to the registration of the transaction with any federal, state or local government body.[166] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events), (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person, (3) does not identify and consider all relevant facts, or (4) fails to meet any other requirement prescribed by the Secretary.

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[164] The term "material advisor" (defined below in connection with the new information filing requirements for material advisors) means any person who provides any material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case).

[165] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[166] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

Coordination with other penalties

Any understatement upon which a penalty is imposed under this provision is not subject to the accuracy-related penalty under section 6662. However, such understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1).

The penalty imposed under this provision shall not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

EFFECTIVE DATE

The provision is effective for taxable years ending after the date of enactment.

3. Modifications of substantial understatement penalty for non-reportable transactions (Sec. 603 of the bill and sec. 6662 of the Code)

PRESENT LAW

Definition of substantial understatement

An accuracy-related penalty equal to 20 percent applies to any substantial understatement of tax. A "substantial understatement" exists if the correct income tax liability for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations).[167]

Reduction of understatement for certain positions

For purposes of determining whether a substantial understatement penalty applies, the amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[168]

The Secretary is required to publish annually in the Federal Register a list of positions for which the Secretary believes there is not substantial authority and which affect a significant number of taxpayers.[169]

REASONS FOR CHANGE

The Committee believes that the present-law definition of substantial understatement allows large corporate taxpayers to avoid the accuracy-related penalty on questionable transactions of a significant size. The Committee believes that an understatement of more than $10 million is substantial in and of itself, regardless of the proportion it represents of the taxpayer's total tax liability.

The Committee believes that a higher compliance standard should be imposed on any taxpayer in order to reduce the amount of an understatement resulting from a transaction that the taxpayer did not adequately disclose. The Committee further believes that a taxpayer should not take a position on a tax return that

[167] Sec. 6662(a) and (d)(1)(A).
[168] Sec. 6662(d)(2)(B).
[169] Sec. 6662(d)(2)(D).

could give rise to a substantial understatement penalty that the taxpayer does not believe is more likely than not the correct tax treatment unless this information is disclosed to the IRS.

EXPLANATION OF PROVISION

Definition of substantial understatement

The provision modifies the definition of "substantial" for corporate taxpayers. Under the provision, a corporate taxpayer has a substantial understatement if the amount of the understatement for the taxable year exceeds the lesser of (1) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or (2) $10 million.

Reduction of understatement for certain positions

The provision elevates the standard that a taxpayer must satisfy in order to reduce the amount of an understatement for undisclosed items. With respect to the treatment of an item whose facts are not adequately disclosed, a resulting understatement is reduced only if the taxpayer had a reasonable belief that the tax treatment was more likely than not the proper treatment. The provision also authorizes (but does not require) the Secretary to publish a list of positions for which it believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper treatment (without regard to whether such positions affect a significant number of taxpayers). The list shall be published in the Federal Register or the Internal Revenue Bulletin.

EFFECTIVE DATE

The provision is effective for taxable years beginning after date of enactment.

4. Tax shelter exception to confidentiality privileges relating to taxpayer communications (Sec. 604 of the bill and sec. 7525 of the Code)

PRESENT LAW

In general, a common law privilege of confidentiality exists for communications between an attorney and client with respect to the legal advice the attorney gives the client. The Code provides that, with respect to tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. This rule is inapplicable to communications regarding corporate tax shelters.

REASONS FOR CHANGE

The Committee believes that the rule currently applicable to corporate tax shelters should be applied to all tax shelters, regardless of whether or not the participant is a corporation.

EXPLANATION OF PROVISION

The provision modifies the rule relating to corporate tax shelters by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. Accordingly, communications with respect to tax shelters are not subject to the confidentiality provision of the Code that otherwise applies to a communication between a taxpayer and a federally authorized tax practitioner.

EFFECTIVE DATE

The provision is effective with respect to communications made on or after the date of enactment.

5. Disclosure of reportable transactions (Sec. 605 of the bill and secs. 6111 and 6707 of the Code)

PRESENT LAW

Registration of tax shelter arrangements

An organizer of a tax shelter is required to register the shelter with the Secretary not later than the day on which the shelter is first offered for sale.[170] A "tax shelter" means any investment with respect to which the tax shelter ratio[171] for any investor as of the close of any of the first five years ending after the investment is offered for sale may be greater than two to one and which is: (1) required to be registered under Federal or State securities laws, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State securities agency, or (3) a substantial investment (greater than $250,000 and involving at least five investors).[172]

Other promoted arrangements are treated as tax shelters for purposes of the registration requirement if: (1) a significant purpose of the arrangement is the avoidance or evasion of Federal income tax by a corporate participant; (2) the arrangement is offered under conditions of confidentiality; and (3) the promoter may receive fees in excess of $100,000 in the aggregate.[173]

In general, a transaction has a "significant purpose of avoiding or evading Federal income tax" if the transaction: (1) is the same as or substantially similar to a "listed transaction,"[174] or (2) is structured to produce tax benefits that constitute an important part of the intended results of the arrangement and the promoter reasonably expects to present the arrangement to more than one taxpayer.[175] Certain exceptions are provided with respect to the second category of transactions.[176]

An arrangement is offered under conditions of confidentiality if: (1) an offeree has an understanding or agreement to limit the disclosure of the transaction or any significant tax features of the

[170] Sec. 6111(a).
[171] The tax shelter ratio is, with respect to any year, the ratio that the aggregate amount of the deductions and 350 percent of the credits, which are represented to be potentially allowable to any investor, bears to the investment base (money plus basis of assets contributed) as of the close of the tax year.
[172] Sec. 6111(c).
[173] Sec. 6111(d).
[174] Treas. Reg. sec. 301.6111–2(b)(2).
[175] Treas. Reg. sec. 301.6111–2(b)(3).
[176] Treas. Reg. sec. 301.6111–2(b)(4).

transaction; or (2) the promoter knows, or has reason to know, that the offeree's use or disclosure of information relating to the transaction is limited in any other manner.[177]

Failure to register tax shelter

The penalty for failing to timely register a tax shelter (or for filing false or incomplete information with respect to the tax shelter registration) generally is the greater of one percent of the aggregate amount invested in the shelter or $500.[178] However, if the tax shelter involves an arrangement offered to a corporation under conditions of confidentiality, the penalty is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration. Intentional disregard of the requirement to register increases the penalty to 75 percent of the applicable fees.

Section 6707 also imposes (1) a $100 penalty on the promoter for each failure to furnish the investor with the required tax shelter identification number, and (2) a $250 penalty on the investor for each failure to include the tax shelter identification number on a return.

REASONS FOR CHANGE

The Committee has been advised that the current promoter registration rules have not proven particularly helpful, because the rules are not appropriate for the kinds of abusive transactions now prevalent, and because the limitations regarding confidential corporate arrangements have proven easy to circumvent.

The Committee believes that providing a single, clear definition regarding the types of transactions that must be disclosed by taxpayers and material advisors, coupled with more meaningful penalties for failing to disclose such transactions, are necessary tools if the effort to curb the use of abusive tax avoidance transactions is to be effective.

EXPLANATION OF PROVISION

Disclosure of reportable transactions by material advisors

The provision repeals the present law rules with respect to registration of tax shelters. Instead, the provision requires each material advisor with respect to any reportable transaction (including any listed transaction)[179] to timely file an information return with the Secretary (in such form and manner as the Secretary may prescribe). The return must be filed on such date as specified by the Secretary.

The information return will include (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. It is ex-

[177] The regulations provide that the determination of whether an arrangement is offered under conditions of confidentiality is based on all the facts and circumstances surrounding the offer. If an offeree's disclosure of the structure or tax aspects of the transaction are limited in any way by an express or implied understanding or agreement with or for the benefit of a tax shelter promoter, an offer is considered made under conditions of confidentiality, whether or not such understanding or agreement is legally binding. Treas. Reg. sec. 301.6111–2(c)(1).

[178] Sec. 6707.

[179] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related provisions.

pected that the Secretary may seek from the material advisor the same type of information that the Secretary may request from a taxpayer in connection with a reportable transaction.[180]

A "material advisor" means any person (1) who provides material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and (2) who directly or indirectly derives gross income in excess of $250,000 ($50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons) for such advice or assistance.

The Secretary may prescribe regulations which provide (1) that only one material advisor has to file an information return in cases in which two or more material advisors would otherwise be required to file information returns with respect to a particular reportable transaction, (2) exemptions from the requirements of this section, and (3) other rules as may be necessary or appropriate to carry out the purposes of this section (including, for example, rules regarding the aggregation of fees in appropriate circumstances).

Penalty for failing to furnish information regarding reportable transactions

The provision repeals the present law penalty for failure to register tax shelters. Instead, the provision imposes a penalty on any material advisor who fails to file an information return, or who files a false or incomplete information return, with respect to a reportable transaction (including a listed transaction).[181] The amount of the penalty is $50,000. If the penalty is with respect to a listed transaction, the amount of the penalty is increased to the greater of (1) $200,000, or (2) 50 percent of the gross income of such person with respect to aid, assistance, or advice which is provided with respect to the transaction before the date the information return that includes the transaction is filed. Intentional disregard by a material advisor of the requirement to disclose a listed transaction increases the penalty to 75 percent of the gross income.

