

PROCEDURE FOR ASSESSING CERTAIN ADDITIONS TO TAX

FEBRUARY 23 (legislative day, FEBRUARY 15), 1960.—Ordered to be printed

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

R E P O R T

[To accompany H.R. 9660]

The Committee on Finance, to whom was referred the bill (H.R. 9660) to amend section 6659(b) of the Internal Revenue Code of 1954 with respect to the procedure for assessing certain additions to tax, having considered the same, report favorably thereon with amendments and recommends that the bill as amended do pass.

The amendments are as follows:

At the end of the bill insert the following:

SEC. 3. (a) Section 213(a) of the Internal Revenue Code of 1954 (relating to deduction for medical, dental, etc. expenses) is amended to read as follows:

“(a) ALLOWANCE OF DEDUCTION.—There shall be allowed as a deduction the following amounts of the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152):

“(1) If neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year—

“(A) the amount of such expenses for the care of any dependent who—

“(i) is the mother or father of the taxpayer or of his spouse or is an individual who stands in loco parentis to the taxpayer or his spouse, and

“(ii) has attained the age of 65 before the close of the taxable year, and

“(B) the amount by which such expenses for the care of the taxpayer, his spouse, and such dependents (other than any dependent described in subparagraph (A)) exceed 3 percent of the adjusted gross income.

“(2) If either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year—

“(A) the amount of such expenses for the care of the taxpayer and his spouse.

“(B) the amount of such expenses for the care of any dependent described in paragraph (1)(A), and

“(C) the amount by which such expenses for the care of such dependents (other than any dependent described in paragraph (1)(A)) exceed 3 percent of the adjusted gross income.”

(b) The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1959.

SEC. 4. (a) Section 151 of the Internal Revenue Code of 1954 (relating to allowance of deductions for personal exemptions) is amended by adding at the end thereof the following new subsection:

“(f) CERTAIN FOREIGN STUDENTS.—

“(1) In general.—An exemption of \$600 for each individual (other than an individual who is a dependent (as defined in section 152))—

“(A) who is not a citizen or a resident of the United States;

“(B) whose presence in the United States is solely for the purpose of pursuing his education in the ninth, tenth, eleventh, or twelfth grades at an educational institution in the United States;

“(C) who is a full-time student in the ninth, tenth, eleventh, or twelfth grades at an educational institution in the United States—

“(i) during each of 7 calendar months during the calendar year in which the taxable year of the taxpayer begins, or

“(ii) during a period of not less than 7 calendar months which ends within such calendar year; and

“(D) who, during the 7 calendar months referred to in subparagraph (C)(i) or during the period referred to in subparagraph (C)(ii), has as his principal place of abode in the United States the home of the taxpayer and is a member of the taxpayer's household.

“(2) EXCEPTIONS.—Paragraph (1) shall not apply with respect to an individual for any taxable year in any case in which the taxpayer receives any money or other property as compensation or reimbursement for maintaining such individual in his home as a member of his household. Clause (ii) of paragraph (1)(C) shall not apply with respect to an individual for any taxable year if the taxpayer was entitled to an exemption under this subsection for such individual for the preceding taxable year by reason of the application of clause (i) of paragraph (1)(C).

“(3) EDUCATIONAL INSTITUTION DEFINED.—For purposes of paragraph (1), the term ‘educational institution’ has the meaning assigned to it by subsection (e)(4).”

(b) Section 213(c) of such Code (relating to limitations on deduction of medical, dental, etc., expenses) is amended by striking out “subsection (c) or (d), relating to additional exemptions for age or blindness” and inserting in lieu thereof “subsection (c), (d), or (f), relating to certain additional exemptions”.

(c) Section 3402(f)(1) of such Code (relating to withholding exemptions) is amended—

(1) by striking out “and” at the end of subparagraph (D);

(2) by striking out the period at the end of subparagraph (E) and inserting in lieu thereof “; and”; and

(3) by adding after subparagraph (E) a new subparagraph as follows:

“(F) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(f) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit.”

