EXECUTIVE COMMITTEE MEETING TO CONSIDER THE NOMINATION OF HENRY M. PAULSON, JR., TO BE SECRETARY OF THE TREASURY; AND TO CONSIDER S. 1321, THE TELEPHONE EXCISE TAX REPEAL ACT OF 2005, AND AN AMENDMENT THAT INCORPORATES S. 832, THE TAXPAYER PROTECTION AND ASSISTANCE ACT OF 2005; AND S. 3569, THE U.S.-OMAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

WEDNESDAY, JUNE 28, 2006

U.S. Senate,

Committee on Finance,

Washington, DC.

The meeting was convened, pursuant to notice, at 10:22 a.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Present: Senators Lott, Snowe, Kyl, Thomas, Santorum, Bunning, Crapo, Baucus, Conrad, Jeffords, Bingaman, Lincoln, Wyden, and Schumer.

Also present: Kolan Davis, Republican Staff Director and Chief Counsel; Russ Sullivan, Democratic Staff Director; Carla Martin, Chief Clerk; and Mark Blair, Deputy Clerk.

Also present: Thomas Barthold, Chief of Staff, Joint Committee on Taxation; David Johanson, International Trade Counsel; Hon. Shaun Donnelly, Assistant U.S. Trade

Representative for Europe and the Middle East, Office of the U.S. Trade Representative; Ken Freiberg, Deputy General Counsel, Office of the U.S. Trade Representative; Mary Baker, Tax Detailee; Tiffany Smith, Tax Detailee; and Janis Lazda, Trade Detailee.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The Chairman. Good morning, everybody. We have, of course, three items on the agenda: nomination of Henry Paulson for Treasury Secretary, the telephone tax repeal proposal, and the good government tax procedure proposal, and the Oman Free Trade Agreement.

Last night, following the hearing yesterday, members--meaning all the members of this committee--submitted 149 questions for the record for Mr. Paulson. My understanding is that Mr. Paulson and administration staff worked throughout the night to answer those questions.

However, as we start this meeting, members have not received the responses, or are maybe in the process of receiving the responses. So in order to allow members sufficient time to review these responses from Mr. Paulson, I am going to have to temporarily set aside the vote on his nomination.

It would be my intention to return to the Paulson nomination after processing the other items on the agenda, so I thank the members for their consideration of that, as we promised members that we would not proceed with the nomination until those responses were up here.

The next item is the telephone tax/good government bill. I am very pleased that today we are able to move forward on these two items, one, by Senator Santorum, the Telephone Excuse Tax bill, and the other one by Senator Bingaman, to address taxpayer protection and assistance.

The Treasury Department recently eliminated the telephone excise tax for long distance, effectively leaving only the local phone tax. This legislation that we mark up today eliminates the local phone tax, the tax that particularly hits families and the elderly.

I am pleased that we can finally hang up on the phone tax today, a tax that has been listed as a temporary tax increase going back to the Spanish and American War in 1898.

In addition to ending the phone tax, we are including, today, several other items related to telecommunication matters. Senators Rockefeller and Burns have been working for a long time to deal with broad band in rural areas, and that, of course, brings modern technology to all Americans.

In addition, Senators Thomas, Baucus, and other Senators have supported better rules regarding depreciation of wireless telecommunications, and that has been included.

We have a great deal of interest by members on

improving tax administration. So in addition to Senator Bingaman's legislation that focuses upon paid preparers, making sure that they have minimum qualifications, we are including a significant number of provisions from S. 882, sponsored by Senator Baucus and me, that passed the Senate in previous Congresses.

We include several provisions from Senator Hatch to promote tax compliance, as well as proposed reforms to the Free File Allowance by Senator Lott. We include provisions from Senators Kerry and Thomas that seek to provide greater privacy of telephone information.

I particularly note that we include a provision offered by Senators Snowe and Hatch dealing with payroll tax deposit agents. Senator Lincoln has a provision that we include that will give veterans more time to seek a refund claim for over-payment on taxes related to disability determination.

Senator Kyl offered two amendments that we have accepted, including providing Tax Court jurisdiction on innocent spouse equitable relief, and that was a suggestion from the Taxpayers Advocate.

Both Oregon Senators have language included, Senator Smith allowing the courts to have tax refunds obligated for unpaid State court debt, and Senator Wyden has encouraged us to make tax filing on the Internet to be

simple and easy.

We have made good steps with this bill, including Senator Akaka's legislation that provided for free electronic filing for all individuals, not just for corporations.

Senator Baucus has many provisions in the bill that I will have him speak to, but I am happy to work with him on language that we have included in the bill. He has been vocal about authorizing language to deal with the tax gap, and I commend him, as he has brought that up in so many of our meetings, even private meetings that we have had with Treasury people.

I would, finally, note that I am especially pleased that this bill includes an amendment offered by Senator Santorum and the Chairman dealing with sex trafficking. This involves the sad fact of 14,000 to 17,000 new victims brought in every year, many, many of them being very young girls, basically subject to this terrible crime.

We take some first steps to have the IRS Office of Criminal Investigation focus on these crimes. The pimps have bragged about the fact that they make big money and pay no taxes. The IRS brought in Al Capone under tax law violation as the only way to get ahold of him, and I think that then the IRS can help here in fighting with

the human tragedy of sex trafficking.