The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only in exceptional circumstances.[182] All or part of the penalty may be rescinded only if: (1) the material advisor on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the Commissioner personally or the head of the Office of Tax Shelter Analysis; this authority to rescind cannot otherwise be delegated by the Commissioner. Thus, a revenue agent, an Appeals officer, or other IRS personnel cannot rescind the penalty. The decision to rescind a penalty must be accompanied by a record describ-

[180] See the previous discussion regarding the disclosure requirements under new section 6707A.

[181] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related provisions.

[182] The Secretary's present-law authority to postpone certain tax-related deadlines because of Presidentially-declared disasters (sec. 7508A) will also encompass the authority to postpone the reporting deadlines established by the provision.

ing the facts and reasons for the action and the amount rescinded. There will be no right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this provision and the reasons for the rescission.

EFFECTIVE DATE

The provision requiring disclosure of reportable transactions by material advisors applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The provision imposing a penalty for failing to disclose reportable transactions applies to returns the due date for which is after the date of enactment.

6. Modification of penalties for failure to register tax shelters or maintain lists of investors (Secs. 606 and 607 of the bill and secs. 6707 and 6708 of the Code)

PRESENT LAW

Investor lists

Any organizer or seller of a potentially abusive tax shelter must maintain a list identifying each person who was sold an interest in any such tax shelter with respect to which registration was required under section 6111 (even though the particular party may not have been subject to confidentiality restrictions).[183] Recently issued regulations under section 6112 contain rules regarding the list maintenance requirements.[184] In general, the regulations apply to transactions that are potentially abusive tax shelters entered into, or acquired after, February 28, 2003.[185]

The regulations provide that a person is an organizer or seller of a potentially abusive tax shelter if the person is a material advisor with respect to that transaction.[186] A material advisor is defined any person who is required to register the transaction under section 6111, or expects to receive a minimum fee of (1) $250,000 for a transaction that is a potentially abusive tax shelter if all participants are corporations, or (2) $50,000 for any other transaction that is a potentially abusive tax shelter.[187] For listed transactions (as defined in the regulations under section 6011), the minimum fees are reduced to $25,000 and $10,000, respectively.

A potentially abusive tax shelter is any transaction that (1) is required to be registered under section 6111, (2) is a listed transaction (as defined under the regulations under section 6011), or (3) any transaction that a potential material advisor, at the time the transaction is entered into, knows is or reasonably expects will become a reportable transaction (as defined under the new regulations under section 6011).[188]

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[183] Sec. 6112.

[184] Treas. Reg. sec. 301–6112–1.

[185] A special rule applies the list maintenance requirements to transactions entered into after February 28, 2000 if the transaction becomes a listed transaction (as defined in Treas. Reg. 1.6011–4) after February 28, 2003.

[186] Treas. Reg. sec. 301.6112–1(c)(1).

[187] Treas. Reg. sec. 301.6112–1(c)(2) and (3).

[188] Treas. Reg. sec. 301.6112–1(b).

The Secretary is required to prescribe regulations which provide that, in cases in which two or more persons are required to maintain the same list, only one person would be required to maintain the list.[189]

Penalty for failing to maintain investor lists

Under section 6708, the penalty for failing to maintain the list required under section 6112 is $50 for each name omitted from the list (with a maximum penalty of $100,000 per year).

REASONS FOR CHANGE

The Committee has been advised that the present-law penalties for failure to maintain customer lists are not meaningful and that promoters often have refused to provide requested information to the IRS. The Committee believes that requiring material advisors to maintain a list of advisees with respect to each reportable transaction, coupled with more meaningful penalties for failing to maintain an investor list, are important tools in the ongoing efforts to curb the use of abusive tax avoidance transactions.

EXPLANATION OF PROVISION

Investor lists

Each material advisor[190] with respect to a reportable transaction (including a listed transaction)[191] is required to maintain a list that (1) identifies each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction, and (2) contains other information as may be required by the Secretary. In addition, the provision authorizes (but does not require) the Secretary to prescribe regulations which provide that, in cases in which 2 or more persons are required to maintain the same list, only one person would be required to maintain the list.

The provision also clarifies that, for purposes of section 6112, the identity of any person is not privileged under the common law attorney-client privilege (or, consequently, the section 7525 federally authorized tax practitioner confidentiality provision).

Penalty for failing to maintain investor lists

The provision modifies the penalty for failing to maintain the required list by making it a time-sensitive penalty. Thus, a material advisor who is required to maintain an investor list and who fails to make the list available upon written request by the Secretary within 20 business days after the request will be subject to a $10,000 per day penalty. The penalty applies to a person who fails to maintain a list, maintains an incomplete list, or has in fact maintained a list but does not make the list available to the Secretary. The penalty can be waived if the failure to make the list available is due to reasonable cause.[192]

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[189] Sec. 6112(c)(2).

[190] The term "material advisor" has the same meaning as when used in connection with the requirement to file an information return under section 6111.

[191] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related provisions.

[192] In no event will failure to maintain a list be considered reasonable cause for failing to make a list available to the Secretary.

EFFECTIVE DATE

The provision requiring a material advisor to maintain an investor list applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The provision imposing a penalty for failing to maintain investor lists applies to requests made after the date of enactment.

The provision clarifying that the identity of any person is not privileged for purposes of section 6112 is effective as if included in the amendments made by section 142 of the Deficit Reduction Act of 1984.

7. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions (Sec. 608 of the bill and sec. 7408 of the Code)

PRESENT LAW

The Code authorizes civil actions to enjoin any person from promoting abusive tax shelters or aiding or abetting the understatement of tax liability.[193]

REASONS FOR CHANGE

The Committee understands that some promoters are blatantly ignoring the rules regarding registration and list maintenance regardless of the penalties. An injunction would place these promoters in a public proceeding under court order. Thus, the Committee believes that the types of tax shelter activities with respect to which an injunction may be sought should be expanded.

EXPLANATION OF PROVISION

The provision expands this rule so that injunctions may also be sought with respect to the requirements relating to the reporting of reportable transactions[194] and the keeping of lists of investors by material advisors.[195] Thus, under the provision, an injunction may be sought against a material advisor to enjoin the advisor from (1) failing to file an information return with respect to a reportable transaction, or (2) failing to maintain, or to timely furnish upon written request by the Secretary, a list of investors with respect to each reportable transaction.

EFFECTIVE DATE

The provision is effective on the day after the date of enactment.

8. Understatement of taxpayer's liability by income tax return preparer (Sec. 609 of the bill and sec. 6694 of the Code)

PRESENT LAW

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to a position for which there was not a realistic possibility of being sustained on its merits and the position was not disclosed (or was frivolous) is liable for a penalty of $250, provided that the preparer

[193] Sec. 7408.
[194] Sec. 6707, as amended by other provisions of this bill.
[195] Sec. 6708, as amended by other provisions of this bill.

knew or reasonably should have known of the position. An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing such a return is liable for a penalty of $1,000.

REASONS FOR CHANGE

The Committee believes that the standards of conduct applicable to income tax return preparers should be the same as the standards applicable to taxpayers. Accordingly, the minimum standard for each undisclosed position on a tax return would be that the preparer must reasonably believe that the tax treatment is more likely than not the proper tax treatment. The Committee believes that this standard is appropriate because the tax return is signed under penalties of perjury, which implies a high standard of diligence in determining the facts and substantial accuracy in determining and applying the rules that govern those facts. The Committee believes that it is both appropriate and vital to the tax system that both taxpayers and their return preparers file tax returns that they reasonably believe are more likely than not correct. In addition, conforming the standards of conduct applicable to income tax return preparers to the standards applicable to taxpayers will simplify the law by reducing confusion inherent in different standards applying to the same behavior.

EXPLANATION OF PROVISION

The provision alters the standards of conduct that must be met to avoid imposition of the first penalty. The provision replaces the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The provision also replaces the not frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

In addition, the provision increases the amount of these penalties. The penalty relating to not having a reasonable belief that the tax treatment was more likely than not the proper tax treatment is increased from $250 to $1,000. The penalty relating to willful or reckless conduct is increased from $1,000 to $5,000.

EFFECTIVE DATE

The provision is effective for documents prepared after the date of enactment.

9. Regulation of individuals practicing before the Department of Treasury (Sec. 610 of the bill and sec. 330 of Title 31, United States Code)

PRESENT LAW

The Secretary of the Treasury is authorized to regulate the practice of representatives of persons before the Department of the Treasury.[196] The Secretary is also authorized to suspend or disbar from practice before the Department a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Department, or who (with intent to defraud) will-

[196] 31 U.S.C. 330.

fully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this provision are contained in Circular 230.

REASONS FOR CHANGE

The Committee believes that it is critical that the Secretary have the authority to censure tax advisors as well as to impose monetary sanctions against tax advisors because of the important role of tax advisors in our tax system. Use of these sanctions is expected to curb the participation of tax advisors in both tax shelter activity and any other activity that is contrary to Circular 230 standards.

EXPLANATION OF PROVISION

The provision makes two modifications to expand the sanctions that the Secretary may impose pursuant to these statutory provisions. First, the provision expressly permits censure as a sanction. Second, the provision permits the imposition of a monetary penalty as a sanction. If the representative is acting on behalf of an employer or other entity, the Secretary may impose a monetary penalty on the employer or other entity if it knew, or reasonably should have known, of the conduct. This monetary penalty on the employer or other entity may be imposed in addition to any monetary penalty imposed directly on the representative. These monetary penalties are not to exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty. These monetary penalties may be in addition to, or in lieu of, any suspension, disbarment, or censure.