(d) The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1959. The amendments made by subsection (c) shall apply with respect to wages paid on or after the first day of the first month which begins more than 20 days after the date of the enactment of this Act.

EXPLANATION OF THE BILL

Section 1. Procedures for assessing certain additions to tax

Section 1, which was adopted by your committee without amendment, deals with the procedure for assessing certain additions to tax.

Section 291(a) of the 1939 Code, as construed by *United States v. Erie Forge Co.* ((3d C.A. 1951) 191 F. 2d 627, cert. denied 343 U.S. 930), provided that additions to income tax, asserted by reason of failure to file a timely return, were to be assessed and collected under the deficiency procedure if the additions to tax were measured by the amount of a deficiency but not if measured by the tax shown on the return. Section 293 of the 1939 Code provided that if any deficiency in income tax was due to negligence or fraud, then the additions to the tax (measured by the deficiency) were to be assessed and collected as if such additions were a deficiency. Section 6659(b) of the 1954 Code, which is derived in part from sections 291(a) and 293 of the 1939 Code, is construed by the Internal Revenue Service as preserving deficiency procedures in appropriate cases of delinquency and in all cases of negligence and fraud but not requiring deficiency notices in other cases. This construction is in harmony with the report of the Committee on Finance which stated that section 6659 “conforms to the rules under existing law.”

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The Courts of Appeals for the Second and Ninth Circuits have rejected the Internal Revenue Service's interpretation of section 6659(b). The court in *Grandquist v. Hackleman* ((9th C.A. 1959) 264 F. 2d 9), held that section 6659(b) warrants a conclusion that additions to the tax shown on the return by reason of a failure to file a timely return are limited by the same restrictions as those imposed on the collection of deficiencies; namely, the addition to the tax cannot be assessed without the issuance of a 90-day letter which permits prepayment review in the Tax Court. The same result was reached by the court in *Strawberry Hill Press, Inc. v. Scanlon* (2d C.A., Dec. 22, 1959).

In a case involving a taxable year under the 1954 Code, the Court of Appeals for the Fifth Circuit held that an addition to tax asserted for the underpayment of estimated tax was a tax to be assessed only after the issuance of a 90-day letter, *Enochs v. Muse* ((5th C.A. 1959), 270 F. 2d 528).

These court decisions have confronted the Internal Revenue Service with very serious administrative problems. For example, before a 90-day letter could be mailed with respect to the addition to tax for late filing, the Internal Revenue Service would have to examine the return to insure that there was no deficiency in tax which might be barred from later assessment because of the restrictions on the issuance of additional 90-day letters under section 6212(c) of the 1954 Code. Such a procedure would force the Service to audit many thousands of returns which otherwise might not be audited. If the Service were forced to follow the 90-day letter procedure for additions to tax for late filing of returns and for underpayment of estimated tax, the number of 90-day letters issued each year would be increased to about 1 million; whereas the Service now issues only about 78,000 90-day letters each year for all causes.

As a consequence, the Internal Revenue Service would either be forced to abandon most of its enforcement efforts in the area of late returns and underpayments of estimated tax or materially curtail the already limited number of returns audited in the course of a year. On the other hand, in practically all these cases there is no dispute either as to law or fact. Moreover, the Internal Revenue Service has for years apparently administered these provisions of the law in a practical, commonsense manner. Under such circumstances little purpose is served by invoking the elaborate 90-day letter procedure before assessing these additions to tax.

Accordingly, section 1 of the bill as passed by the House and approved by the committee provides a general rule that the additions to tax for the late filing of income, estate, and gift tax returns and the underpayment of estimated income tax are to be assessed and collected without the issuance of a 90-day letter. This would restore the procedure followed by the Internal Revenue Service for many years.

