DESCRIPTION OF THE
"TAXPAYER PROTECTION ACT OF 2007"

Scheduled for Markup
By the
HOUSE COMMITTEE ON WAYS AND MEANS
on March 28, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways & Means has scheduled a markup on March 28, 2007. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Taxpayer Protection Act of 2007."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Taxpayer Protection Act of 2007"* (JCX-18-07), March 26, 2007.

I. TAXPAYER RIGHTS

A. Family Business Tax Simplification

Present Law

Under present law, a partnership is defined to include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a trust or estate or a corporation (sec. 7701(a)(2)).[2] A partnership is treated as a pass-through entity, and income earned by the partnership, whether distributed or not, is taxed to the partners. The income of a partnership and its partners is determined under subchapter K of the Code. An election not to be subject to the rules of subchapter K is provided for certain partnerships that meet specified criteria (i.e., the partnership is for investment purposes only, is for the joint production, extraction, or use of property, but not for selling services or property produced or extracted, or is used by securities dealers for short periods to underwrite, sell or distribute securities). Otherwise, the rules of subchapter K apply to a venture that is treated as a partnership for Federal tax purposes.

In the case of an individual with self-employment income, the income subject to self-employment tax is the net earnings from self-employment (sec. 1402(a)). Net earnings from self-employment is the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules. If the individual is a partner in a partnership, the net earnings from self-employment generally include his or her distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership.

Description of Proposal

The proposal generally permits a qualified joint venture whose only members are a husband and wife filing a joint return not to be treated as a partnership. A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect to have the proposal apply.

Under the proposal, a qualified joint venture conducted by a husband and wife who file a joint return is not treated as a partnership for Federal income tax purposes. All items of income, gain, loss, deduction, and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Thus, it is anticipated that each spouse would account for his or her respective share on the appropriate form, such as Schedule C. The proposal is not intended to change the determination under present law of whether an entity is a partnership for Federal income tax purposes (without regard to the election provided by the proposal).

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[2] Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, are amended (the "Code").

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for Federal income tax purposes under the proposal (i.e., in accordance with their respective interests in the venture). A corresponding change is made to the definition of net earnings from self-employment under the Social Security Act. The proposal is not intended to prevent allocations or reallocations, to the extent permitted under present law, by courts or by the Social Security Administration of net earnings from self-employment for purposes of determining Social Security benefits of an individual.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2006.

B. Taxpayer Notification of Suspected Identity Theft

Present Law

Section 6103 provides that returns and return information are confidential and may not be disclosed by the Internal Revenue Service ("IRS"), other Federal employees, State employees, and certain others having access to the information except as provided in the Code.[3] The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the Code for any tax, penalty, interest, fine, forfeiture, or other imposition or offense.[4] Thus, information gathered by the IRS in connection with an investigation of a person for a Title 26 offense, such as fraud, is the return information of the person being investigated and is subject to the confidentiality restrictions of section 6103.

Description of Proposal

The proposal provides that if, in the course of an investigation under section 7206 (relating to fraud and false statements) or section 7207 (relating to fraudulent returns, statements or other documents), the Secretary determines that there may have been an unauthorized use of a

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[3] Sec. 6103(a).

[4] Sec. 6103(b)(2). Return information is

- a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,

- any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,

- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and

- any closing agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement.

Return information does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

taxpayer’s identity[5] or that of the taxpayer’s dependents, the Secretary shall (1) as soon as practicable and without jeopardizing such investigation, notify the taxpayer of such determination and (2) if any person is criminally charged by indictment or information under either of such sections, notify such taxpayer as soon as practicable of such charge.

Effective Date

The proposal applies to determinations made after the date of enactment.

[5] Taxpayer identity means the name of a person with respect to whom a return is filed, mailing address, his taxpayer identifying number, or a combination thereof (sec. 6103(b)(6)).

C. Extension of Time Limit for Return of Property for Wrongful Levy

Present Law

The IRS is authorized to return property that has been wrongfully levied upon.[6] In general, monetary proceeds from the sale of levied property, or an amount equal to the amount of levied upon, may be returned within nine months of the date of the levy.