The provision also confirms the present-law authority of the Secretary to impose standards applicable to written advice with respect to an entity, plan, or arrangement that is of a type that the Secretary determines as having a potential for tax avoidance or evasion.

EFFECTIVE DATE

The modifications to expand the sanctions that the Secretary may impose are effective for actions taken after the date of enactment.

10. Penalty on promoters of tax shelters (Sec. 611 of the bill and sec. 6700 of the Code)

PRESENT LAW

A penalty is imposed on any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if in connection with such activity the person makes or furnishes a qualifying false or fraudulent statement or a gross valuation overstatement.[197] A qualified false or fraudulent statement is any statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement

[197] Sec. 6700.

which the person knows or has reason to know is false or fraudulent as to any material matter. A "gross valuation overstatement" means any statement as to the value of any property or services if the stated value exceeds 200 percent of the correct valuation, and the value is directly related to the amount of any allowable income tax deduction or credit.

The amount of the penalty is $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). A penalty attributable to a gross valuation misstatement can be waived on a showing that there was a reasonable basis for the valuation and it was made in good faith.

REASONS FOR CHANGE

The Committee believes that the present-law penalty rate is insufficient to deter the type of conduct that gives rise to the penalty.

EXPLANATION OF PROVISION

The provision modifies the penalty amount to equal 50 percent of the gross income derived by the person from the activity for which the penalty is imposed. The new penalty rate applies to any activity that involves a statement regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that such statement is false or fraudulent as to any material matter. The enhanced penalty does not apply to a gross valuation overstatement.

EFFECTIVE DATE

The provision is effective for activities after the date of enactment.

11. Statute of limitations for taxable years for which required listed transactions not disclosed (Sec. 612 of the bill and sec. 6501 of the Code)

PRESENT LAW

In general, the Code requires that taxes be assessed within three years[198] after the date a return is filed.[199] If there has been a substantial omission of items of gross income that totals more than 25 percent of the amount of gross income shown on the return, the period during which an assessment must be made is extended to six years.[200] If an assessment is not made within the required time periods, the tax generally cannot be assessed or collected at any future time. Tax may be assessed at any time if the taxpayer files a false or fraudulent return with the intent to evade tax or if the taxpayer does not file a tax return at all.[201]

REASONS FOR CHANGE

The Committee believes that extending the statute of limitations if a taxpayer required to disclose a listed transaction fails to do so

[198] Sec. 6501(a).
[199] For this purpose, a return that is filed before the date on which it is due is considered to be filed on the required due date (sec. 6501(b)(1)).
[200] Sec. 6501(e).
[201] Sec. 6501(c).

will encourage taxpayers to provide the required disclosure and will afford the IRS additional time to discover the transaction if the taxpayer does not disclose it.

EXPLANATION OF PROVISION

The provision extends the statute of limitations with respect to a listed transaction if a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction[202] which is required to be included (under section 6011) with such return or statement. The statute of limitations with respect to such a transaction will not expire before the date which is one year after the earlier of (1) the date on which the Secretary is furnished the information so required, or (2) the date that a material advisor (as defined in 6111) satisfies the list maintenance requirements (as defined by section 6112) with respect to a request by the Secretary. For example, if a taxpayer engaged in a transaction in 2005 that becomes a listed transaction in 2007 and the taxpayer fails to disclose such transaction in the manner required by Treasury regulations, then the transaction is subject to the extended statute of limitations.[203]

EFFECTIVE DATE

The provision is effective for taxable years with respect to which the period for assessing a deficiency did not expire before the date of enactment.

12. Denial of deduction for interest on underpayments attributable to tax-motivated transactions (Sec. 613 of the bill and sec. 163 of the Code)

PRESENT LAW

In general, corporations may deduct interest paid or accrued within a taxable year on indebtedness.[204] Interest on indebtedness to the Federal government attributable to an underpayment of tax generally may be deducted pursuant to this provision.

REASONS FOR CHANGE

The Committee believes that it is inappropriate for corporations to deduct interest paid to the Government with respect to certain tax shelter transactions.

EXPLANATION OF PROVISION

The provision disallows any deduction for interest paid or accrued within a taxable year on any portion of an underpayment of tax that is attributable to an understatement arising from (1) an

[202] The term "listed transaction" has the same meaning as described in a previous provision regarding the penalty for failure to disclose reportable transactions.

[203] If the Treasury Department lists a transaction in a year subsequent to the year in which a taxpayer entered into such transaction and the taxpayer's tax return for the year the transaction was entered into is closed by the statute of limitations prior to the date the transaction became a listed transaction, this provision does not re-open the statute of limitations with respect to such transaction for such year. However, if the purported tax benefits of the transaction are recognized over multiple tax years, the provision's extension of the statute of limitations shall apply to such tax benefits in any subsequent tax year in which the statute of limitations had not closed prior to the date the transaction became a listed transaction.

[204] Sec. 163(a).

undisclosed reportable avoidance transaction, or (2) an undisclosed listed transaction.[205]

EFFECTIVE DATE

The provision is effective for underpayments attributable to transactions entered into in taxable years beginning after the date of enactment.

13. Authorization of appropriations for tax law enforcement (Sec. 614 of the bill)

PRESENT LAW

There is no explicit authorization of appropriations to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

REASONS FOR CHANGE

The Committee believes that authorizing an additional $300 million to the Internal Revenue Service to be used to combat abusive tax avoidance transactions will aid in the implementation of the tax shelter measures the Committee is simultaneously approving.

EXPLANTION OF PROVISION

The provision includes an authorization of an additional $300 million to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Other Corporate Governance Provisions

1. Affirmation of consolidated return regulation authority (Sec. 621 of the bill and sec. 1502 of the Code)

PRESENT LAW

An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns. A condition of electing to file a consolidated return is that all corporations that are members of the consolidated group must consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for filing such return.[206]

Section 1502 states:

> The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and

[205] The definitions of these transactions are the same as those previously described in connection with the proposal to modify the accuracy-related penalty for listed and certain reportable transactions.

[206] Sec. 1501.

> the various factors necessary for the determination of such liability, and in order to prevent the avoidance of such tax liability.[207]

Under this authority, the Treasury Department has issued extensive consolidated return regulations.[208]

In the recent case of *Rite Aid Corp.* v. *United States,*[209] the Federal Circuit Court of Appeals addressed the application of a particular provision of certain consolidated return loss disallowance regulations, and concluded that the provision was invalid.[210] The particular provision, known as the "duplicated loss" provision,[211] would have denied a loss on the sale of stock of a subsidiary by a parent corporation that had filed a consolidated return with the subsidiary, to the extent the subsidiary corporation had assets that had a built-in loss, or had a net operating loss, that could be recognized or used later.[212]

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[207] Sec. 1502.

[208] Regulations issued under the authority of section 1502 are considered to be "legislative" regulations rather than "interpretative" regulations, and as such are usually given greater deference by courts in case of a taxpayer challenge to such a regulation. See, S. Rep. No. 960, 70th Cong., 1st Sess. at 15 (1928), describing the consolidated return regulations as "legislative in character". The Supreme Court has stated that ". . . legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.,* 467 U.S. 837, 844 (1984) (involving an environmental protection regulation). For examples involving consolidated return regulations, see, e.g., *Wolter Construction Company* v. *Commissioner,* 634 F.2d 1029 (6th Cir. 1980); *Garvey, Inc.* v. *United States,* 1 Ct. Cl. 108 (1983), aff'd 726 F.2d 1569 (Fed. Cir. 1984), cert. denied, 469 U.S. 823 (1984). Compare, e.g., *Audrey J. Walton* v. *Commissioner,* 115 T.C. 589 (2000), describing different standards of review. The case did not involve a consolidated return regulation.

[209] 255 F.3d 1357 (Fed. Cir. 2001), reh'g denied, 2001 U.S. App. LEXIS 23207 (Fed. Cir. Oct. 3, 2001).

[210] Prior to this decision, there had been a few instances involving prior laws in which certain consolidated return regulations were held to be invalid. See, e.g., *American Standard, Inc.* v. *United States,* 602 F.2d 256 (Ct. Cl. 1979), discussed in the text infra. see also *Union Carbide Corp.* v. *United States,* 612 F.2d 558 (Ct. Cl. 1979), and *Allied Corporation* v. *United States,* 685 F. 2d 396 (Ct. Cl. 1982), all three cases involving the allocation of income and loss within a consolidated group for purposes of computation of a deduction allowed under prior law by the Code for Western Hemisphere Trading Corporations. See also *Joseph Weidenhoff* v. *Commissioner,* 32 T.C. 1222, 1242–1244 (1959), involving the application of certain regulations to the excess profits tax credit allowed under prior law, and concluding that the Commissioner had applied a particular regulation in an arbitrary manner inconsistent with the wording of the regulation and inconsistent with even a consolidated group computation. Cf. *Kanawha Gas & Utilities Co.* v. *Commissioner,* 214 F.2d 685 (1954), concluding that the substance of a transaction was an acquisition of assets rather than stock. Thus, a regulation governing basis of the assets of consolidated subsidiaries did not apply to the case. See also *General Machinery Corporation* v. *Commissioner,* 33 B.T.A. 1215 (1936); *Lefcourt Realty Corporation,* 31 B.T.A. 978 (1935); *Helvering* v. *Morgans, Inc.,* 293 U.S. 121 (1934), interpreting the term "taxable year."