The bill provides two exceptions to this general rule that the deficiency procedure does not apply to any addition to tax for late filing or for underpayment of estimated tax. First, an addition to tax for late filing which is attributable to a deficiency in tax will be subject to the 90-day letter procedure. Also, where no return is filed for a taxable year, an addition to tax for underpayment of estimated tax will be subject to the 90-day letter procedure. These

exceptions were present under the 1939 Code and exist because in such cases there is a deficiency in the tax itself which justifies an opportunity for review in the Tax Court.

Section 2. Effective date of section 1, etc.

The first sentence of section 2 of the bill provides that the amendment to section 6659(b) made by the first section of the bill shall apply with respect to assessments made after the date of enactment of the bill.

The second sentence of section 2 of the bill provides that any addition to tax under section 6651, 6654, or 6655, assessed and collected on or before the date of enactment of the bill, shall not be considered an overpayment solely on the ground that the assessment was invalid, if such assessment would not have been invalid had the amendment made by the first section of the bill applied with respect to such assessment. However, a credit or refund may be made of any overpayment of the addition attributable to other grounds, such as a mathematical error, a showing of reasonable cause, or the applicability of a statutory exception under section 6654(d) or 6655(d). In any case where an addition to tax under section 6651, 6654, or 6655 has been assessed on or before the date of enactment of the bill without issuance of a notice of deficiency and the amount has not been collected, it will be necessary to abate the assessment and make a new assessment under the amendment, provided the period of limitations on assessment has not expired. If any amount is assessed on or before the date of the enactment of the bill and is collected after the date of enactment, such amount is an overpayment not subject to the second sentence of section 2 of the bill. In such a case, a new assessment may be made unless the period for assessment has expired.

Section 3. Medical expenses of certain dependent parents

Section 3 of the bill was added by your committee. It removes the 3-percent limit on medical expenses incurred by the taxpayer for the care of his dependent mother or dependent father or the dependent mother or father of his spouse or a dependent individual who stands in loco parentis to the taxpayer or his spouse, if such dependent has attained the age of 65 before the close of the taxable year. (The 3-percent limitation permits a deduction for medical expenses only to the extent they exceed 3 percent of the taxpayer's adjusted gross income.) Under the existing law, the 3-percent limitation is removed only with respect to medical expenses for the care of a taxpayer or his spouse, if either has attained the age of 65 before the close of the taxable year. The amendment applies to taxable years beginning after December 31, 1959.

Section 4. Personal exemption for certain foreign students

Section 4 of the bill was also added by your committee. Generally section 4 allows a \$600 deduction to a taxpayer who maintains a foreign student in his home as a member of his household for a period of not less than 7 months during which the foreign student is enrolled full time at an educational institution, defined in the statute. To qualify the taxpayer for this deduction, the foreign student must not be a citizen or resident of the United States; his presence in the United States must be solely for the purpose of pursuing his education in the 9th, 10th, 11th, or 12th grade at an educational institution in

the United States; and he must be a full-time student in such grades in such educational institution during each of 7 calendar months in the calendar year in which the taxable year of the taxpayer begins, or during a period of not less than 7 calendar months which ends within such calendar year. While this provision does not require the taxpayer to meet the support test to qualify for the \$600 deduction, it will be denied if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the foreign student in his home as a member of his household.

While section 4 allows a deduction for a foreign student who meets the prescribed requirements, it does not qualify the foreign student as a dependent of the taxpayer and therefore provisions of the 1954 Code relating to dependents are not affected. Section 4 also contains an amendment to prevent an increase in the maximum limitation on the deduction for medical expenses by reason of a taxpayer's being entitled to an exemption for a foreign student.

In addition to allowing a deduction in the case of a foreign student who meets the prescribed requirements, section 4 of the bill permits an exemption for purposes of the withholding tax if the taxpayer reasonably expects an exemption for the foreign student will be allowable for the taxable year to which the withholding relates.