Generally, any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in levied property and such property was wrongfully levied upon may bring a civil action for wrongful levy in a district court of the United States.[7] Generally, an action for wrongful levy must be brought within nine months from the date of levy.[8] Under present law, if the taxpayer makes a request to the IRS for a return of property, the nine month period is extended for a period of 12 months from the date of filing of such request or six months from the date of mailing of an IRS notice of disallowance of such request.[9]

Description of Proposal

The proposal extends from nine months to two years the general period for returning money and the monetary proceeds from the sale of property that has been wrongfully levied upon.

The proposal also extends from nine months to two years the period for bringing a civil action for wrongful levy.

Effective Date

The proposal 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 nine-month period has not expired as of the date of enactment.

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[6] Sec. 6343.

[7] Sec. 7426(a)(1).

[8] Sec. 6532.

[9] Sec. 6531(c).

D. Individuals Held Harmless on Improper Levy on Individual Retirement Plan

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 59-1/2 or on account of certain other circumstances. Amounts withdrawn from an IRA due to a levy are not subject to the 10-percent early withdrawal tax, regardless of whether the amount is includible in income.

Present law provides rules under which the IRS returns amounts subject to 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.

Description of Proposal

Under the proposal, 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 proposal 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 recontribution may be made to the same IRA or to any other individuated retirement plan (other than an endowment contract) to which a rollover from the IRA levied upon is permitted. That is, the recontribution may be made to the same IRA or to an IRA of the same type.

Under the proposal, 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 is excludable from gross income if the interest is contributed to an IRA under the proposal. An amount contributed to an IRA under the proposal will only be treated as interest paid by the IRS to the extent the total amount contributed under the proposal exceeds the amount of the levy.

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 proposal.

Effective Date

The proposal is effective for levied amounts (and interest thereon) returned to individuals after the date of enactment.

E. Clarification of IRS Unclaimed Refund Authority

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. Section 6103(m) allows the IRS to give the press taxpayer identity information for this purpose. Taxpayer identity includes name, mailing address, taxpayer identification number, or combination thereof.[10]

The IRS believes that the current statutory framework of "press and other media" does not permit disclosures via the Internet. The legislative history of the present-law proposal 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.

Description of Proposal

The proposal allows the IRS to use any means of "mass communication," including the Internet, to notify the taxpayer of an undelivered refund.

Effective Date

The proposal is effective on the date of enactment.

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[10] Sec. 6103(b)(6).

F. Prohibition on IRS Debt Indicators for Predatory Refund Anticipation Loans

Present Law

A refund anticipation loan is a loan made by a commercial lender to a taxpayer based on the refund the taxpayer expects to receive. The IRS is not involved in the making of a refund anticipation loan, rather the loan is a private contract between the taxpayer and a commercial lender. There is controversy over refund anticipation loans because of high fees and rates sometimes associated with those loans.[11] However, the Code does not regulate the making of refund anticipation loans.

Under Notice 99-58,[12] certain tax practitioners that file returns electronically and financial institutions may apply to obtain a Debt Indicator for their customer taxpayers in exchange for screening individual income tax returns for potential abuse. The Debt Indicator facilitates the making of refund anticipation loans because it tells whether or not a taxpayer has any scheduled offsets against a claimed refund. Thus, the Debt Indicator reduces the lender's risk of making a refund anticipation loan because it informs the lender whether the taxpayer's refund will be paid or intercepted for government debts.

Description of Proposal

The proposal prohibits the Secretary from providing a Debt Indicator to any person with respect to any refund anticipation loan if the Secretary determines that the business practices of such person involve refund anticipation loans and related charges and fees that are predatory. Under the proposal, a refund anticipation loan is any loan of money or any other thing of value to a taxpayer secured by the taxpayer's anticipated receipt of a Federal tax refund. For purposes of the proposal, a Debt Indicator means a notification provided to a tax practitioner or financial institution pursuant to a program (such as the program under Notice 99-58) that a taxpayer's refund will be offset to repay debts for delinquent Federal or State taxes, student loans, child support, or other Federal agency debt.

Effective Date

The proposal is effective with respect to returns filed after the date of enactment.

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[11] Testimony of J. Russell George, Treasury Inspector General for Tax Administration, *Hearing before the U.S. Senate Committee on Appropriations, Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies* (April 27, 2006).

[12] 1999-51 I.R.B. 693.