[211] Treas. Reg. Sec. 1.1502–20(c)(1)(iii).

[212] Treasury Regulation section 1.1502–20, generally imposing certain "loss disallowance" rules on the disposition of subsidiary stock, contained other limitations besides the "duplicated loss" rule that could limit the loss available to the group on a disposition of a subsidiary's stock. Treasury Regulation section 1.1502–20 as a whole was promulgated in connection with regulations issued under section 337(d), principally in connection with the so-called *General Utilities* repeal of 1986 (referring to the case of *General Utilities & Operating Company* v. *Helvering,* 296 U.S. 200 (1935)). Such repeal generally required a liquidating corporation, or a corporation acquired in a stock acquisition treated as a sale of assets, to pay corporate level tax on the excess of the value of its assets over the basis. Treasury regulation section 1.1502–20 principally reflected an attempt to prevent corporations filing consolidated returns from offsetting income with a loss on the sale of subsidiary stock. Such a loss could result from the unique upward adjustment of a subsidiary's stock basis required under the consolidated return regulations for subsidiary income earned in consolidation, an adjustment intended to prevent taxation of both the subsidiary and the parent on the same income or gain. As one example, absent a denial of certain losses on a sale of subsidiary stock, a consolidated group could obtain a loss deduction with respect to subsidiary stock, the basis of which originally reflected the subsidiary's value at the time of the purchase of the stock, and that had then been adjusted upward on recognition of any built-in income or gain of the subsidiary reflected in that value. The regulations also contained the duplicated loss factor addressed by the court in *Rite Aid.* The preamble to the regulations stated: "it is not administratively feasible to differentiate between loss attributable to built-in gain and duplicated loss." T.D. 8364, 1991–2 C.B. 43, 46 (Sept. 13, 1991). The government also argued in the *Rite Aid* case that duplicated loss was a separate concern of the regulations. 255 F.3d at 1360.

The Federal Circuit Court opinion contained language discussing the fact that the regulation produced a result different than the result that would have been obtained if the corporations had filed separate returns rather than consolidated returns.[213]

The Federal Circuit Court opinion cited a 1928 Senate Finance Committee Report to legislation that authorized consolidated return regulations, which stated that "many difficult and complicated problems, * * * have arisen in the administration of the provisions permitting the filing of consolidated returns" and that the committee "found it necessary to delegate power to the commissioner to prescribe regulations legislative in character covering them."[214] The Court's opinion also cited a previous decision of the Court of Claims for the proposition, interpreting this legislative history, that section 1502 grants the Secretary "the power to conform the applicable income tax law of the Code to the special, myriad problems resulting from the filing of consolidated income tax returns;" but that section 1502 "does not authorize the Secretary to choose a method that imposes a tax on income that would not otherwise be taxed."[215]

The Federal Circuit Court construed these authorities and applied them to invalidate Treas. Reg. Sec. 1.1502–20(c)(1)(iii), stating that:

> The loss realized on the sale of a former subsidiary's assets after the consolidated group sells the subsidiary's stock is not a problem resulting from the filing of consolidated income tax returns. The scenario also arises where a corporate shareholder sells the stock of a non-consolidated subsidiary. The corporate shareholder could realize a loss under I.R.C. sec. 1001, and deduct the loss under I.R.C. sec. 165. The subsidiary could then deduct any losses from a later sale of assets. The duplicated loss factor, therefore, addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383,

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[213] For example, the court stated: "The duplicated loss factor * * * addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165." 255 F.3d 1357, 1360 (Fed. Cir. 2001).

[214] S. Rep. No. 960, 70th Cong., 1st Sess. 15 (1928). Though not quoted by the court in *Rite Aid,* the same Senate report also indicated that one purpose of the consolidated return authority was to permit treatment of the separate corporations as if they were a single unit, stating "The mere fact that by legal fiction several corporations owned by the same shareholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit." S. Rep. No. 960, 70th Cong., 1st Sess. 29 (1928).

[215] *American Standard, Inc.* v. *United States,* 602 F.2d 256, 261 (Ct. Cl. 1979). That case did not involve the question of separate returns as compared to a single return approach. It involved the computation of a Western Hemisphere Trade Corporation ("WHTC") deduction under prior law (which deduction would have been computed as a percentage of each WHTC's taxable income if the corporations had filed separate returns), in a case where a consolidated group included several WHTCs as well as other corporations. The question was how to apportion income and losses of the admittedly consolidated WHTCs and how to combine that computation with the rest of the group's consolidated income or losses. The court noted that the new, changed regulations approach varied from the approach taken to a similar problem involving public utilities within a group and previously allowed for WHTCs. The court objected that the allocation method adopted by the regulation allowed non-WHTC losses to reduce WHTC income. However, the court did not disallow a method that would net WHTC income of one WHTC with losses of another WHTC, a result that would not have occurred under separate returns. Nor did the court expressly disallow a different fractional method that would net both income and losses of the WHTCs with those of other corporations in the consolidated group. The court also found that the regulation had been adopted without proper notice.

> Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165.[216]

The Treasury Department has announced that it will not continue to litigate the validity of the duplicated loss provision of the regulations, and has issued interim regulations that permit taxpayers for all years to elect a different treatment, though they may apply the provision for the past if they wish.[217]

REASONS FOR CHANGE

The Committee is concerned that Treasury Department resources might be unnecessarily devoted to defending challenges to consolidated return regulations on the mere assertion by a taxpayer that the result under the consolidated return regulations is different than the result for separate taxpayers. The consolidated return regulations offer many benefits that are not available to separate taxpayers, including generally rules that tax income received by the group once and attempt to avoid a second tax on that same income when stock of a subsidiary is sold.

The existing statute authorizes adjustments to clearly reflect the income of the group and of the separate members of the group, during and after the period of affiliation. The Committee believes that this standard, which is stated in the present-law statute, should be reiterated.

EXPLANATION OF PROVISION

The provision confirms that, in exercising its authority under section 1502 to issue consolidated return regulations, the Treasury Department may provide rules treating corporations filing consolidated returns differently from corporations filing separate returns.

Thus, under the statutory authority of section 1502, the Treasury Department is authorized to issue consolidated return regulations utilizing either a single taxpayer or separate taxpayer approach or a combination of the two approaches, as Treasury deems necessary in order that the tax liability of any affiliated group of corporations making a consolidated return, and of each corporation in the group, both during and after the period of affiliation, may be determined and adjusted in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such liability.

Rite Aid is thus overruled to the extent it suggests that the Secretary is required to identify a problem created from the filing of consolidated returns in order to issue regulations that change the application of a Code provision. The Secretary may promulgate consolidated return regulations to change the application of a tax code provision to members of a consolidated group, provided that such

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[216] *Rite Aid,* 255 F.3d at 1360.

[217] See Temp. Reg. Sec. 1.1502–20T(i)(2), Temp. Reg. Sec. 1.337(d)-2T, and Temp. Reg. Sec. 1.1502–35T. The Treasury Department has also indicated its intention to continue to study all the issues that the original loss disallowance regulations addressed (including issues of furthering single entity principles) and possibly issue different regulations (not including the particular approach of Treas. Reg. Sec. 1.1502–20(c)(1)(iii)) on the issues in the future. See Notice 2002–11, 2002–7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (March 12, 2002); REG–102740–02, 67 F.R. 11070 (March 12, 2002); see also Notice 2002–18, 2002–12 I.R.B. 644 (March 25, 2002); REG–131478–02, 67 F.R. 65060 (October 18, 2002) T.D. 9048, 68 F.R. 12287 (March 14, 2003); and T.D. 9118, REG–153172–03 (March 17, 2004).

regulations are necessary to clearly reflect the income tax liability of the group and each corporation in the group, both during and after the period of affiliation.

The provision nevertheless allows the result of the *Rite Aid* case to stand with respect to the type of factual situation presented in the case. That is, the legislation provides for the override of the regulatory provision that took the approach of denying a loss on a deconsolidating disposition of stock of a consolidated subsidiary[218] to the extent the subsidiary had net operating losses or built in losses that could be used later outside the group.[219]

Retaining the result in the *Rite Aid* case with respect to the particular regulation section 1.1502–20(c)(1)(iii) as applied to the factual situation of the case does not in any way prevent or invalidate the various approaches Treasury has announced it will apply or that it intends to consider in lieu of the approach of that regulation, including, for example, the denial of a loss on a stock sale if inside losses of a subsidiary may also be used by the consolidated group, and the possible requirement that inside attributes be adjusted when a subsidiary leaves a group.[220]

EFFECTIVE DATE

The provision is effective for all years, whether beginning before, on, or after the date of enactment of the provision. No inference is intended that the results following from this provision are not the same as the results under present law.

2. Chief Executive Officer required to sign declaration with respect to corporate income tax returns (Sec. 622 of the bill)

PRESENT LAW

The Code requires[221] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[222] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[223] ($500,000 in the case of a corporation) or imprison-

[218] Treas. Reg. Sec. 1.1502–20(c)(1)(iii).

[219] The provision is not intended to overrule the current Tresury Department regulations, which allow taxpayers in certain circumstances for the past to follow Treasury Regulations Section 1.1502–20(c)(1)(iii), if they choose to do so. Temp. Reg. Sec. 1.1502–20T(i)(2).