It is provided that the \$600 deduction shall apply with respect to taxable years beginning after December 31, 1959, and that the provision relating to withholding exemptions shall apply with respect to wages paid on or after the first day of the first month which begins more than 20 days after the date of enactment of the bill.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in *italic*, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SEC. 151. ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

(a) ALLOWANCE OF DEDUCTIONS.—In the case of an individual, the exemptions provided by this section shall be allowed as deductions in computing taxable income.

(b) TAXPAYER AND SPOUSE.—An exemption of \$600 for the taxpayer; and an additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(c) ADDITIONAL EXEMPTION FOR TAXPAYER OR SPOUSE AGED 65 OR MORE.—

(1) FOR TAXPAYER.—An additional exemption of \$600 for the taxpayer if he has attained the age of 65 before the close of his taxable year.

(2) **FOR SPOUSE.**—An additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse has attained the age of 65 before the close of such taxable year, and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(d) **ADDITIONAL EXEMPTION FOR BLINDNESS OF TAXPAYER OR SPOUSE.**—

(1) **FOR TAXPAYER.**—An additional exemption of \$600 for the taxpayer if he is blind at the close of his taxable year.

(2) **FOR SPOUSE.**—An additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income, and is not the dependent of another taxpayer. For purposes of this paragraph, the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer; except that if the spouse dies during such taxable year such determination shall be made as of the time of such death.

(3) **BLINDNESS DEFINED.**—For purposes of this subsection, an individual is blind only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(e) **ADDITIONAL EXEMPTION FOR DEPENDENTS.**—

(1) **IN GENERAL.**—An exemption of \$600 for each dependent (as defined in section 152)—

(A) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than \$600, or

(B) who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student.

(2) **EXEMPTION DENIED IN CASE OF CERTAIN MARRIED DEPENDENTS.**—No exemption shall be allowed under this subsection for any dependent who has made a joint return with his spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

(3) **CHILD DEFINED.**—For purposes of paragraph (1) (B), the term “child” means an individual who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer.

(4) **STUDENT AND EDUCATIONAL INSTITUTION DEFINED.**—For purposes of paragraph (1) (B) (ii), the term “student” means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins—

(A) is a full-time student at an educational institution; or

(B) is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution or of a State or political subdivision of a State.

For purposes of this paragraph, the term "educational institution" means only an educational institution which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on.

(f) *CERTAIN FOREIGN STUDENTS.*—

(1) *IN GENERAL.*—*An exemption of \$600 for each individual (other than an individual who is a dependent (as defined in section 152))—*

(A) *who is not a citizen or a resident of the United States;*

(B) *whose presence in the United States is solely for the purpose of pursuing his education in the ninth, tenth, eleventh, or twelfth grades at an educational institution in the United States;*

(C) *who is a full-time student in the ninth, tenth, eleventh, or twelfth grades at an educational institution in the United States—*

(i) *during each of 7 calendar months during the calendar year in which the taxable year of the taxpayer begins, or*

(ii) *during a period of not less than 7 calendar months which ends within such calendar year; and*

(D) *who, during the 7 calendar months referred to in subparagraph (C)(i) or during the period referred to in subparagraph (C)(ii), has as his principal place of abode in the United States the home of the taxpayer and is a member of the taxpayer's household.*

(2) *EXCEPTIONS.*—*Paragraph (1) shall not apply with respect to an individual for any taxable year in any case in which the taxpayer receives any money or other property as compensation or reimbursement for maintaining such individual in his home as a member of his household. Clause (ii) of paragraph (1)(C) shall not apply with respect to an individual for any taxable year if the taxpayer was entitled to an exemption under this subsection for such individual for the preceding taxable year by reason of the application of clause (i) of paragraph (1)(C).*

(3) *EDUCATIONAL INSTITUTION DEFINED.*—*For purposes of paragraph (1) the term "educational institution" has the meaning assigned to it by subsection (e) (4).*

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SEC. 213. MEDICAL, DENTAL, ETC., EXPENSES.