This bill is fully offset--emphasize, fully offset--primarily paid for with economic substance legislation that has previously passed the Senate, as well as revenue raisers from the IRS reform package, and, finally, legislation offered by Senator Schumer dealing with inversions.

The bill is actually in the black, given these revenue raisers, but it would be my intent that, when passed by the Senate, that it would be revenue neutral.

I also want to highlight two other amendments for members' attention. We have heard from the Commissioner of IRS, in testimony last week, about problems of erroneous refund claims made by corporations. The Commissioner noted that there were not any real penalties to address this problem. We include in the bill today new strong penalties for dealing with erroneous claims.

We also include legislation that doubles the fines and penalties on tax-exempt organizations that engage in inappropriate political activity and lobbying. The use of charities for lobbying is clearly a very clear problem across the political spectrum.

Senator Baucus and I have been looking at these matters over a period of two and a half years, and I expect that we will be doing more in this area to combat

the inappropriate use of charities for lobbying. This has been a bipartisan effort. As often, I am able to appreciate Senators working with us, particularly Senator Baucus, to make this mark-up what I hope will be a success for taxpayers.

I now turn to Senator Baucus for his opening statement.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. Thank you, Mr. Chairman.

Today we meet to report out three distinct, and I think quite important, matters: the nomination of the Treasury Secretary, tax legislation on the telephone tax and tax preparers, and the Oman Free Trade Agreement.

First, we consider the nomination of Hank Paulson to become Secretary of Treasury. Mr. Paulson is a man with great talents. He will need them. The government is running a $300 billion budget deficit. The balance of trade is ever widening. Economic competition is coming from China and India, and the Treasury Department suffers depressed morale. Plainly, we need strong new leadership at Treasury, and I hope that Hank Paulson will be the man for the job.

Next, we consider the telephone tax, first instituted to pay for the Spanish-American War. Henry Cabot Lodge once said, "The war of the United States with Spain was very brief. Its results were many, startling, and of world-wide meaning."

One of those "startling" results was the longevity of the Federal telephone excise tax. The war lasted just 229 days, but the tax lasted more than a century. It is

time to give Americans relief from this progressive tax; it is time to repeal it.

Mr. Chairman, I know that you have worked hard with all the members of the committee to ensure that their proposals related to the telephone taxes and to improve tax administration have been considered, and as a result, I think we have a good bill that will finally repeal the tax.

Your mark will also significantly improve tax administration and crack down on incompetent and unethical tax preparers. I am pleased that this bill gives us the opportunity to fix so many of the problems with paid preparers that were exposed during this committee's hearing in April.

GAO testified about its undercover visits to paid preparers who were only too willing to look the other way when it came to cash income or unwarranted credits. GAO testified that its undercover visits resulted in just two correct tax returns out of 19 prepared.

This bill will require all preparers to meet competency requirements, and this bill significantly strengthens penalties on those preparers who choose to ignore tax laws.

It protects taxpayers from having their tax return information from being sold to the highest bidder for who

knows what purpose.

The time is right to protect law-abiding Americans as they fulfill their yearly tax obligation. The Senate passed many of the provisions in this bill already as part of my Good Government Act of 2004, and very importantly, the bill is fully paid for. It is a good bill, and I look forward to its passage.

Third, we continue to consider legislation to implement the U.S.-Oman Free Trade Agreement. This mark-up is the second-to-last step in this committee's consideration of the U.S.-Oman FTA under trade promotion authority, otherwise known as TPA.

We do not have the opportunity to amend the legislation before us today. Rather, we are asked to vote on the implementing legislation as the administration has presented it to us.

Two months ago, we held a mock mark-up of the draft implementing text that the administration submitted for Finance Committee consideration. The mock mark-up allows this committee to consider amendments to the draft text before the text is submitted to Congress and it becomes unamendable under trade promotion authority.

This practice, developed decades ago to ensure that Congress' constitutional prerogative to regulate international commerce, will not be undermined. In

exchange for this practice, trade promotion authority delegated to the executive branch the power to negotiate free trade agreements with foreign countries.

During the mock mark-up, we heard a lively and engaging discussion in this committee on an amendment drafted by Senator Conrad. We heard a respectful exchange of ideas and viewpoints. We heard a discussion that led to a consensus of the members of this committee.

However, the administration chose not to listen. We heard 18 members of this committee vote in favor of Senator Conrad's amendment, and we heard 19 members of this committee vote in favor of the draft implementing text, as amended.

But again, the administration chose not to listen. Instead of working to reconcile the different versions of this legislation, the unamended House Ways and Means Committee version was chosen without a work, without a conference, and without listening.

So before us today is implementing legislation that does not include the Conrad amendment text. These actions fail to respect how this committee voted unanimously. These actions seriously violate the spirit of the process. These actions abuse the trust that Congress placed in the administration by granting it fast track authority.

The administration has clearly chosen not to listen on trade agreements. It did not listen now, and it did not listen last year. Last year, this committee passed an amendment in the mock mark-up of legislation to implement CAFTA, and the administration ignored that action as well.

I hope that they are listening now, because what they will hear is another nail driven into the coffin of trade promotion authority.

Mr. Chairman, the administration has misused trade promotion authority, and harm and resentment runs deep. It is sad, Mr. Chairman, that this disrespect for congressional power and prerogatives is not confined to trade promotion authority. It runs through all manner of issues.

The administration dismissed congressional inquiries as unnecessary or as harmful, and the administration issues Presidential signing statements indicating the administration's intent to ignore whatever provisions of law it chooses.