[220] See, e.g., Notice 2002–11, 2002–7 I.R.B. 526 (Feb. 19, 2002); Temp. Reg. Sec. 1.337(d)-2T, (T.D. 8984, 67 F.R. 11034 (March 12, 2002) and T.D. 8998, 67 F.R. 37998 (May 31, 2002)); REG–102740–02, 67 F.R. 11070 (March 12, 2002); see also Notice 2002–18, 2002–12 I.R.B. 644 (March 25, 2002); REG–131478–02, 67 F.R. 65060 (October 18, 2002); Temp. Reg. Sec. 1.1502–35T (T.D. 9048, 68 F.R. 12287 (March 14, 2003)); and T.D. 9118, REG–153172–03 (March 17, 2004). In exercising its authority under section 1502, the Secretary is also authorized to prescribe rules that protect the purpose of *General Utilities* repeal using presumptions and other simplifying conventions.

[221] Sec. 6062.

[222] Sec. 7206.

[223] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

ment of not more than three years, or both, together with the costs of prosecution.

REASONS FOR CHANGE

The Committee believes that the filing of accurate tax returns is essential to the proper functioning of the tax system. The Committee believes that requiring that the chief executive officer of a corporation sign a declaration that its corporate income tax return complies with the Internal Revenue Code will elevate both the level of care given to the preparation of those returns and the level of compliance with the Code's requirements, which will in turn help ensure that the proper amount of tax is being paid.

EXPLANATION OF PROVISION

The provision requires that the chief executive officer of a corporation sign a declaration under penalties of perjury that the chief executive officer has put in place processes and procedures to ensure that the corporation's Federal income tax return complies with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy of all material aspects of the return. This declaration is part of the income tax return. The provision is in addition to the requirement of present law as to the signing of the income tax return itself. Because a CEO's duties generally do not require a detailed or technical understanding of the corporation's tax return, it is anticipated that this declaration of the CEO will be more limited in scope than the declaration of the officer required to sign the return itself.

The Secretary of the Treasury shall prescribe the matters to which the declaration of the CEO applies. It is intended that the declaration help insure that the preparation and completion of the corporation's tax return be given an appropriate level of care. For example, it is anticipated that the CEO would declare that processes and procedures have been implemented to ensure that the return complies with the Internal Revenue Code and applicable regulations and rules promulgated thereunder. Although appropriate processes and procedures can vary for each taxpayer depending on the size and nature of the taxpayer's business, in every case the CEO should be briefed on all material aspects of the corporation's tax return by the corporation's officer signing the return.

It is also anticipated that, as part of the declaration, the CEO would certify that, to the best of the CEO's knowledge and belief: (1) the processes and procedures for ensuring that the corporation files a tax return that complies with the requirements of the Code are operating effectively; (2) the return is true, accurate, and complete; (3) the officer signing the return did so under no compulsion to adopt any tax position with which that person did not agree; (4) the CEO was briefed on all listed transactions as well as all reportable tax avoidance transactions otherwise required to be disclosed on the tax return; and (5) all required disclosures have been filed with the return. The Secretary may by regulations prescribe additional requirements for this declaration.[224]

If the corporation does not have a chief executive officer, the IRS may designate another officer of the corporation; otherwise, no

[224] Sec. 6011(a).

other person is permitted to sign the declaration. It is intended that the IRS issue general guidance, such as a revenue procedure, to: (1) address situations when a corporation does not have a chief executive officer; and (2) define who the chief executive officer is, in situations (for example) when the primary official bears a different title, when a corporation has multiple chief executive officers, or when the corporation is a foreign corporation and the CEO is not a U.S. resident.[225] It is intended that, in every instance, the highest ranking corporate officer (regardless of title) sign this declaration.

The provision does not apply to the income tax returns of mutual funds;[226] they are required to be signed as under present law.

EFFECTIVE DATE

The provision is effective for returns filed after the date of enactment.

3. Denial of deduction for certain fines, penalties, and other amounts (Sec. 623 of the bill and sec. 162 of the Code)

PRESENT LAW

Under present law, no deduction is allowed as a trade or business expense under section 162(a) for the payment of a fine or similar penalty to a government for the violation of any law (sec. 162(f)). The enactment of section 162(f) in 1969 codified existing case law that denied the deductibility of fines as ordinary and necessary business expenses on the grounds that "allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof."[227]

Treasury regulation section 1.162–21(b)(1) provides that a fine or similar penalty includes an amount: (1) paid pursuant to conviction or a plea of guilty or nolo contendere for a crime (felony or misdemeanor) in a criminal proceeding; (2) paid as a civil penalty imposed by Federal, State, or local law, including additions to tax and additional amounts and assessable penalties imposed by chapter 68 of the Code; (3) paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or (4) forfeited as collateral posted in connection with a proceeding which could result in imposition of such a fine or penalty. Treasury regulation section 1.162–21(b)(2) provides, among other things, that compensatory damages (including damages under section 4A of the Clayton Act (15 U.S.C. 15a), as amended) paid to a government do not constitute a fine or penalty.

REASONS FOR CHANGE

The Committee is concerned that there is a lack of clarity and consistency under present law regarding when taxpayers may deduct payments made in settlement of government investigations of

[225] With respect to foreign corporations, it is intended that the rules for signing this declaration generally parallel the present-law rules for signing the return. See Treas. Reg. sec. 1.6062–1(a)(3).

[226] The provision does, however, apply to the income tax returns of mutal fund management companies and advisors.

[227] S. Rep. 91–552, 91st Cong., 1st Sess. 273–74 (1969), referring to *Tank Truck Rentals, Inc.* v. *Commissioner,* 356 U.S. 30 (1958).

potential wrongdoing, as well as in situations where there has been a final determination of wrongdoing. If a taxpayer deducts payments made in settlement of an investigation of potential wrongdoing or as a result of a finding of wrongdoing, the publicly announced amount of the settlement payment does not reflect the true after-tax penalty on the taxpayer. The Committee also is concerned that allowing a deduction for such payments in effect shifts a portion of the penalty to the Federal government and to the public.

EXPLANATION OF PROVISION

The provision modifies the rules regarding the determination whether payments are nondeductible payments of fines or penalties under section 162(f). In particular, the provision generally provides that amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government in relation to the violation of any law or the governmental investigation or inquiry into the potential violation of any law[228] are nondeductible under any provision of the income tax provisions.[229] The provision applies to deny a deduction for any such payments, including those where there is no admission of guilt or liability and those made for the purpose of avoiding further investigation or litigation. An exception applies to payments that the taxpayer establishes are restitution (including remediation of property).[230] There is also an exception for any amount paid or incurred as taxes due.

The provision applies only where a government (or other entity treated in a manner similar to a government under the bill) is a complainant or investigator with respect to the violation or potential violation of any law.[231]

It is intended that a payment will be treated as restitution only if substantially all of the payment is required to be paid to the specific persons, or in relation to the specific property, actually harmed (or, in the case of property, not in compliance with the required standards) by the conduct of the taxpayer that resulted in the payment. Thus, a payment to or with respect to a class substantially broader than the specific persons or property that were actually harmed (e.g., to a class including similarly situated persons or property) does not qualify as restitution.[232] Restitution is limited

[228] The provision does not affect amounts paid or incurred in performing routine audits or reviews such as annual audits that are required of all organizations or individuals in a similar business sector, or profession, as a requirement for being allowed to conduct business. However, if the government or regulator raises an issue of compliance and a payment is required in settlement of such issue, the provision would affect such payment. In such cases, the restitution exception could permit otherwise allowable deductions of amounts paid with respect to specific property or persons to avoid noncompliance or to bring the taxpayer into compliance with the required standards (for example, to bring a machine up to required emissions or other standards).

[229] The provision provides that such amounts are nondeductible under chapter 1 of the Internal Revenue Code.

[230] The provision does not affect the treatment of antitrust payments made under section 4 of the Clayton Act, which will continue to be governed by the provisions of section 162(g).

[231] Thus, for example, the provision would not apply to payments made by one private party to another in a lawsuit between private parties, merely because a judge or jury acting in the capacity as a court directs the payment to be made. The mere fact that a court enters a judgment or directs a result in a private dispute does not cause a payment to be made "at the direction of a government" for purposes of the provision.

[232] Similarly, a payment to a charitable organization benefitting a substantially broader class than the persons or property actually harmed, or to be paid out without a substantial quantitative relationship to the harm caused, would not qualify as restitution. Under the provision, such a payment not deductible under section 162 would also not be deductible under section 170.

to the amount that bears a substantial quantitative relationship to the harm (or, in the case of property, to the correction of noncompliance) caused by the past conduct or actions of the taxpayer that resulted in the payment in question. If the party harmed is a government or other entity, then restitution includes payment to such harmed government or entity, provided the payment bears a substantial quantitative relationship to the harm. However, restitution does not include reimbursement of government investigative or litigation costs, or payments to whistleblowers.

Amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, any self-regulatory entity that regulates a financial market or other market that is a qualified board or exchange under section 1256(g)(7), and that is authorized to impose sanctions (e.g., the National Association of Securities Dealers) are likewise subject to the provision if paid in relation to a violation, or investigation or inquiry into a potential violation, of any law (or any rule or other requirement of such entity). To the extent provided in regulations, amounts paid or incurred to, or at the direction of, any other nongovernmental entity that exercises self-regulatory powers as part of performing an essential governmental function are similarly subject to the provision. The exceptions (e.g., for payments that the taxpayer establishes are restitution) likewise apply in these cases.