[(a) **ALLOWANCE OF DEDUCTION.**—There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152)—

[(1) if neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year, to the extent that such expenses exceed 3 percent of the adjusted gross income; or

[(2) if either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year—

[(A) the amount of such expenses for the care of the taxpayer and his spouse, and

[(B) the amount by which such expenses for the care of such dependents exceed 3 percent of the adjusted gross income.]

(a) *ALLOWANCE OF DEDUCTION.*—There shall be allowed as a deduction the following amounts of the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152):

(1) *If neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year—*

(A) *the amount of such expenses for the care of any dependent who—*

(i) *is the mother or father of the taxpayer or of his spouse, or is an individual who stands in loco parentis to the taxpayer or his spouse, and*

(ii) *has attained the age of 65 before the close of the taxable year, and*

(B) *the amount by which such expenses for the care of the taxpayer, his spouse, and such dependents (other than any dependent described in subparagraph (A)) exceed 3 percent of the adjusted gross income.*

(2) *If either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year—*

(A) *the amount of such expenses for the care of the taxpayer and his spouse,*

(B) *the amount of such expenses for the care of any dependent described in paragraph (1)(A), and*

(C) *the amount by which such expenses for the care of such dependents (other than any dependent described in paragraph (1)(A)) exceed 3 percent of the adjusted gross income.*

(b) *LIMITATION WITH RESPECT TO MEDICINE AND DRUGS.*—Amounts paid during the taxable year for medicine and drugs which (but for this subsection) would be taken into account in computing the deduction under subsection (a) shall be taken into account only to the extent that the aggregate of such amounts exceeds 1 percent of the adjusted gross income.

(c) *MAXIMUM LIMITATIONS.*—Except as provided in subsection (g), the deduction under this section shall not exceed \$2,500, multiplied by the number of exemptions allowed for the taxable year as a deduction under section 151 (other than exemptions allowed by reason of [subsection (c) or (d), relating to additional exemptions for age or blindness] subsection (c), (d), or (f), relating to certain additional exemptions); except that the maximum deduction under this section shall be—

(1) \$5,000, if the taxpayer is single and not the head of a household (as defined in section 1(b)(2)) and not a surviving spouse (as defined in section 2(b)) or is married but files a separate return; or

(2) \$10,000, if the taxpayer files a joint return with his spouse under section 6013, or is the head of a household (as defined in section 1(b)(2)) or a surviving spouse (as defined in section 2(b)).

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SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

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(f) *WITHHOLDING EXEMPTIONS.*—

(1) *IN GENERAL.*—An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself;

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(B) one additional exemption for himself if, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c)(1) (relating to old age) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(C) one additional exemption for himself if, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(d)(1) (relating to the blind) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A), (B), or (C), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption; **[and]**

(E) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(e) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a **[credit.]** *credit; and*

(f) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(f) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit.

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SEC. 6659. APPLICABLE RULES.

(a) ADDITIONS TREATED AS TAX.—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to “tax” imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

[(b) ADDITIONS TO TAX FOR FAILURE TO FILE RETURN OR PAY TAX.—Any addition under section 6651 or section 6653 to a tax imposed by another subtitle of this title shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax (including the provisions of subchapter B of chapter 63, relating to deficiency procedures for income, estate, and gift taxes).**]**

(b) *PROCEDURE FOR ASSESSING CERTAIN ADDITIONS TO TAX.*—
For purposes of subchapter B of chapter 63 (relating to deficiency procedures for income, estate, and gift taxes), subsection (a) shall not apply to any addition to tax under section 6651, 6654, or 6655; except that it shall apply—

(1) in the case of an addition described in section 6651, to that portion of such addition which is attributable to a deficiency in tax described in section 6211; or

(2) to an addition described in section 6654 or 6655, if no return is filed for the taxable year.

