

# **Summary of Staff Discussion Draft: Tax Administration**

**Chairman Max Baucus  
U.S. Senate Committee on Finance**

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## **Overview**

As part of his work towards federal tax reform, Chairman Max Baucus is releasing a staff discussion draft today of proposed reforms to the administration of the tax laws. The Chairman and his staff are grateful to the Joint Committee on Taxation (JCT) and Senate Legislative Counsel for their assistance with this draft.

Each year Americans spend more than 6 billion hours filing over 150 million federal income tax returns. In addition to paying their taxes and filing income tax returns, each year individuals and businesses file an additional 1.4 billion information returns, such as Forms W-2 and 1099. The tax code is so complex and difficult to comply with that nearly 90 percent of taxpayers now rely on paid tax return preparers or software to complete and file their returns. Collectively, Americans spend nearly \$170 billion each year on tax compliance. And small businesses spend approximately \$1,500 per employee on tax compliance.

Moreover, tax refund fraud through identity theft has grown to alarming levels. In 2010, there were nearly a half million reported incidents where a stolen identity was used to file a tax return and fraudulently claim a tax refund. These incidents more than doubled to over a million cases in 2011. These crimes cause great hardship on identity theft victims because the tax refunds lawfully owed to them are greatly delayed. They are also very difficult and labor intensive for the IRS to resolve. The Treasury Inspector General for Tax Administration recently reported that it takes the IRS, on average, over 400 days to resolve a single case. In addition to the hardship that it imposes on victims, tax-related identity theft costs the government billions of dollars annually.

Non-compliance with the tax laws also continues to be a significant problem. Most Americans voluntarily comply with the tax laws and approximately 83% of income taxes properly owed are paid. Nevertheless, the IRS estimated that the difference between the amount of tax owed and the amount ultimately paid was \$345 billion in 2006 (the most recent "tax gap" estimate available). Compliance improves to nearly 95 percent when third parties report income and transactions through information reporting processes.

Over the past three years, the Finance Committee has held over two dozen hearings related to tax reform. Many of those hearings have involved tax administration issues, with most witnesses calling for tax simplification. The Committee has also issued a paper on tax reform options in this area. This staff discussion draft proposes a package of reforms to modernize tax administration, minimize compliance burdens, reduce tax-related identity theft, and shrink the tax gap. These proposals should be considered as a package and not as stand-alone proposals.

## **Summary of the Staff Discussion Draft**

### ***Tax Filing Reforms***

The first set of proposals in the staff discussion draft would simplify the tax filing process, remove deadwood from the tax code, and leverage the dramatic technological advances that have occurred since Congress last reformed the tax code in 1986. The proposals are summarized below.

#### **Improving the Information Return Filing Process**

- Taxpayers are no longer required to file corrected information returns if the error is less than \$25.
- The IRS must develop a simple internet platform for preparing and filing Forms 1099 that is functionally similar to the *Business Services Online* platform (<http://www.ssa.gov/bso/bsowelcome.htm>) that employers use to file Forms W-2.
- Returns generated by a computer but filed on paper must contain a scannable code, which will enable the IRS to more efficiently upload the return information. This proposal is based on a provision in S.1289 (112<sup>th</sup>), TAX GAP Act of 2011, sponsored by Sen. Carper.
- Information returns, including Forms W-2 and 1099, must be filed with the government by February 21<sup>st</sup> of each year, rather than by the current law dates of February 28<sup>th</sup> (for paper forms) and March 31<sup>st</sup> (for electronic forms). Information returns must still be delivered to recipients by January 31<sup>st</sup>.

#### **Common Sense Filing Deadlines**

- Under current law, tax returns for calendar year corporations, including S corporations, are due on March 15<sup>th</sup> (September 15<sup>th</sup> if an extension is filed). Calendar year partnership and individual returns are due on April 15<sup>th</sup> (October 15<sup>th</sup> if an extension is filed). Individuals and corporations often depend on tax return information provided by

partnerships and S Corporations to complete their returns. The staff discussion draft changes certain filing deadlines so that taxpayers will receive the information needed to file complete returns on a more timely and orderly basis. This proposal is based on a provision in S.420 (113<sup>th</sup>), Tax Return Due Date Simplification and Modernization Act of 2013, sponsored by Sen. Enzi.