No inference is intended as to the treatment of payments as nondeductible fines or penalties under present law. In particular, the bill is not intended to limit the scope of present-law section 162(f) or the regulations thereunder.

EFFECTIVE DATE

The provision is effective for amounts paid or incurred on or after April 28, 2003; however the provision does not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Any order or agreement requiring court approval is not a binding order or agreement for this purpose unless such approval was obtained on or before April 27, 2003.

4. Denial of deduction for punitive damages (Sec. 624 of the bill and sec. 162 of the Code)

PRESENT LAW

In general, a deduction is allowed for all ordinary and necessary expenses that are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business.[233] However, no deduction is allowed for any payment that is made to an official of any governmental agency if the payment constitutes an illegal bribe or kickback or if the payment is to an official or employee of a foreign government and is illegal under Federal law.[234] In addition, no deduction is allowed under present law for any fine or similar payment made to a government for violation of any law.[235] Furthermore, no deduction is permitted for two-thirds of any dam-

[233] Sec. 162(a).
[234] Sec. 162(c).
[235] Sec. 162(f).

age payments made by a taxpayer who is convicted of a violation of the Clayton antitrust law or any related antitrust law.[236]

In general, gross income does not include amounts received on account of personal physical injuries and physical sickness.[237] However, this exclusion does not apply to punitive damages.[238]

REASONS FOR CHANGE

The Committee believes that allowing a tax deduction for punitive damages undermines the societal role of punitive damages in discouraging and penalizing the activities or actions for which punitive damages are imposed. Furthermore, the Committee believes that determining the amount of punitive damages to be disallowed as a tax deduction is not administratively burdensome because taxpayers generally can make such a determination readily by reference to pleadings filed with a court, and plaintiffs already make such a determination in determining the taxable portion of any payment.

EXPLANATION OF PROVISION

The provision denies any deduction for punitive damages that are paid or incurred by the taxpayer as a result of a judgment or in settlement of a claim. If the liability for punitive damages is covered by insurance, any such punitive damages paid by the insurer are included in gross income of the insured person and the insurer is required to report such amounts to both the insured person and the IRS.

EFFECTIVE DATE

The provision is effective for punitive damages that are paid or incurred on or after the date of enactment.

5. Increase the maximum criminal fraud penalty for individuals to the amount of the tax at issue (Sec. 625 of the bill and secs. 7201, 7203, and 7206 of the Code)

PRESENT LAW

Attempt to evade or defeat tax

In general, section 7201 imposes a criminal penalty on persons who willfully attempt to evade or defeat any tax imposed by the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than five years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Willful failure to file return, supply information, or pay tax

In general, section 7203 imposes a criminal penalty on persons required to make estimated tax payments, pay taxes, keep records, or supply information under the Code who willfully fails to do so. Upon conviction, the Code provides that the penalty is up to $25,000 or imprisonment of not more than one year (or both). In

[236] Sec. 162(g).
[237] Sec. 104(a).
[238] Sec. 104(a)(2).

the case of a corporation, the Code increases the monetary penalty to a maximum of $100,000.

Fraud and false statements

In general, section 7206 imposes a criminal penalty on persons who make fraudulent or false statements under the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than three years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Uniform sentencing guidelines

Under the uniform sentencing guidelines established by 18 U.S.C. 3571, a defendant found guilty of a criminal offense is subject to a maximum fine that is the greatest of: (a) the amount specified in the underlying provision, (b) for a felony[239] $250,000 for an individual or $500,000 for an organization, or (c) twice the gross gain if a person derives pecuniary gain from the offense. This Title 18 provision applies to all criminal provisions in the United States Code, including those in the Internal Revenue Code. For example, for an individual, the maximum fine under present law upon conviction of violating section 7206 is $250,000 or, if greater, twice the amount of gross gain from the offense.

REASONS FOR CHANGE

In light of the recent reports of possible criminal behavior in connection with the filing and preparation of tax returns, the Committee believes it is important to strengthen the criminal tax penalties.

EXPLANATION OF PROVISION

Attempt to evade or defeat tax

The provision increases the criminal penalty under section 7201 of the Code for individuals to $250,000 and for corporations to $1,000,000. The provision increases the maximum prison sentence to ten years.

Willful failure to file return, supply information, or pay tax

The provision increases the criminal penalty under section 7203 of the Code from a misdemeanor to a felony and increases the maximum prison sentence to ten years.

Fraud and false statements

The provision increases the criminal penalty under section 7206 of the Code for individuals to $250,000 and for corporations to $1,000,000. The provision increases the maximum prison sentence to five years. The provision also provides that in no event shall the amount of the monetary penalty under this provision be less than the amount of the underpayment or overpayment attributable to fraud.

[239] Section 7206 states that this offense is a felony. In addition, it is a felony pursuant to the classification guidelines of 18 U.S.C. 3559(a)(5).

EFFECTIVE DATE

The provision is effective for underpayments and overpayments attributable to actions occurring after the date of enactment.

6. Doubling of certain penalties, fines, and interest on underpayments related to certain offshore financial arrangements (Sec. 626 of the bill)

PRESENT LAW

In general

The Code contains numerous civil penalties, such as the delinquency, accuracy-related and fraud penalties. These civil penalties are in addition to any interest that may be due as a result of an underpayment of tax. If all or any part of a tax is not paid when due, the Code imposes interest on the underpayment, which is assessed and collected in the same manner as the underlying tax and is subject to the same statute of limitations.

Delinquency penalties

Failure to file.—Under present law, a taxpayer who fails to file a tax return on a timely basis is generally subject to a penalty equal to 5 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent. An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

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

Failure to make timely deposits of tax.—The penalty for the failure to make timely deposits of tax consists of a four-tiered structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. A depositor is subject to a penalty equal to 2 percent of the amount of the underpayment if the failure is corrected on or before the date that is five days after the prescribed due date. A depositor is subject to a penalty equal to 5 percent of the amount of the underpayment if the failure is corrected after the date that is five days after the prescribed due date but on or before the date that is 15 days after the prescribed due date. A depositor is subject to a penalty equal to 10

percent of the amount of the underpayment if the failure is corrected after the date that is 15 days after the due date but on or before the date that is 10 days after the date of the first delinquency notice to the taxpayer (under sec. 6303). Finally, a depositor is subject to a penalty equal to 15 percent of the amount of the underpayment if the failure is not corrected on or before the date that is 10 days after the date of the day on which notice and demand for immediate payment of tax is given in cases of jeopardy.

An exception from the penalty applies if the failure is due to reasonable cause. In addition, the Secretary may waive the penalty for an inadvertent failure to deposit any tax by specified first-time depositors.

Accuracy-related penalties

The accuracy-related penalty is imposed at a rate of 20 percent of the portion of any underpayment that is attributable, in relevant part, to (1) negligence, (2) any substantial understatement of income tax and (3) any substantial valuation misstatement. In addition, the penalty is doubled for certain gross valuation misstatements. These consolidated penalties are also coordinated with the fraud penalty. This statutory structure operates to eliminate any stacking of the penalties.

No penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith. However, Treasury has issued proposed regulations that limit the defenses available to the imposition of an accuracy-related penalty in connection with a reportable transaction when the transaction is not disclosed.

Negligence or disregard for the rules or regulations.—If an underpayment of tax is attributable to negligence, the negligence penalty applies only to the portion of the underpayment that is attributable to negligence. Negligence means any failure to make a reasonable attempt to comply with the provisions of the Code. Disregard includes any careless, reckless or intentional disregard of the rules or regulations.

Substantial understatement of income tax.—Generally, an understatement is substantial if the understatement exceeds the greater of (1) 10 percent of the tax required to be shown on the return for the tax year or (2) $5,000. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return.

Substantial valuation misstatement.—A penalty applies to the portion of an underpayment that is attributable to a substantial valuation misstatement. Generally, a substantial valuation misstatement exists if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis. The amount of the penalty for a substantial valuation misstatement is 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis. If the value or adjusted basis claimed is 400 percent or more

of the correct value or adjusted basis, then the overvaluation is a gross valuation misstatement.

Gross valuation misstatements.—The rate of the accuracy-related penalty is doubled (to 40 percent) in the case of gross valuation misstatements.

Fraud penalty

The fraud penalty is imposed at a rate of 75 percent of the portion of any underpayment that is attributable to fraud. The accuracy-related penalty does not apply to any portion of an underpayment on which the fraud penalty is imposed.

Interest provisions

Taxpayers are required to pay interest to the IRS whenever there is an underpayment of tax. An underpayment of tax exists whenever the correct amount of tax is not paid by the last date prescribed for the payment of the tax. The last date prescribed for the payment of the income tax is the original due date of the return.

Different interest rates are provided for the payment of interest depending upon the type of taxpayer, whether the interest relates to an underpayment or overpayment, and the size of the underpayment or overpayment. Interest on underpayments is compounded daily.

Offshore Voluntary Compliance Initiative

In January 2003, Treasury announced the Offshore Voluntary Compliance Initiative ("OVCI") to encourage the voluntary disclosure of previously unreported income placed by taxpayers in offshore accounts and accessed through credit card or other financial arrangements. A taxpayer had to comply with various requirements in order to participate in OVCI, including sending a written request to participate in the program by April 15, 2003. This request had to include information about the taxpayer, the taxpayer's introduction to the credit card or other financial arrangements and the names of parties that promoted the transaction. Taxpayers eligible under OVCI will not be liable for civil fraud, the fraudulent failure to file penalty or the civil information return penalties. The taxpayer will pay back taxes, interest and certain accuracy-related and delinquency penalties.