In my view, the Senate has been far too timid in asserting its authority as a co-equal branch of government. I commend the Senate Judiciary Committee for holding a hearing yesterday on Presidential signing statements.

As an institutional matter and for the good of the country, the Congress, I think, must act as a check on the power of the executive branch, because that, after all, was exactly the intent of our founding fathers. That is why they came over here, to escape the tyranny of excess executive power over in England.

Frankly, the administration's actions make today's vote a close call for me. It is a close call whether I should oppose, in committee, the implementing text before us today as a means to protest what I consider to be a bad process. I know some of my colleagues plan to do so, and I cannot blame them.

Overall, I think the U.S.-Oman Free Trade Agreement is a good agreement. The Omanis still have some work to do. They have made strong commitments and they must live up to them. They must meet their obligations and they must enforce them vigorously.

After much consideration, I have decided to support this agreement. This was not an easy decision, but I will do so because I believe that Oman and the Omani people should not be punished for the process failures that tarnish and otherwise good agreement.

Yet, the administration must understand that its actions on this agreement will have effects far beyond and long after this mark-up. I would like to work with

the administration to repair the damage done, but today I am not hopeful.

Thank you, Mr. Chairman.

The Chairman. Thank you very much.

I would now call up the Chairman's mark, S. 1321, and ask Mr. Thomas Barthold, Chief of Staff of the Joint Committee on Taxation, if he would briefly highlight the modifications.

And the reason for briefly highlighting is because the modifications have been developed by the Republican and Democratic staffs cooperating in the Finance Committee, and also there will be opportunities for members to ask questions, if they want to, after Mr. Barthold has given his brief highlight of the modification.

Go ahead.

Mr. Barthold. Thank you, Mr. Chairman.

The members have before them JCX-28-06, which is the detailed description of the Chairman's modification. But perhaps for a shorthand reference purpose, there is also our revenue table that we prepared, JCX-29-06, the provision's match-up.

As the Chairman noted in his opening statement, most of the modifications relate to tax administration and improved tax compliance, and many of the modifications

have passed this committee and the Senate in the past.

For that reason, it is probably best to turn directly to any questions that members might have. I did want to highlight, as the Chairman also highlighted in his opening statement, the primary revenue offset provisions, which are on the last two pages of the revenue table, Item A is the clarification of the application of economic substance doctrine, and penalties to transactions which lead to under-payment, where it is determined that the transaction lacks economic substance. Again, as the Chairman had said, this has been passed by this committee and the Senate on multiple occasions.

An additional provision changes the effective date which would apply to corporations covered by the provision enacted in the American Jobs Creation Act of 2004, relating to corporations which invert and domesticate their operations abroad in an effort to save on U.S. corporate income taxes.

That provision of law treats the corporation as a U.S. corporation under certain circumstances. The provision included in the Chairman's modification would have that apply to certain inversions that occurred after March 20, 2003, rather than March 4, 2004. The March 20th date of 2003 was, again, a date that was adopted by this committee in consideration of a prior bill.

There is one additional point of detail that I would like to make, and that is II-P, which is roughly the top third of page 2, and relates to an authorization to the Internal Revenue Service for combatting abusive tax shelter avoidance, and Item VI-I, which is close to the middle of page 4, is another authorization of appropriations to combat the tax gap.

In developing our description of the Chairman's modification, there is some overlap. The dollar figure of authorization of Item II-P is included in the authorization provided under VI-I. I apologize for the overlap and the confusion in the document.

The Chairman. All right.

Now it is time for members to ask questions, if you have any. Nobody seeks recognition? [No response] Then I would move to modify the Chairman's mark. [No response] Without objection, the Chairman's mark is modified.

In light of the modified mark, are there any members wishing to speak or to offer an amendment?

Senator Lincoln. Mr. Chairman?

The Chairman. Senator Lincoln?

Senator Lincoln. Mr. Chairman, I just want to take a moment to thank you and Senator Baucus, and particularly your staff, for the incredibly hard work

that you have put into this mark.

Not only will the legislation provide tax relief to America's consumers, but it also really sets in place, I think, some very important protections that will hopefully provide taxpayers with some peace of mind.

I want to especially thank both of your staffs for being so willing, open, and helpful. I know some of the requests that I have made have been very technical, and they have been extremely patient in working with us.

In the Chairman's mark, you have included a provision that I have been working on since the 107th Congress, which would clarify the depreciation treatment for wireless network equipment, which, through the years, as you know, the advancement of that technology, to continue depreciating over a period that is two or four times the depreciable life of similar high-technology wired equipment just seems crazy. So, we appreciate the hard work there.

Also, on behalf of veterans and their tax returns, what we have proposed is intended to help the thousands of disabled veterans who are unfairly taxed because of inefficiencies in the VA claim process. We do not think they should suffer because of the slowness and the inadequacy of the claims processed at the VA, and I appreciate your guidance on that.

I know there are some kinks that need to be worked out, and I appreciate the guidance of both the committee staff and IRS in helping me better understand how we meet the needs of the veterans, and do so in a way that is compatible with the law, and we do so in a way that will be clarified and helpful to them.

Then, finally, there is a much-needed provision that fixes a glitch that was created by the Highway bill that left our agricultural aviators with no process to apply for the refunds of the fuel excise tax.

