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The Tax Administration Reform Act of 2002 (H.R. 5728)

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Summary

The Tax Administration Reform Act of 2002, H.R. 5728, was passed by the House on November 15, 2002. The Senate adjourned before considering the bill, but it seems likely that the measures will reappear in the 108th session of Congress. The proposal is aimed at providing beneficial collection procedures to taxpayers, further safeguarding confidential taxpayer information, improving the efficiency of tax administration, and reforming certain interest and penalty provisions.

The Tax Administration Reform Act of 2002, H.R. 5728, was introduced in the House on November 14, 2002. The House passed the bill by unanimous consent on November 15, 2002. On November 22, 2002, the Senate adjourned for the session without considering H.R. 5728. It seems likely that a similar bill may reemerge in the next session of Congress since many of its provisions have been repeatedly introduced over the past few years. The provisions seem especially popular in the House, as exemplified by its unanimous passage of a similar bill, H.R. 4163, in the 106th Congress (the Senate did not act on the bill).

The majority of the bill's provisions are advantageous to taxpayers. Title I includes changes to the Internal Revenue Service's tax collection procedures that would benefit the taxpayers involved in such actions. Title II contains measures for improving the efficiency of tax administration and for strengthening the protection afforded to confidential taxpayer information. Title III is aimed at reforming certain interest and penalty provisions in ways that favor taxpayers and at expanding the IRS's ability to penalize frivolous taxpayer actions.

¹ This report was written by Erika Lunder under the supervision of Marie Morris, Legislative Attorney.

Title I – Fairness in Tax Collection Procedures

Section 101 would allow the Internal Revenue Service (IRS) to enter into installment agreements for the partial payment of tax liabilities. Currently, a taxpayer who owes taxes may qualify under section 6159 of the Internal Revenue Code (I.R.C.) to enter into an agreement with the IRS to pay the liability in installments. Present law is not clear as to whether the IRS may enter into an installment agreement that only requires partial payment of the liability. The bill would expressly allow installment agreements for partial payment. The agreements would have to be reviewed by the Treasury Secretary every two years.

Sections 102 and 103 relate to situations where a levy has been wrongfully placed on a taxpayer's property. When a taxpayer fails to pay taxes owed, the IRS may collect the liability by placing a levy on the taxpayer's property, including money (e.g., wages). Under I.R.C. § 6343(b), the Treasury Secretary must return any property upon which a levy is wrongfully placed. When money has been levied or when the levied property has been sold by the government, the Treasury Secretary has 9 months from the date of the levy to return an amount of money equal to the amount levied or to the selling price. Section 102 of the bill would extend this period until 2 years after the date of the levy. Additionally, the period within which an individual other than the taxpayer may file a claim of wrongful levy against the IRS would be lengthened. Currently, such an individual who has an interest in the levied property must file a claim within 9 months of the levy. Section 102 would change the deadline to 2 years after the date of the levy.

Section 103 would allow the Treasury Secretary, upon the determination that a levy was wrongly or prematurely placed upon an individual retirement plan, to deposit the amount of money levied plus interest into the plan if the plan allows rollovers. The entire deposit would be exempt from tax.

Section 104 would restrict the IRS's ability to toll certain statutes of limitation when a taxpayer seeks a taxpayer assistance order. The IRS must meet certain deadlines, called statutes of limitation, when it pursues collection actions against taxpayers. Under I.R.C. § 7811(d), these deadlines are suspended when a taxpayer requests assistance from the National Taxpayer Advocate. The suspension continues until the Advocate makes a decision as to whether to grant the request. Section 104 would disallow the deadline suspension if the Advocate's decision was made within 7 days of the taxpayer's request.

Section 105 would require the Treasury Secretary to conduct a study of the IRS's use of lien and levy actions. The study would address two issues: (1) the IRS's declining use of liens and levies and (2) the practicality of taking such an action when its cost is greater than the amount to be realized from the property.

Section 106 relates to clinics that represent low-income taxpayers for little or no fee in disputes with the IRS. Under I.R.C. § 7526, the Treasury Secretary may grant a total of \$6 million in funding to qualifying low-income taxpayer clinics. Section 106 would gradually increase the amount of available grant money to \$15 million by 2004. Furthermore, the bill would make clear that clinics providing routine tax preparation do not qualify for the grants.