Voluntary Disclosure Initiative

A taxpayer's timely, voluntary disclosure of a substantial unreported tax liability has long been an important factor in deciding whether the taxpayer's case should ultimately be referred for criminal prosecution. The voluntary disclosure must be truthful, timely, and complete. The taxpayer must show a willingness to cooperate (as well as actual cooperation) with the IRS in determining the correct tax liability. The taxpayer must make good-faith arrangements with the IRS to pay in full the tax, interest, and any penalties determined by the IRS to be applicable. A voluntary disclosure does not guarantee immunity from prosecution. It creates no substantive or procedural rights for taxpayers.

REASONS FOR CHANGE

The Committee is aware that individuals and corporations, through sophisticated transactions, are placing unreported income in offshore financial accounts accessed through credit or debit cards or other financial arrangements in order to avoid or evade Federal income tax. Such a phenomenon poses a serious threat to the efficacy of the tax system because of both the potential loss of revenue and the potential threat to the integrity of the self-assessment system. The IRS estimates there may be several hundred thousand taxpayers using offshore financial arrangements to conceal taxable income from the IRS costing the government billions of dollars in lost revenue. Under the OVCI initiative, only 1,253 taxpayers from 46 states stepped forward to participate in the program. From these cases, the IRS expects to identify at least $100 million in uncollected tax. At the start of the program, the clear message to taxpayers was that those who failed to come forward would be pursued by the IRS and would be subject to more significant penalties and possible criminal sanctions. The Committee believes that doubling the civil penalties, fines and interest applicable to taxpayers who entered into these arrangements and did not take advantage of OVCI will provide the IRS with the significant sanctions needed to stem the promotion and participation in these abusive schemes.

EXPLANATION OF PROVISION

The provision increases by a factor of two the total amount of civil penalties, interest and fines applicable for taxpayers who would have been eligible to participate in either the OVCI or the Treasury Department's voluntary disclosure initiative (which applies to the taxpayer by reason of the taxpayer's underpayment of U.S. income tax liability through certain financing arrangements) but did not participate in either program.

EFFECTIVE DATE

The provision generally is effective with respect to a taxpayer's open tax years on or after date of enactment.

C. Extension of IRS User Fees

(Sec. 631 of the bill and sec. 7528 of the Code)

PRESENT LAW

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination.[240] Public Law 108–89[241] extended the statutory authorization for

[240] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Pub. Law No. 100–203, December 22, 1987). Public Law 104–117 (An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996)) extended the statutory authorization for these user fees through September 30, 2003.

[241] 117 Stat. 1131; H.R. 3146, signed by the President on October 1, 2003.

these user fees through December 31, 2004, and moved the statutory authorization for these fees into the Code.[242]

REASONS FOR CHANGE

The Committee believes that it is appropriate to provide a further extension of the applicability of these user fees.

EXPLANATION OF PROVISION

The provision extends the statutory authorization for these user fees through September 30, 2013.

EFFECTIVE DATE

The provision is effective for requests made after the date of enactment.

II. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the provisions of the bill as reported.

[242] That Public Law also moved into the Code the user fee provision relating to pension plans that was enacted in section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. 107–16, June 7, 2001).

ESTIMATED BUDGET EFFECTS OF
THE "TAX ADMINISTRATION GOOD GOVERNMENT ACT,"
AS REPORTED BY THE COMMITTEE ON FINANCE

Fiscal Years 2004 - 2013

[Millions of Dollars]

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
I. Improvements in Tax Administration and Taxpayer Safeguards													
A. Improve Efficiency and Safeguards in IRS Collection													
1. Waiver of user fee for installment agreements using automated withdrawals [1]	aeio/a 180da DOE	---	-3	-3	-3	-3	-3	-3	-3	-4	-4	-12	-29
2. Authorize IRS to enter into installment agreements that provide for partial payment	iaeio/a DOE	24	33	10	[2]	[2]	[2]	[2]	[2]	[2]	[2]	67	67
3. Termination of installment agreements	foo/a DOE	*Negligible Revenue Effect*											
4. Office of Chief Counsel Review of offers-in-compromise	oicsopo/a DOE	*No Revenue Effect*											
5. Permit the IRS to require increased electronic filing of returns prepared by paid return preparers	DOE	*No Revenue Effect*											
6. Place threshold on tolling of statute of limitations during review by Taxpayer Advocate Service	afa DOE	*Negligible Revenue Effect*											
7. Increase in penalty for bad checks and money orders	comora DOE	[2]	2	2	2	2	2	2	2	2	2	8	18
8. Extend time limit for contesting IRS levy to 2 years	[3]	*Negligible Revenue Effect*											
9. Individuals held harmless on improper levy on individual retirement plan	lartia 12/31/04	*Negligible Revenue Effect*											
10. Allow the Financial Management Service to retain transaction fees from levied amounts [1]	DOE	*No Revenue Effect*											
11. Elimination of restriction on offsetting refunds from former residents	DOE	*No Revenue Effect*											
B. Processing and Personnel													
1. Information regarding statute of limitations	[4]	*No Revenue Effect*											
2. Annual report on IRS performance measures	[5]	*No Revenue Effect*											
3. Disclosure of tax information to facilitate combined employment tax reporting	DOE	*No Revenue Effect*											
4. Extension of declaratory judgment procedures to non-501(c)(3) tax-exempt organizations	[6]	*Negligible Revenue Effect*											
5. Amendment to treasury auction reforms [1]	mha DOE	*No Revenue Effect*											
6. Revisions relating to termination of employment of IRS employees for misconduct	DOE	*Negligible Revenue Effect*											
7. Expand IRS oversight board authority	DOE	*No Revenue Effect*											
8. IRS oversight board approval of use of critical pay authority	pha DOE	*No Revenue Effect*											
9. Low-income taxpayer clinics [1]	gma DOE	*No Revenue Effect*											
10. Taxpayer access to financial institutions [7]	DOE	*No Revenue Effect*											
11. Enrolled agents	DOE	*No Revenue Effect*											

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
12. Establishment of disaster response team	DOE	No Revenue Effect											
13. Study of accelerated tax refunds	1ya DOE	No Revenue Effect											
14. Study of clarifying recordkeeping responsibilities	1ya DOE	No Revenue Effect											
15. Streamline reporting process for National Taxpayer Advocate	[8]	No Revenue Effect											
16. IRS Free File program	rfa 12/31/04	No Revenue Effect											
17. Modification of TIGTA reporting requirements	DOE	No Revenue Effect											
18. Study of IRS accounts receivable	1ya DOE	No Revenue Effect											
19. Electronic commerce advisory group	180da DOE	No Revenue Effect											
20. Study of modifications to Schedule M-1	6 ma DOE	No Revenue Effect											
21. Regulation of Federal income tax return preparers and refund anticipation loan providers	DOE & DOE	No Revenue Effect											
C. Other Provisions													
1. Penalty for failure to report interests in foreign financial accounts	voa DOE	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	1	3
2. Repeal of application of below-market loan rules to amounts paid to certain continuing care facilities	cyba 12/31/04	---	-1	-2	-2	-2	-2	-2	-2	-2	-2	-7	-17
Improvements in Tax Administration and Taxpayer Safeguards		**24**	**31**	**7**	**-3**	**-3**	**-3**	**-3**	**-3**	**-4**	**-4**	**57**	**42**
II. Reform of Penalty and Interest													
A. Individual Estimated Tax	etpmf tyba 12/31/04	---	---	-100	-103	-107	-110	-114	-119	-121	-124	-310	-898
B. Corporate Estimated Tax	tyba 12/31/04	---	-40	1	1	1	1	1	1	1	1	-37	-32
C. Increase in Large Corporation Threshold for Estimated Tax Payments	tyba 12/31/04	---	-64	-85	-79	-74	-70	-72	-82	-87	-91	-302	-704
D. Abatement of Interest	iao/a DOE	[13]	-6	-10	-15	-19	-23	-26	-30	-34	-38	-51	-202
E. Deposits Made to Suspend the Running of Interest on Potential Underpayments	dma 1ya DOE	---	79	76	-6	-6	-6	-6	-7	-7	-7	143	110
F. Freeze of Provision Regarding Suspension of Interest Where Secretary Fails to Contact Taxpayer	tyba 12/31/03	---	---	46	184	186	187	189	191	193	194	416	1,370
G. Clarification of Application of Federal Tax Deposit Penalty	DOE	-1	-5	-5	-5	-5	-6	-6	-6	-6	-7	-21	-52
H. Frivolous Tax Returns and Submissions	[10]	[2]	3	3	3	3	3	3	3	3	3	12	27
I. Extension of Notice Requirements with Respect to Interest and Penalty Calculations	nib 7/1/06	No Revenue Effect											
J. Expansion of Interest Netting	iaa 12/31/10	---	---	---	---	---	---	---	-352	-267	-275	---	-894
Total of Reform of Penalty and Interest		**-1**	**-33**	**-74**	**-20**	**-21**	**-24**	**-31**	**-401**	**-325**	**-344**	**-150**	**-1,275**
III. United States Tax Court Modernization													
A. Tax Court Procedure	various	Negligible Revenue Effect											
B. Tax Court Pension and Compensation [11] [12]	various	-3	[13]	[13]	[13]	[13]	[13]	[13]	[13]	[13]	-1	-4	-6
Total of United States Tax Court Modernization		**-3**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**-1**	**-4**	**-6**
IV. Confidentiality and Disclosure													
A. Clarification of Definition of Church Tax Inquiry	DOE	No Revenue Effect											
B. Collection Activities With Respect to a Joint Return Disclosable Based on Oral Request	rarma DOE	No Revenue Effect											