### **Expansion of Electronic Filing**

- The number of returns that trigger an electronic filing requirement is gradually reduced over a three year period from 250 returns per year to 25.
- Paid return preparers must electronically file all tax returns and information documents that they prepare for their clients.
- Forms M-3 and 990 must be filed electronically. The Treasury Department has authority to delay implementation if appropriate.
- Electronic filing of Forms 5500 by employee benefit plans is increased. This proposal is based on a provision of S.1289 (112<sup>th</sup>), TAX GAP Act of 2011, sponsored by Sen. Carper.

### **Repeal of Deadwood Provisions and Technical Corrections**

- A JCT document listing 108 provisions that may be obsolete is being released with the staff discussion draft. The Chairman's staff proposes to repeal these provisions to the extent that doing so is consistent with other aspects of tax reform.
- JCT has also prepared legislative language addressing a number of provisions in the tax code in need of technical correction. The Chairman's staff proposes to address these technical issues to the extent that doing so is consistent with other aspects of tax reform.

### ***Tax-Related Identity Theft and Other Tax Fraud Prevention***

The second set of reforms in the staff discussion draft provides the IRS with new tools to combat tax-related identity theft and assist the victims of this crime.

#### **Tax-Related Identity Theft**

- Access to the Social Security Administration's public death data – the Death Master File (DMF) – is restricted for three years. An exception is provided for individuals or entities with a legitimate fraud prevention or business need for the information and who agree to keep the data private. Disclosure to third parties is permitted if they agree to protect

the information. Penalties apply to any unauthorized disclosure. In the case of unauthorized disclosure by third parties, penalties apply to both the third party and the original recipient of the information. Individuals and entities can use existing customer, client, or patient information protection systems to meet the requirements of the proposal. This proposal is based on a provision in S.676 (113<sup>th</sup>), Identity Theft and Tax Fraud Prevention Act of 2013, sponsored by Sen. Nelson.

- Form W-2 will no longer include the taxpayer's full Social Security Number (SSN); instead, the IRS may require use of only the taxpayer's truncated SSN or other taxpayer identification number.
- The IRS is granted authority to use the Department of Health and Human Services' National Directory of New Hires to verify employment data.
- The staff discussion draft establishes new criminal penalties for tax-related identity theft. Filing a tax return using another person's identity is a felony subject to a fine of not more than \$250,000 fine and/or up to 5 years in prison. This proposal is based on a provision in S.676 (113<sup>th</sup>), Identity Theft and Tax Fraud Prevention Act of 2013, sponsored by Sen. Nelson.
- The staff discussion draft provides aid to taxpayers who have been victims of tax-related identity theft by requiring the IRS to notify taxpayers that it determines to be victims of identity theft. In addition, the IRS is required to assign each victim a single point of contact to help facilitate rapid case resolution. This proposal is based on a provision in S.676 (113<sup>th</sup>), Identity Theft and Tax Fraud Prevention Act of 2013, sponsored by Sen. Nelson.
- The IRS is required to report to Congress on the viability of expanding the existing personal identification number (PIN) program available for victims of tax-related identity theft. The report must consider whether allowing all taxpayers the option of obtaining a PIN from the IRS to secure their return filing is an effective way to combat tax-related identity theft. The report must also determine whether the IRS should authenticate taxpayer identity and distribute PINs to participating taxpayers through an internet platform similar to *my Social Security* (<http://www.ssa.gov/myaccount/>) used by the Social Security Administration.

### **Other Tax Fraud Prevention**

- The due diligence requirements currently imposed on tax return preparers with respect to the Earned Income Tax Credit are extended to include the Child Tax Credit. A tax

return preparer who does not comply with the Child Tax Credit due diligence requirements must pay a penalty of \$500 for each failure.

### ***Reducing the Tax Gap***

The third set of reforms in the staff discussion draft reduces the tax gap by increasing information reporting in certain areas, providing the IRS with additional collection tools, and clarifying that the IRS may regulate tax return preparers.