I particularly want to thank Elizabeth Paris for taking the time, because I know it was extremely technical. But it has certainly been an issue that I have been hearing a lot about from back home over the years, and our agricultural aviators are very, very grateful for the committee's willingness to take the time and figure out what the problem was and work through it.

So, I thank you, Mr. Chairman, for working with me on those particular issues and really bringing this up.

The Chairman. Senator Santorum was next.

Senator Santorum. Thank you, Mr. Chairman. I just want to thank you for bringing up the Telephone Excise Tax Repeal. This is a piece of legislation that I have been working on for quite some time, and been an advocate for the repeal of this tax.

I introduced the legislation actually a year ago tomorrow, and have written Secretary Snow, I guess, a couple of months ago, and have been advocating with the administration to repeal this tax in the face of, now, up to 14 court cases where they have lost in court about the appropriateness of continuing to collect a tax that was put in place, as you mentioned, back in 1899, which taxed time and distance phone calls.

As you know, with flat-rate phone long-distance plans they no longer charge based on time and distance, so the courts found that this tax was being collected inappropriately.

We called for the repeal and, as a result, we are in a situation where the Secretary announced that they would no longer collect the long-distance portion of the tax, and in fact would issue refunds, which will amount into the billions of dollars.

Most Americans do not realize that in the next year they are going to receive probably a couple hundred dollars or more, depending on how much you use your telephone, in a rebate from the Federal Government in taxes collected over the last three years, but the Secretary felt that they could not repeal the local end of it.

That is what this bill now does. This bill takes

care of the rest, which was not unilaterally repealed by the Treasury Department. This now takes care of the local side.

As Senator Baucus said, this has now become even a more regressive tax, because the only people that are left paying this tax, if we do not act now, are folks who basically have basic service, who pay per call. Those are, by and large, low-income individuals who just buy basic services.

So now we have a Federal tax that only taxes the low income on basic service. That is completely inappropriate. So, I would encourage the committee, obviously, to adopt this.

I would hope that this is a piece of legislation that we could get through and pass, because if we do not, the Treasury Department is going to be asking the telephone companies to stop collecting the Federal tax, and it will be an administrative nightmare for them to begin to separate taxes that they are going to collect on some bills and not on other bills.

We need to pass this, repeal the whole thing, get rid of the entire tax, get rid of the regressivity that is now in place, and the administrative hassle of the companies having to decide what they are going to tax and what they are not going to tax.

So I would encourage not only for the committee to move this forward, but hopefully we can get some good bipartisan cooperation here to get this through the U.S. Senate to the House and to the President hopefully before the August recess.

Thank you, Mr. Chairman.

The Chairman. Senator Bingaman?

Senator Bingaman. Thank you very much, Mr. Chairman, for your leadership and Senator Baucus' leadership in getting this mark developed. I think this Taxpayer Protection and Assistance Act, in particular, is one that I have been involved in and feel very strongly about. I also, of course, support the repeal of the excise tax that Senator Santorum just spoke about.

I did want to mention, briefly, there is an amendment which I think is on your list as Amendment 42. This is an amendment that I filed and intended to bring up today and urge the committee to adopt.

It is an outgrowth of the testimony we got two weeks ago when the Comptroller General came before the committee here and raised his concerns about changes that were needed to reduce noncompliance by Federal contractors.

It is my understanding that the Internal Revenue Service has raised some concerns about the

recommendations that he made, and so I gather what we need to probably do before we can take action on this amendment, is to get the GAO, the IRS, and your staff, Senator Baucus' staff, and my staff here at the Finance Committee together in the next week or two and try to sort out what the right language is to deal with the problems.

I think in principle, we are all in agreement with the Comptroller General, that this is a problem we need to fix. We just do not have the right language.

So I will not, at this point, push that Amendment 42, which I guess was also listed as Bingaman Amendment #5. But I will try to work with you and your staff, and Senator Baucus and his staff to see if we can get this problem solved before we move ahead with this legislation on the Senate floor.

The Chairman. Well, Senator Bingaman, I share your concerns. We passed that legislation very recently to require that withholding by contractors, but I agree with you that we need to see if more should be done.

So, you have my commitment to make sure that the GAO, the IRS, and our staffs, together, come up with an amendment that will be ready for this bill when it comes to the floor. I will be Senator Baucus agrees with me.

Senator Baucus. I do.

Senator Bingaman. Thank you very much. I appreciate that.

The Chairman. Now, Senator, you have an amendment, I believe.

Senator Wyden. I do, Mr. Chairman.

The Chairman. Go ahead.

Senator Wyden. Mr. Chairman, I am very glad that the committee is trying to keep taxes to a low rumble on telecommunications. I think that is very much in the public interest.

To further promote that kind of principle, this amendment that I am offering now would remove the sunset of the Internet Tax Non-Discrimination Act that has passed the Senate three times since 1996.

I think colleagues are aware that multiple and discriminatory taxes on electronic commerce can cause great harm to our economy, and I do not want to see those who use the Internet end up like our ancestors.

Our ancestors were told the Spanish-American War phone tax was temporary, that it was just needed to pay for the war. Here we are, two centuries later, just getting around to getting rid of the tax.

It seems to me that once we slap multiple and discriminatory taxes on electronic commerce, they are going to be darned hard to get off and we should not do

it.

These really are--and I want to emphasize this--discriminatory and multiple taxes on the technology side of our economy. Taxes and government fees already add as much as another 20 percent to the phone bills of our citizens.