G. Prohibition on Misuse of Department of the Treasury Names and Symbols

Present Law

Section 333 of Title 31 prohibits the use, in connection with advertisements, solicitations, and other business activities, of the words, abbreviations, titles, letters, symbols, or emblems associated with the Department of the Treasury (and services, bureaus, offices, or subdivisions of the Department, including the IRS) in a manner which could reasonably be interpreted as conveying a connection with or approval by the Department of the Treasury (or one of its bureaus, offices, or subdivisions) in the absence of such connection or approval.

The provision provides for a civil penalty of not more than $5,000 per violation (or not more than $25,000 in the case of a broadcast or telecast). In addition, the provision provides a criminal penalty of not more than $10,000 (or not more than $50,000 in the case of a broadcast or telecast) or imprisonment of not more than one year, or both, in any case in which the prohibition is knowingly violated. Any determination of whether there is a violation is made without regard to the use of a disclaimer of affiliation with the Federal Government.

The IRS recently issued warnings to taxpayers about Internet sites that resemble the official IRS site:

> Taxpayers may be confused by the proliferation of Internet sites that contain some form of the Internal Revenue Service name or IRS acronym with a .com, .net, .org or other designation in the address instead of .gov. Since many of these sites also bear a striking resemblance to the real IRS site, taxpayers may be misled into thinking that the site they have accessed is indeed the official IRS government site. These sites are not the official IRS Web site and have no connection to the official IRS site or to the IRS.[13]

The IRS also warned consumers of an ongoing Internet scam in which consumers receive an e-mail informing them of a Federal tax refund.[14] The e-mail claims to be from the IRS and directs the consumer to a link (often resembling the IRS website) that requests personal and financial information. The practice is called "phishing" for information. Once the information is obtained, it could be used in identity theft and stealing a taxpayer's financial assets.

Description of Proposal

The proposal clarifies that "phishing," misleading websites, and other mass communications by electronic means, which could reasonably be interpreted as falsely conveying a connection to or approval by the Department of the Treasury (or its components), are subject to the civil penalty of $25,000 per violation and criminal penalty of $50,000 per

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[13] Internal Revenue Service, IRS Urges Caution about Internet Sites that Resemble the Official IRS Site (IR-2007-58, March 13, 2007).

[14] Id.

violation, currently applicable to broadcasts and telecasts. The proposal reaffirms that the use of the words, abbreviations, titles, letters, symbols, or emblems associated with the Department of the Treasury (and services, bureaus, offices or subdivisions of the Department, including the IRS) in an Internet domain name is covered by 31 U.S.C. sec. 333.

Effective Date

The proposal is effective with respect to violations occurring after the date of enactment.

H. Earned Income Credit Outreach

Present Law

In general

Low and moderate-income taxpayers may be eligible for the refundable earned income credit ("EIC")[15]. Generally, the amount of the EIC is based on the presence and number of qualifying children in the taxpayer's family, as well as on adjusted gross income ("AGI") and earned income[16]. Other rules apply.

Three separate schedules apply in computing the taxpayer's EIC: one schedule for taxpayers with no qualifying children, one schedule for taxpayers with one qualifying child, and one schedule for taxpayers with more than one qualifying child[17].

The EIC generally equals a specified percentage of earned income up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or AGI), if greater) in excess of the beginning of the phaseout range, the maximum EIC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. All income thresholds are adjusted annually for inflation.

Wage Withholding

In general, the Code requires employers to withhold income tax on wages paid to employees, including wages and salaries of employees or elected officials of Federal, state, and local government units. Withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the

[15] The EIC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. Under an advance payment system, eligible taxpayers may elect to receive the credit in their paychecks, rather than waiting to claim a refund on their tax return filed by April 15 of the following year.

[16] Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the taxpayer's net self-employment earnings.

[17] 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 of 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.

employee. The Code also requires that employers report wage withholding information annually to the IRS and their employees (e.g. Form W-2 and Form W-3).[18]

EIC outreach and assistance

Pre tax return filing

The IRS has developed an outreach effort to inform taxpayers potentially eligible for the EIC and their employers about the EIC and how to claim the credit. One such public notice, contained in IRS Notice 797, explains the EIC, its eligibility rules, and how to claim the credit. In addition the IRS works with employers, community groups and other stakeholders to inform eligible taxpayers of the EIC. The IRS also helps taxpayers below certain income levels compute their Federal income tax liability including the amount of EIC, if any.