#### **Narrowly Targeted Information Reporting Enhancements**

- Banks must report the existence of bank accounts, including accounts on which no interest was earned, during the taxable year. This proposal is based on a provision in S.1289 (112<sup>th</sup>), TAX GAP Act of 2011, sponsored by Sen. Carper.
- Information returns on mortgage interest must include the outstanding balance of the mortgage; the address of the encumbered property; property taxes, if any, paid from escrow; and the loan origination date. This proposal is based on a provision in S.1289 (112<sup>th</sup>), TAX GAP Act of 2011, sponsored by Sen. Carper.
- Life insurance companies must file information returns on the sale of a life insurance policy into the secondary market. The staff discussion draft also clarifies that the basis in a life insurance policy is not reduced by the cost of insurance, and that certain transfers of interests in trusts or partnerships that hold life insurance policies are treated as transfers for valuable consideration. This proposal is based on a provision in S.2048 (112<sup>th</sup>), A bill to amend the Internal Revenue Code of 1986 to clarify the tax treatment of certain life insurance contract transactions, and for other purposes, sponsored by Sen. Casey.
- Colleges and universities must report the amounts received (rather than either amounts received or billed) for tuition and other higher education expenses on Form 1098-T.
- Businesses must show how much of their gross receipts and expenses are reflected in separately filed Forms 1099 by breaking those amounts out on their Form 1040 Schedule C. The staff discussion draft also requests a report from the Treasury Department on how to improve tax compliance by sole proprietors. This proposal is based on a provision in S.1289 (112<sup>th</sup>), TAX GAP Act of 2011, sponsored by Sen. Carper.

#### **Additional Tools for Collections**

- The IRS is authorized to impose a levy of up to 100 percent on payments to Medicare providers that are seriously delinquent in their taxes. This proposal is based on a

provision in S. 3457 (112<sup>th</sup>), Veterans Jobs Corps Act of 2012, sponsored by Sen. Bill Nelson.

- The State Department is authorized to revoke passports of individuals with seriously delinquent tax debts in excess of \$50,000.
- The IRS is authorized to waive fees for installment agreements if the taxpayer agrees to make payment through automated withdrawals. This proposal is based on a provision in H.R.1528 (108<sup>th</sup>), the Tax Administration Good Government Act, sponsored by then-Rep. Portman.

### **Regulation of Tax Return Preparers**

In the recent case, *Loving v. I.R.S.*, the United States District Court for the District of Columbia concluded that the IRS and Treasury Department do not have the authority to regulate tax return preparers that only prepare returns for their clients. This case is currently on appeal to the United States Court of Appeals for the District of Columbia.

The staff discussion draft amends 31 U.S.C. 330 to make it clear that the Treasury and IRS have the authority to regulate all paid tax return preparers. No negative inference is intended or should be taken with respect to whether the IRS and Treasury Department have the authority to regulate return preparers in past periods.

### ***Other Reforms***

In addition to the proposals detailed above, the staff discussion draft includes several other administrative changes, including expanding taxpayer access to the U.S. Tax Court, and permitting the IRS to share certain tax information with the Bureau of Labor Statistics.

### **Request for Comments and Unaddressed Issues**

Comments are requested on all aspects of the staff discussion draft as well as other areas of tax administration practice and procedure. Comments on the additional issues listed below that are not addressed in the discussion draft but that the Chairman's staff is considering are of particular interest. All comments should be submitted to [tax\\_reform@finance.senate.gov](mailto:tax_reform@finance.senate.gov). While comments will be accepted at any time, the staff requests comments by January 17, 2014 in order to be able to give them full consideration.

The unaddressed issues that the Chairman's staff is considering are listed below:

- Streamlining and Reducing the Number of Information Returns. Currently, there are 17 distinct Forms 1099. Each applies to different types of income or transactions, requests different information, and often has a different filing threshold. As part of its efforts to simplify tax compliance, the Chairman's staff is looking at ways to combine the existing forms so that a single form can report multiple types of information. Comments are requested on ways to reduce the number of Forms 1099, what information is critical in the information return process, and whether a universal filing threshold is appropriate.
- Roll-Over of Small Information Return Errors. In addition to the proposed de minimis error rule for correction of Forms 1099, the Chairman's staff is considering whether a process should be established that permits taxpayers to roll small errors forward into the subsequent year. The goal would be to ensure that small errors (for example, between \$25 and \$150) are reported and corrected, but in a manner that avoids issuing corrected documents and filing amended returns. Comments are requested on whether such an approach would effectively reduce taxpayer compliance burdens and how such a program could be structured to be administratively efficient while protecting government revenues. Comments are also requested on the type and magnitude of errors that should be eligible for roll-over correction.
- Correctable Taxpayer Errors. Currently, the IRS has authority to correct math errors without subjecting the taxpayer to a full audit. Math errors must be clear on the face of the current return without cross-referencing any other information. Given advances in technology that make access to prior year tax records easier, the Chairman's staff is considering whether similarly clear errors that are confirmable based on other return information should also be automatically correctable by the IRS. This class of errors could include errors relating to filing thresholds, lifetime maximums or caps, age criteria, and other requirements that the IRS can verify based on the taxpayer's prior returns or third party information reporting. Comments are requested on whether math error authority should be expanded in this manner and, if so, what specific errors should be automatically correctable by the IRS. Comments are also requested on what taxpayer protections would be necessary to make sure that the IRS does not overstep such authority, and what third party information, if any, is sufficiently reliable to be used as a basis for automatic corrections.
- Role of IRS Appeals. The IRS Appeals function helps resolve disputes between the IRS and taxpayers by providing an additional review of proposed audit adjustments. Comments are requested on whether to create a statutory taxpayer right to review by the Appeals office prior to the IRS issuing a notice of deficiency, and whether such a

right would protect taxpayers and create a more efficient dispute resolution environment.

- Penalties. It has been 24 years since Congress last overhauled the tax penalty regime. The Chairman's staff is interested in reforming the current penalty structure to ensure that penalties are used appropriately to effectively promote taxpayer compliance. Comments are requested on how best to target penalties, when penalties should be waivable, and when a strict liability standard should apply. Comments are also requested on how to ensure that similarly-situated taxpayers are treated similarly within a penalty regime. Finally, comments are requested on how to structure penalties to avoid overlap and which penalties are obsolete, unnecessary, or otherwise ineffective.
- Electronic Filing. Comments are requested on whether, and how, to penalize a taxpayer who violates a requirement to electronically file a return by instead filing a paper return.
- Death Master File Access. Under the staff discussion draft, parties that satisfy requirements, including a "legitimate fraud prevention or business purpose" test, are allowed immediate access to the Death Master File. The Chairman's staff recognizes that various parties without obvious legitimate interests, such as forensic or genealogical researchers, may have a legitimate need for immediate access. Comments are requested on how the concept of "legitimate fraud prevention or business purpose" should be defined.
- Taxpayer Privacy. The U.S. tax system is at its core a voluntary system. A cornerstone of this system is that taxpayers know that the IRS will protect their private, personal information. That is why the tax laws impose strong penalties when taxpayer information is made public. The Chairman's staff recognizes that taxpayer privacy is now under threat more than ever. The recent hacking of the South Carolina Revenue Department highlights the importance of securing taxpayer information. Nevertheless, taxpayer information can provide valuable information for administering other government programs and, when anonymous, researching the effects and effectiveness of tax and other government policies. Therefore, the Code provides exceptions that allow sharing of taxpayer information in very limited circumstances, similar to the proposed sharing of information with the Bureau of Labor Statistics contained in this staff discussion draft. Comments are requested on how to modify and update the Code's privacy protections to ensure that they are effective, while at the same time recognizing the benefits that limited information sharing can provide for detecting and preventing fraud in other government programs and improving tax and other government policies.



- Protecting Taxpayer Rights. Protecting taxpayer rights must always be a top priority of Congress, the IRS, and the Treasury Department. Congress last acted on taxpayer rights in the Taxpayer Bill of Rights II (“TBOR II”) in 1998. Given that it has been 15 years since taxpayer rights were last updated and the National Taxpayer Advocate has recommended adding TBOR II to the tax code, the Chairman’s staff is considering whether to update TBOR II. Comments are requested on whether the current TBOR II adequately protects taxpayers, whether new rules are needed, and whether those rules need to be included in the Internal Revenue Code.
- Interested parties are encouraged to suggest other proposals that improve or simplify tax administration, reduce the tax gap, and reduce compliance or enforcement burdens.