The reason it is a double tax, is essentially the cable franchise fees; you pay to build out the streets and the infrastructure, then you have telephone taxes for the lines. This is multiple, it is discriminatory. The U.S. Senate has recognized this three times, most recently by a vote of 93 to 4, and I think it is time now to make it clear that we are permanently against multiple and discriminatory taxes on electronic commerce.

I want to emphasize, this gives no one a free ride. All it says, is that you must do online what you do offline. The reality is, 10 years ago when we started this, people would buy the newspaper the traditional way, they would face no tax. They buy the online version, the interactive version, they get slapped with a tax. The Senate, to its credit, stepped in and barred that.

I think it is time now, particularly on a very logical vehicle where the Senate, in a bipartisan way, is trying to hold down telecommunications taxes, which I strongly support, to finally wrap this job up. Both the

Chairman and the Ranking Minority Member have been supporting me on this for a decade, for which I am appreciate.

There is strong bipartisan support in this committee, and that is why I am offering this amendment at this time, Mr. Chairman.

The Chairman. You are within you right to offer the amendment. I was hoping to have this bill voted out clean. Very much so, I appreciate your bringing it up, because there has been some question about jurisdiction between us and another committee.

Senator Baucus. There is no question, Mr. Chairman, this committee has jurisdiction. [Laughter].

The Chairman. I have no question about it. There are other people who would claim jurisdiction that I disagree with.

Senator Baucus. I just want to make that clear.

The Chairman. Yes. So you said it properly. So from that standpoint, I welcome it. Senator Baucus and I have discussed when we might bring this up sometime in the middle of July, but you are in your rights to bring it up now.

So is there further discussion of it? Senator Bingaman?

Senator Bingaman. Mr. Chairman, reluctantly, I have

to raise some concern about this amendment. As far as I know, we have had no hearing on the issue.

The Chairman. You are right.

Senator Bingaman. We may have jurisdiction; I am not trying to argue with you and Senator Baucus on that question. I think the Commerce Committee claims they have jurisdiction.

But it would be good, if we were going to act on it, that we have a hearing on the issue. I am informed that this is problematic in my State, in that our State would have to change its laws if we went ahead and made this permanent, in order to avoid disparate treatment between different groups in our State.

So I have some concerns about it. As I say, it is just something I was not expecting to come up today and I am not fully prepared to offer an alternative or suggest the problems. There may not be overwhelming problems, but I just was not aware that it was going to be added as part of this mark. Therefore, I raise those concerns and would prefer not to see it added.

The Chairman. All right.

Anybody else wish to discuss this amendment? [No response]

The Chairman. I would like to have a voice vote, if we could.

Those in favor, say aye.

[Chorus of ayes]

The Chairman. Those opposed, say no.

[Chorus of nays]

The Chairman. I believe the ayes have it. The ayes do have it. The amendment is adopted.

Are there any other amendments? [No response]

If not, then I would ask that the Chairman's mark, as amended, be adopted.

Those in favor, say aye.

[Chorus of ayes]

The Chairman. Those opposed, say no.

[No response]

The Chairman. Obviously the ayes have it. The Chairman's mark, as amended, is adopted.

I now ask the committee to favorably report the Chairman's mark.

I would ask those in favor, say aye.

[Chorus of ayes]

The Chairman. Those opposed, say no.

(No response)

The Chairman. It is obvious that the ayes have it, so in the opinion of the Chair, it is passed.

As we traditionally do, I ask that the staff have the authority to draft necessary technical and conforming

amendments.

Now we would turn to the third agenda item, the Oman Free Trade Agreement. I think, instead of making a statement, we can put this in the record.

Senator Baucus, you spoke about this. I did not speak about it.

Senator Baucus. May I?

The Chairman. Yes, a little bit. I will speak now, and then you speak if you want to again, too, as well.

Senator Baucus. All right.

The Chairman. I would like to make some remarks about it.

Senator Baucus. All right. Sure. Thank you, Mr. Chairman.

The Chairman. Then I will make some. Yuo can go ahead.

Senator Baucus. Right. Thank you, Mr. Chairman.

As I indicated, I have some very grave concerns about this provision, this Oman Free Trade Agreement, and that is because this committee unanimously passed a very important amendment, the amendment offered by Senator Conrad. The amendment was debated and it was debated thoroughly.

After the debate, 18 members of this committee voted for that amendment offered by Senator Conrad. When the

full FTA measure was acted on, all 19 members of this committee voted in favor of that bill, including the amendment offered by the Senator from North Dakota.

The administration has disrespected the process here by not including the amendment that this committee passed. Now, under the law, it is arguable that the administration has that authority, but the administration clearly disrespected the intent of this committee, it disrespected the spirit of the process by not including the amendment, and certainly by not including some version of it, by not, as far as I know, discussing the amendment with the author of the amendment, Senator Conrad.

Basically, they just said--it seemed, anyway--they are going to just send it up without the amendment, totally not recognizing the action this committee took. That is troublesome. That is very troublesome. It is troublesome for this free trade agreement, it is troublesome for the precedent that it sets.

I might add, this is not really precedential because they have done it before. They did it with the CAFTA FTA. And it is very dangerous. It is very dangerous for the administration to take this tack, because it causes more disrespect in the Congress for free trade agreements that the administration may or may not be sending up to

the Congress in the future.