Post tax return filing

The IRS sends out notice letters addressed to taxpayers who it has identified as potentially eligible for the EIC in the immediately prior taxable year.

The notice letters are different depending on the presence of a qualifying child or children in the taxpayer's household. If the IRS identifies a taxpayer with one or more qualifying children as potentially eligible for the EIC, the notice letter informs the taxpayer that IRS records indicate that: (1) the taxpayer's income falls in the eligible range to receive the EIC; (2) the taxpayer has one or more dependents who may be an EIC qualifying child; and (3) the taxpayer did not claim the EIC for the applicable taxable year on his or her return filed with the IRS. If the IRS identifies a taxpayer without qualifying children as potentially eligible for the EIC, the notice letter informs the taxpayer that IRS records indicate that: (1) the taxpayer's income falls in the eligible range to receive the EIC and (2) the taxpayer did not claim the EIC for the applicable taxable year on his or her return filed with the IRS.

In all cases, the notice letters ask the taxpayers to complete an "EIC Eligibility Check-Sheet" and to return it to the IRS, if the check-sheet indicates eligibility for the EIC. The EIC Eligibility Check-Sheet requests the taxpayer to provide all the information necessary to determine EIC eligibility. The EIC Eligibility Check-Sheet is completed under penalty of perjury by the taxpayer (and the taxpayer's spouse in the case of a joint return). The IRS reviews the information submitted by the taxpayer and either: (1) sends any applicable refund within eight weeks (net of any other amounts the IRS is required to collect), or (2) sends an explanation to the taxpayer stating why the taxpayer does not qualify for the EIC.

The notice letters also provide information to help eligible taxpayers correctly claim the EIC in future taxable years.

Under present law, these notice letters are only sent by the IRS to individuals who have filed a tax return for the applicable taxable year. The absence of the taxpayer's filed tax return,

[18] Information returns, such as Form W-2, are returns within the meaning of section 6103(b)(1).

notwithstanding the receipt by the IRS of return information or an information return (e.g., Form W-2 indicating wage withholding on the taxpayer) from the taxpayer's employer does not trigger a notice letter to the taxpayer.

Limitations on credits and refunds

Under section 6511, a claim for credit or refund of overpayment of tax with respect to which a return must be filed must be made within the later of: (1) three years from the time the return was filed or (2) two years from the time the tax was paid. If no return was filed by the taxpayer, then the applicable time period ends two years after the tax was paid.

Description of Proposal

The proposal requires that the IRS expand its notice requirements relating to potential eligibility for the EIC to all potentially eligible taxpayers regardless of whether they have filed a tax return for the applicable taxable year. Specifically, the IRS is required to provide annually and to the extent possible[19], notice to all taxpayers who have been identified based on return or return information as being potentially eligible for the EIC in any taxable year for which a claim for credit or refund is not barred by the limitation period under sec. 6511. Such notice must be in writing and must be sent to the last known address of such taxpayers: (1) who did not file a claim the EIC for such taxable year, and (2) who the IRS identified as potentially eligible for the EIC for such taxable year based on a return or return information (as defined in sec. 6103(b)).

Upon receipt of this notice letter, the taxpayer who had filed a return for the applicable taxable years would complete the applicable EIC Eligibility Check-Sheet for each of the applicable taxable years. It is anticipated that this Check-Sheet would ask for all the information relating to the taxpayer's eligibility for the EIC (e.g., earned income, AGI, presence and number of qualifying children, and taxpayer identification numbers). If eligible for the EIC, in one or more of the applicable taxable years, the taxpayer would return the EIC Eligibility Check-Sheet to the IRS for any refund (including wages withheld by the taxpayer's employer). In the case of an eligible taxpayer who had not filed a return for the applicable taxable years, the taxpayer would be instructed to file a tax return claiming the EIC to the IRS for any refund (including wages withheld by the taxpayer's employer) for each of the applicable taxable years.

Effective Date

The proposal is effective on the date of enactment.

[19] It is anticipated that the type of available return information and available IRS resources will affect the IRS' ability to issue the additional notice letters contemplated under this proposal.