Title II – Improved Administrative Efficiency and Confidentiality

Subtitle A – Efficiency of Tax Administration

Section 201 would expand the range of disciplinary actions faced by IRS employees for certain types of misconduct. Currently, an IRS employee who violates section 1203 of the IRS Restructuring and Reform Act of 1998 is automatically terminated. Most of the section 1203 provisions are related to protecting taxpayers from abusive acts by IRS employees. The bill would allow the Treasury Secretary to impose disciplinary actions other than termination. It would also require that most triggering violations be “willfully” performed by the IRS employee.

Section 202 would authorize the Tax Court to apply the doctrine of equitable recoupment. This doctrine allows the government to collect a tax or a taxpayer to collect a refund when the deadline for such collection action has run so long as the collection is fair and just. Confusion exists as to whether the Tax Court may use this doctrine and the bill would expressly allow the court to apply it.

Section 203 would give the Tax Court sole jurisdiction over collection due process cases, which are taxpayer appeals from hearings approving the IRS’s levying of taxpayer property. Under I.R.C. § 6330(d)(1), the U.S. district courts have jurisdiction in these cases if the Tax Court does not have jurisdiction over the underlying tax liability. The bill would give the Tax Court sole jurisdiction over all collection due process cases.

Section 204 would eliminate the requirement that the IRS’s Office of Chief Counsel (OCC) review offers in compromise. Under I.R.C. § 7122, when the IRS offers to compromise with a taxpayer over the amount of tax, interest, or penalty owed, the OCC must review the offer if the amount of unpaid liability will be at least \$50,000. In all other cases, the Treasury Secretary may ask for the OCC’s opinion on the offer. The bill would make all offers reviewable by the OCC solely upon the Secretary’s request.

Section 205 would give taxpayers who electronically file individual income tax returns an extra 15 days to file their returns and to pay any taxes owed. Thus, such individuals could wait until April 30 to file and pay without penalty.

Subtitle B – Confidentiality and Disclosure

Section 211 would make it easier for an individual to request information from the IRS concerning taxes owed from a return filed jointly with the individual’s former or separated spouse. Currently, an individual may make a written request under I.R.C. § 6103(e) to the IRS for information concerning any IRS action to collect the deficiency from the other person. The bill would allow the individual to make an oral request to the IRS for the information.

Section 212 would clarify that a taxpayer representative may not be subject to examination solely because the represented taxpayer is being examined.

Section 213 would require that a Federal agency or State take certain actions before disclosing taxpayer information to contractors of that agency or State. The bill would require that the agency or State (1) ensures that contractors have safeguards to protect the

confidentiality of taxpayer information, (2) reviews the adequacy of these safeguards and submits the findings to the Treasury Secretary, and (3) certifies to the Secretary that contractors are in compliance with the safeguards.

Section 214 would elaborate on the current procedure for IRS disclosure of taxpayer information to a taxpayer's designee. Under I.R.C. § 6103(c), the IRS may disclose taxpayer information to a taxpayer's designee upon the request or consent of the taxpayer. Section 214 would specify that all requests designate a recipient and be dated and certified. Additionally, the designee would be required to keep the information confidential and to use it solely for the request's purpose. The bill would also require that the Treasury Secretary create a request form with a warning to taxpayers that only completed forms should be signed and information on what to do if coerced into signing an incomplete form. Finally, the Treasury Inspector General for Tax Administration (TIGTA) would be required to submit a report to Congress on compliance with these new rules.

Section 215 would require that the IRS notify taxpayers whose return or other information was inspected or disclosed by an IRS employee or by someone else. Currently, I.R.C. § 7431(e) only requires taxpayer notification when a person is criminally charged with the inspection or disclosure of taxpayer information. The bill would expand the notification requirement to situations where TIGTA determines that the information was unlawfully disclosed or inspected. Section 215 would also require an annual report from TIGTA detailing the incidences of unauthorized disclosure and inspection.

Section 216 would expand the group of law enforcement agencies to which the IRS may disclose limited information in certain emergency circumstances. I.R.C. § 6103(i)(3)(B) allows such disclosure to federal or state law enforcement agencies and the bill would include local law enforcement agencies.

Subtitle C – Other Provisions

Section 221 would require that TIGTA report to Congress on whether newer communication technologies (e.g., e-mail and fax) are feasible methods of communication between the IRS and taxpayers.

Section 222 would allow the Treasury Secretary to issue regulations on the conduct of enrolled agents who practice before the IRS. The bill would also allow these agents to identify themselves with the enrolled agent credentials.