We may have a Doha Round Agreement sent to this Congress. Trade promotion authority has to be renewed next year. Already, there are many members of the Congress who do not like trade promotion authority because it does not allow for amendments to free trade agreements. Free trade agreements, under the process, are all-or-nothing; we vote for them or we vote against them. We do not have an opportunity to amend.

So, Mr. Chairman, this presents a tough question for me because there comes a point when, although the agreements are good on their face, the process is so disrespected, it is time to vote no.

This is a question that I have been wrestling with for the last couple, three days. Have we come to that point yet where it is time to vote no because the administration has been so disrespectful of the process here?

I finally concluded that I am going to vote for this agreement because I do not think that abuse of the process should prevent a good agreement from going through, but I am saying that I am close to that point. In the future, I hope that the administration pays a lot more time, attention, and respect to the first branch of government.

After all, in the Constitution it is written that the U.S. Congress sets trade policy. In order to deal with this unique situation we have in dealing with parliamentary forms of government, we set up this trade promotion authority process as a way to kind of bridge that gap between Article 1 and Article 2 authorities under our Constitution. It is a delicate process. It is delicate in framing trade promotion authority. It was not easy. Both sides, both ends of Pennsylvania Avenue, have a role here.

So, finally, not to be too repetitive, I will vote for it, but I must say, I am quite concerned and I hope the administration, in the future, pays close note to the angst that it itself is causing in the way it is utilizing this process.

The Chairman. Senator Wyden?

Senator Wyden. Can I just ask the staff a procedural question at this time, Mr. Chairman, with respect to how this agreement would go forward? Is that an appropriate thing to do now?

The Chairman. Yes. Go ahead.

Senator Wyden. Thank you. This Oman agreement is not on fast track, it is basically on a supersonic track, because my understanding is that some may even want to bring it up this afternoon.

The Chairman. That is true. The Leader sent out some e-mail to that effect.

Senator Wyden. Could the staff explain, given the fast track statute, what the rights are with respect to a Senator on this? Senator Grassley and I, for example, have led the effort to require that holds be public.

You cannot hold a trade bill because of the statute, but are there any rights that Senators have so that we could begin to address some of the questions that Senator Baucus has brought up? This is just a question about the procedure under fast track with respect to the rights of a Senator.

Mr. Johanson. Yes. Well, the Senator can consult with the Chairman at any time. There has been consultation throughout the process with USTR.

Senator Wyden. Can a Senator ask, under fast track authority, for a delay that would even allow us a couple of days? I happen to share the concerns of Senator Baucus, and I think other Senators do.

I guess I am one of the last of the people who consider themselves a free trader, but I think Senator Conrad has brought up issues with respect to labor rights and others I want to have addressed.

Can you have, under the statute, even a delay of a couple of days?

Mr. Johanson. From what I understand, under TPA, that is not addressed. It would take a conversation with the leadership. I might add as well that the hearing on this was held in March and the mock mark-up was held in May, so there has been a rather long period of time for this to go through the process.

Senator Wyden. So at this point, under fast track authority, you cannot even get a day to see if we could make some progress to try to address some of these concerns that have been raised?

Mr. Johanson. Not that I am aware of.

Senator Wyden. Thank you, Mr. Chairman.

Senator Lincoln. Mr. Chairman?

The Chairman. Senator Lincoln?

Senator Lincoln. Thank you, Mr. Chairman. I feel compelled to express my frustration as well, and want to associate myself with Senator Baucus' remarks on his frustration.

With all due respect to you, Mr. Chairman, when we talk about the opportunity and time that we have to effect these pieces of statute and legislation and trade agreements, although the mock mark-up was held in May, when we voted on it, Senator Conrad's amendment was there.

I think the big concern that we have, is that those

things that we move in a unanimous way and we feel strongly about--or against, like slave labor--get so disregarded when it comes back to us at a point where we are supposed to say all or nothing.

Throughout my public service, Mr. Chairman, I have been enormously supportive of our Nation's trade agenda. I think it is so critically important to our economy. But I think I have become increasingly frustrated, as have my constituents, when we view such a lack of respect for the role of the committee and the Congress in this overall trade process.

We did, in the mock mark-up on Oman in May, it was the only time when we are able to do any amending under TPA. We certainly know that Senator Conrad's amendment was passed here in the committee unanimously.

Those of us that supported TPA, understanding the importance that that process bring, to be able to move expeditiously trade agreements, but we did so with the understanding that the committee would have a true role in the process, that the Congress would have a true role in the process and that we would be consulted, and could consult with the administration in a meaningful way, and that amendments that are passed would be considered and dealt with according to our established congressional practices.

I guess the frustration that I, and again, my constituency, feels, is that we are left with nothing but a "yes" or a "no," that those processes and those consultations that we are supposed to be engaged with are just insignificant or unimportant to the administration.

It makes those of us that really realize how important opening up trade markets and presenting free trade is, and yet losing the support that we have at home for being able to do that.

Of course, our support at home is critically important, people being able to understand that processes exist here in the Congress for us to be able to make sure their voices are heard in terms of things that are important to them.

So, I know all of our staffs tell us not to talk about process because it is not fun and it does not really translate to your average American, but here, process is critically important. We all appreciate and recognize the many, many steps that the Omani government has made, and will make, in trying to reform labor laws.

We really appreciate our strong relationship with the country. But, Mr. Chairman, ultimately it is difficult to move forward on a process that we continue to get left out of. So I appreciate the opportunity to be able to at least come and express my frustration and the frustration

of the people that I represent.