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
C. Taxpayer Representatives Not Subject to Examination on Sole Basis of Representation of Taxpayers	DOE	*No Revenue Effect*											
D. Prohibition of Disclosure of Taxpayer Identification Number With Respect to Disclosure of Accepted Offers-in-Compromise	Dma DOE	*No Revenue Effect*											
E. Compliance by Contractors With Confidentiality Safeguards	Dma DOE	*No Revenue Effect*											
F. Higher Standards for Requests for and Consents to Disclosure	[14]	*No Revenue Effect*											
G. Civil Damages for Unauthorized Inspection or Disclosure	180da DOE	*No Revenue Effect*											
H. Expanded Disclosure in Emergency Circumstances	DOE	*No Revenue Effect*											
I. Disclosure of Taxpayer Identity for Tax Refund Purposes	DOE	*No Revenue Effect*											
J. Disclosure to State Officials of Proposed Actions Related to Section 501(c) Organizations	DOE	*No Revenue Effect*											
K. Treatment of Public Records	boaa DOE	*No Revenue Effect*											
L. Employee Identity Disclosures	DOE	*No Revenue Effect*											
M. Taxpayer Identification Number Matching	DOE	*No Revenue Effect*											
N. Form 8300 Disclosures	DOE	*No Revenue Effect*											
O. Disclosure to Law Enforcement Agencies Regarding Terrorist Activities	DOE	*No Revenue Effect*											
Total of Confidentiality and Disclosure		***No Revenue Effect***											
V. Simplification													
A. Establish Uniform Definition of a Qualifying Child	tyba 12/31/04	---	-67	-140	-143	-149	-160	-195	-188	-75	-75	-499	-1,192
B. Simplification Through Elimination of Inoperative Provisions	DOE	*No Revenue Effect*											
Total of Simplification		**---**	**-67**	**-140**	**-143**	**-149**	**-160**	**-195**	**-188**	**-75**	**-75**	**-499**	**-1,192**
VI. Revenue Raisers													
A. Provisions Designed to Curtail Tax Shelters													
1. Provisions relating to reportable transactions and tax shelters	[15]	10	76	119	120	124	131	139	150	164	179	449	1,212
2. Modification to the substantial understatement penalty	tyba DOE	---	---	7	15	23	26	30	34	38	38	45	211
3. Impose a civil penalty (of up to $5,000) on failure to report interest in foreign financial accounts	DOE	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	1	3
4. Actions to enjoin conduct with respect to tax shelters	DOE	*Negligible Revenue Effect*											
5. Understatement of taxpayer's liability by income tax return preparer	dpa DOE	*Negligible Revenue Effect*											
6. Regulation of individuals practicing before the Department of Treasury	ata DOE	*No Revenue Effect*											
7. Extend statute of limitations for undisclosed listed transactions	[16]	---	---	1	1	1	1	1	1	1	1	3	8
8. Deny deduction for interest paid to the IRS on underpayments involving certain tax motivated													

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
9. Authorize additional $300 million per year to the IRS to combat abusive tax avoidance transactions [17]	DOE	No Revenue Effect											
B. Other Corporate Governance Provisions													
1. Affirmation of consolidated return regulation authority	[18]	Negligible Revenue Effect											
2. Chief executive officer required to sign declaration as part of corporate income tax return	rfa DOE	Negligible Revenue Effect											
3. Denial of deduction for certain fines, penalties, and other amounts	generally apoio/a 4/27/03	126	60	10	10	10	10	10	10	10	10	216	266
4. Denial of deduction for punitive damages	dpoio/a DOE	10	29	30	31	32	33	34	35	36	37	132	307
5. Increase the maximum criminal fraud penalty for individuals to the amount of the tax at issue	uaoataoa DOE	---	---	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[9]	5
6. Double certain penalties, fines, and interest on underpayments related to certain offshore financial arrangements	oyo/a DOE	1	2	1	[2]	[2]	[2]	[2]	[2]	[2]	[2]	4	6
C. Extension of IRS User Fees (through 9/30/13) [1]	rma DOE	---	25	33	35	38	39	41	43	45	47	131	346
Total of Revenue Raisers		**147**	**192**	**202**	**213**	**231**	**244**	**259**	**277**	**298**	**316**	**986**	**2,389**
NET TOTAL		**167**	**123**	**-5**	**47**	**58**	**57**	**30**	**-315**	**-106**	**-108**	**390**	**-42**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

aeio/a = agreements entered into on or after
afa = application filed after
apoio/a = amounts paid or incurred on or after
ata = actions taken after
boaa = before, on, and after
ccceia = continuing care contracts entered into after
comora = checks or money orders received after
dma = deposits made after
Dma = disclosures made after
DOE = date of enactment
dpa = documents prepared after
dpoio/a = damages paid or incurred on or after
etpmf = estimated tax payments made for
foo/a = failures occurring on or after
gma = grants made after
iaa = interest accrued after
iaeio/a = installment agreements entered into on or after
iao/a = interest accruing on or after
lartia = levied amounts returned to individuals after
ma = months after
oicsopo/a = offers in compromise submitted or pending on or after
oyo/a = open years on or after
rmha = meetings held after
nib = notices issued before
pha = personnel hired after
rarma = requests and reports made after
rfa = returns filed after
rma = requests made after
tyba = taxable years beginning after
uaoataoa = underpayments and overpayments attributable to actions occurring after
voa = violations occurring after
180da = 180 days after
1ya = 1 year after

[1] Estimate provided by Congressional Budget Office.
[2] Gain of less than $500,000.
[3] Effective with respect to levies made after the date of enactment and levies made on or before the date of enactment provided that the 9-month period has not expired as of the date of enactment.
[4] The revisions to Publication 1 would be required to be made as soon as practicable, but not later than 180 days after the date of enactment. The revisions to the Form 1040 instructional packages would be required to be made for instructions for taxable years beginning after December 31, 2004.
[5] Effective for fiscal year 2004 and thereafter.
[6] The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations would be effective for pleadings filed with respect to determinations (or requests for determinations) made after December 31, 2004.

Footnotes for Table continued:

[7] Estimate of offsetting receipts to be provided by Congressional Budget Office.
[8] The provision combining the reports is effective for reports in 2005 and thereafter. The provision authorizing reports on significant issues affected taxpayer rights is effective on the date of enactment.
[9] Gain of less than $1 million.
[10] Effective for submissions made and issues raised after the date on which the Secretary first prescribes the required list.
[11] Certain portions of the estimate were provided by the Congressional Budget Office.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
[12] Includes the following increase in outlay effects	3	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	3	5

[13] Loss of less than $500,000.
[14] Provision applies to requests and consents made after three months after the date of enactment.
[15] Effective dates for provisions relating to reportable transactions and tax shelters: the penalty for failure to disclose reportable transactions is effective for returns and statements the due date of which is after the date of enactment; the modification to the accuracy-related penalty for listed or reportable transactions is effective for taxable years ending after the date of enactment; the tax shelter exception to confidentiality privileges is effective for communications made on or after the date of enactment; the material advisor and investor list disclosure provisions applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment; the failure to register tax shelter penalty applies to returns the due date for which is after the date of enactment; the investor list penalty applies to requests made after the date of enactment; and the penalty on promoters of tax shelters is effective for activities after the date of enactment.
[16] Effective for taxable years with respect to which the period for assessing deficiencies did not expire before the date of enactment.
[17] Estimate is subject to review by the Congressional Budget Office.
[18] Effective for all taxable years, whether beginning before, on, or after the date of enactment.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of section 310 of the bill involve new or increased budget authority with respect to the Tax Court Judicial Officers' Retirement Fund.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part III.A., above). The revenue increasing provisions of the bill generally involve reduced tax expenditures (see revenue table in Part III.A., above).

C. Consultation With Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the bill. The letter from the Congressional Budget Office has not been received, and therefore will be provided separately.]

III. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the votes taken on the Committee's consideration of the bill.

Motion to report the bill

The bill as amended was ordered favorably reported by voice vote, a quorum being present, on February 2, 2004.

Votes on amendments

The amendment in the nature of a substitute was passed by voice vote. No other amendments were offered and voted upon.

IV. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as amended.

Impact on individuals and businesses

The bill includes provisions to improve tax administration and taxpayer safeguards, to reform the penalty and interest provisions of the Internal Revenue Code, to modernize the procedures and operation of the United States Tax Court, to improve the confidentiality of tax information, to simplify the tax laws, to curtail tax shelters, and to improve corporate governance.

The bill includes various other provisions that are not expected to impose additional administrative requirements or regulatory burdens on individuals or businesses.

Impact on personal privacy and paperwork

The provisions of the bill do not reduce personal privacy. Several provisions of the bill may improve personal privacy protections, such as the provision ensuring compliance by contractors with confidentiality safeguards (section 405) and the provision imposing higher standards for requests for and consents to disclosure (section 406).

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (P.L. 104–4).

The Committee has determined that the tax provisions of the bill contain no Federal private sector mandates.

The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread applicability" to individuals or small businesses.

V. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

○