Section 223 would enable the Financial Management Service, a division of the Treasury Department that provides centralized payment and collection services for the federal government, to charge the IRS for the full cost of implementing the continuous levy program found in I.R.C. § 6331.

Section 224 would allow for the information about certain security auctions that is discussed at Treasury Borrowing Advisory Committee meetings to be publically disclosed once the Treasury Secretary releases the minutes of the meetings. Current law only allows for disclosure once the Secretary makes a public announcement about the auction.

Title III – Reform of Penalty and Interest Provisions

Section 301 would change the way taxpayers are penalized for failing to make an estimated tax payment. Currently, a taxpayer who fails to make a payment is assessed a penalty under I.R.C. § 6654. Section 301 would reorganize section 6654 and renumber it as section 6641. Two substantive changes would also be made. First, the penalty would be changed to an interest charge. Second, the safe harbor would be increased from \$1000 to \$2000 so that taxpayers with underpayments of less than \$2000 would not be assessed the interest charge.

Section 302 would exclude from taxable income certain interest payments made on income tax overpayments. Under I.R.C. § 6611, the IRS must pay interest to qualifying taxpayers who have overpaid the amount of taxes owed. The bill would make these payments nontaxable if the interest is from the overpayment of individual income tax and if the Treasury Secretary has not determined that the purpose of the overpayment was to collect the tax-free interest.

Section 303 would ease the restrictions on the abatement of interest owed to the IRS. Under I.R.C. § 6404(e)(2), the IRS may not begin to charge interest on an erroneous refund until the IRS demands the refund's repayment. However, the IRS may charge interest before the repayment demand if the taxpayer caused the erroneous refund or if the erroneous refund is more than \$50,000. Section 303 would make erroneous refunds exceeding \$50,000 eligible for abatement. Furthermore, under I.R.C. § 6404(f), the IRS may not charge a penalty or addition to tax that is attributable to erroneous written advice from the IRS. The bill would extend this abatement rule to any interest attributable to such a written statement.

Section 304 would allow taxpayers to make deposits to the IRS for the purpose of paying taxes not yet assessed. Once an assessment is made, the deposit date would be treated as the date the tax was paid, thus averting any interest charge for the underpayment of taxes. The deposit would have to be returned at the written request of the taxpayer unless the Treasury Secretary determines that the return would jeopardize tax collection.

Section 305 would give individual taxpayers greater opportunity to take advantage of interest rate netting. Under I.R.C. § 6621(d), when a taxpayer owes interest payments on an underpayment of tax and is concurrently owed interest payments on an equivalent tax overpayment, the net interest rate is zero. Thus, the taxpayer neither owes nor is owed interest payments. This symmetry is disturbed by I.R.C. § 6611(e), which disallows interest on overpayments that are refunded within 45 days of the date that either the return is due or the refund is claimed. This rule prevents a taxpayer who owes interest during this period from netting the interest rate to zero. Section 305 would prevent the 45 day rule from applying for the interest rate netting purposes of individual taxpayers.

Section 306 would waive certain penalties for first-time unintentional taxpayer errors. Under I.R.C. § 6651, a taxpayer who fails to file a tax return or to pay a tax is assessed a penalty on such failure unless the failure was due to a reasonable cause and not to willful neglect. The bill would grant the Treasury Secretary the discretion to not penalize first-time unintentional errors. The Secretary would have to find that the taxpayer has a history of tax compliance and took prompt corrective action, the error was

unintentional and minor, imposition of the penalty would be unfair, and the waiver of the penalty would promote taxpayer compliance and efficient tax administration.

Section 307 would expand the penalties for frivolous tax filings under I.R.C. § 6702. First, the civil fine for filing a frivolous tax return would be increased from \$500 to \$5,000. Second, a \$5,000 fine would be imposed on the making of a specified frivolous submission, including a request for a lien or levy hearing and an application for a taxpayer assistance order, installment agreement, or compromise. A taxpayer could withdraw a frivolous submission and the penalty would then be waived. The Secretary would also be able to reduce the \$5000 penalty if the reduction would promote tax collection and efficient tax administration.

Section 308 would clarify that the highest percentage penalty under I.R.C. § 6656 for the failure to make a deposit of taxes only applies when the failure is for more than 15 days. The percentages of underpayment charged as the penalty are unchanged: 2% if the failure is for less than 6 days, 5% if the failure lasts for 6 to 15 days, and 10% if the failure is for more than 15 days.