I certainly hope, Mr. Chairman, that we can do better and that the administration will do better in actually utilizing the consultation that exists under TPA, because, like my colleagues, I think if we do not, that the trade promotion authority has little opportunity to continue, and it is a valuable tool in moving trade agreements along.

Thank you, Mr. Chairman.

The Chairman. Senator Thomas?

Senator Thomas. Well, Mr. Chairman, I certainly agree with the idea of having an opportunity, but I think some of our friends have not read some of the papers that are here. Certainly, if we are dealing with the law, the problem of indentured labor and so on, it is spelled out very well in your papers here. It is already laid out that we have a law against it, so does Oman, and so on.

So to suggest that this issue has not been covered, I think, is not appropriate, because if you read the materials here, you would find that it has been dealt with.

Thank you, sir.

Senator Conrad. Mr. Chairman?

The Chairman. Senator Conrad?

Senator Conrad. Mr. Chairman, I really believe this

action just makes a mockery of the whole fast track process. It just makes a mockery of it. I do not know how anybody could reach any other conclusion.

Under the fast track process, Congress gives up its right to extended debate, gives up its right to amend, in exchange for a process that allows this committee to review and have what is called a mock mark-up, in which we offer amendments before the final agreement is submitted to Congress. That is what is supposed to occur. We did that.

I offered an amendment; it passed unanimously. It dealt with the issue of slave labor or of conditions in sweat shops so egregious as to approach slave labor. Every single member of this committee voted for it, despite the administration saying it was not needed.

Well, clearly it is needed, because we just had the experience with Jordan in which workers from all over Asia went to Jordan on the promise that they were going to get wages much higher than they could earn in their own country, and when they got there, their passports were taken away so they could not leave, and they were required to work 90 to 120 hours a week. In many cases, they were not paid. They certainly were not paid what they were promised. If they complained, they were beaten.

Now, that indicates the law is not covering these matters. That is why I offered the amendment; I assume that is why members voted for it. We voted for it in the so-called mock mark-up, which is our opportunity to alter an agreement before it is submitted. The amendment passed unanimously; the administration disregarded it.

If that does not make a mockery of the process, I do not know what it would take. This has now become a total sham proceeding. Congress has no ability to affect these agreements. We have lost the ability to affect these agreements.

So to me, this is one more nail in the coffin of fast track because it is just a sham. What could be more clear? I could offer the amendment again, make my colleagues vote on it again. The Chairman could rule it out of order. I could then appeal the ruling of the chair. I am not going to put my colleagues through that. I am going to vote no, because this has become a farce. This is a farce.

Senator Wyden. Mr. Chairman?

The Chairman. Senator Wyden?

Senator Wyden. Can I ask one other procedural question of the staff? I feel badly about dragging you all in. Under fast track authority, there is no legal requirement that you vote today. Is that correct?

Mr. Johanson. No, there is not.

Senator Wyden. All right.

Mr. Chairman, the reason that I asked that and wanted to establish that, is my understanding is that this trade agreement was formerly submitted to the Congress on June 26. So if you say June 26 and you look at the statute, that gives you 90 session days to give Oman an up or down vote.

So it would just seem to me that at least a short period of time--and I come to this having voted, with the welts on my back, recently, for the CAFTA legislation, it would seem to me that we could take a little bit of time to try to work this out in a bipartisan way and to have this considered now, and then, lickety-split, vote on it this afternoon, something I guess reconfigures fast track into supersonic track, as I called it. I just do not think that makes sense.

Now that we have established that there is no legal requirement, I would like to announce that after an entire career of voting for free trade agreements, most recently the CAFTA legislation, it is my intent, with great reluctance, today to vote no.

Thank you, Mr. Chairman.

The Chairman. I hope that we can get a quorum here to vote this out. So if staff would see if they could

get people here, I would appreciate it. If we do not, then obviously on this one and on the Paulson nomination, we will have to do it when we can meet off the floor.

But I would like to respond to some of the things that have been said here today, and not really to disagree, but to put in perspective.

To some extent, I would have to admit that amendments we offer here, that by the time those amendments are offered and we try to impact that process, that specific agreement at that time, it is a little bit like locking the barn door after the horse has gotten out.

Where we probably have not done enough as a committee, and the extent to which individual members have been concerned that we maybe have not done enough to influence the process, maybe the Chairman should take the blame.

But let me suggest that I hope that I have been responsive to members in making this committee function, that maybe members have not come to me often enough to say, now we are beginning negotiation with Egypt, maybe we had better sit down and talk with the administration about Egypt.

We have been in negotiations with Thailand. It is kind of held up now. Maybe we ought to be sitting down and talking with them about Thailand. We are in

negotiations in regard to Ecuador that are now being held up because of a couple of specific things. Maybe we ought to be talking about that, and South Korea, as another example.

I do not have members come and talk to me about it, yet we do periodically have the administration up here in a general way, sometimes in rump sessions, sometimes in formal sessions to talk about this.

To me, that is the point of making an impact on what we think ought to be negotiated. So, I would like to have members putting emphasis on complaining that we are not doing enough at that point, than at a point where, in a sense, when we adopt an amendment, it is a recommendation to the administration.

We all know that the administration can heed that recommendation or ignore it. Of course, various members here, when that is recommended or it is ignored, they do not like it. In the case of the Conrad amendment, I voted for that, so I can say the same thing.

But I wish Senator Conrad was here. He used some words I made note of: "Now the process has become a sham." I hope that nothing has happened in the last four or five years that is different than previous trade promotion or fast track legislation, that the process is that much different now than before that you can say this

has become a sham. If you want to be accurate, if you feel it is a sham, then it has always been a sham, I believe.

I do not pretend to know the entire history of 50 years of this authority to the President, but those are things that I would like to have people take into consideration when they view us at this point compared to the impact that this committee is intended to have on these agreements so that they come back, so that all these criticisms cannot be raised in the first place, so maybe you do not even have to offer an amendment at that point, because that is just a little bit too late.

Now, we can recommend, and we hope the administration takes our recommendations, but the law does not require that. So, that is where I think we are.

If I could, I would like to just give some background while we are waiting to get a quorum here so I can say that the process that we have gone through with this, I think, has been very deliberate.

Now, we got this agreement.

Senator Baucus. Mr. Chairman? While we are on the subject here.

The Chairman. Go ahead.

Senator Baucus. I appreciate your comments. What this really comes down to, clearly, is cooperation

between the executive and the legislative branches here, because we have this unique constitutional predicament.

But it means, I think, that administrations have to do a better job listening to Congress when Congress does have concerns about trade agreements. In previous trade agreements, this committee has mock mark-ups and has passed amendments which, at a later date, the administration has included in the bill that is sent up.

An example, is the Canadian Free Trade Agreement. Another example, is NAFTA. Another example, is the Uruguay Round. In those instances, the committee met and the administration listened to Congress and sent up changes apropos to the amendments that this committee passed. There is just a sense that that is not being honored as much recently as it was in the past.

So, you made a very good point, namely, members who try to come earlier in the process, anticipating problems, trying to work things out with the administration, that is a good point.

But it is also true that the administration needs to spend some time talking to Congress, too, because that is the only way we are going to get good, solid cooperation between both bodies here. So I just urge the administration to listen more closely, because after all, we do have a point of view.

Senator Bunning. Mr. Chairman?

Senator Thomas. Mr. Chairman?

The Chairman. If I could, just a minute. Then I will go to Senator Bunning and to Senator Thomas.

Maybe, in a sense, you are saying that the administration ought to say, do you not want to hear more from us and do you not think you ought to sit down and meet with us. I am willing to take those invites from the administration, but I also think that since it is our constitutional authority, we need to push the administration.

Maybe that ought to be one person's decision, my decision. Maybe I ought to just say, every month we are going to meet on this agreement or that agreement, and we are going to do whatever it takes to get in. I also know that when we have some of these meetings, that very few people come. I want to know that we are making our time well-spent.

I think Senator Bunning is next.

Senator Baucus. We have a quorum.

The Chairman. We have a quorum. Could we vote?

Senator Bunning. Do your thing, Mr. Chairman, if you have a quorum.

The Chairman. All right.

I would now like to move the Oman agreement to the

floor. I would ask, since there has been a lot of division here, we might as well have a roll call vote.

Would the Clerk call the roll?

The Clerk. Mr. Hatch?

Senator Hatch. Aye.

The Clerk. Mr. Lott?

The Chairman. Aye by proxy.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. Aye.

The Clerk. Mr. Thomas?

Senator Thomas. Aye.

The Clerk. Mr. Santorum?

The Chairman. Aye by proxy.

The Clerk. Mr. Frist?

The Chairman. Aye by proxy.

The Clerk. Mr. Smith?

The Chairman. Aye by proxy.

The Clerk. Mr. Bunning?

Senator Bunning. Aye.

The Clerk. Mr. Crapo?

Senator Crapo. Aye.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?
Senator Baucus. No by proxy.
The Clerk. Mr. Conrad?
Senator Baucus. No by proxy.
The Clerk. Mr. Jeffords?
Senator Baucus. Aye by proxy.
The Clerk. Mr. Bingaman?
Senator Baucus. No by proxy.
The Clerk. Mr. Kerry?
Senator Baucus. Aye by proxy.
The Clerk. Mrs. Lincoln?
Senator Lincoln. No.
The Clerk. Mr. Wyden?
Senator Wyden. No.
The Clerk. Mr. Schumer?
Senator Schumer. Aye.
The Clerk. Mr. Chairman?
The Chairman. Aye.
The Clerk. Mr. Chairman, the tally of those present and voting is 8 ayes, 3 nays.
The Chairman. And we have a quorum present?
The Clerk. Yes, sir.
The Chairman. All right.
Senator Bunning. Excuse me. Would you repeat the vote?

The Clerk. The tally of those present and voting is 8 ayes, 3 nays.

Senator Bunning. In other words, we are not allowed to vote proxies?

The Chairman. You can vote proxies, but they cannot count towards the quorum.

Senator Bunning. I am asking staff. What is the story?

The Clerk. The Chairman is correct.

Senator Baucus. The answer is no. They can vote ut it cannot affect the result.

The Chairman. There are two members who have come in that I voted proxy, and I would give them an opportunity, Senator Frist and Senator Smith, to vote in person if they desire.

The Clerk. Mr. Frist?

Senator Frist. Aye.

The Clerk. Mr. Smith?

Senator Smith. Aye.

The Chairman. Now, tally it again, please.

The Clerk. Mr. Chairman, the tally of those present and voting is 10 ayes, 3 nays.

The Chairman. According to the vote you just heard, the Oman agreement is reported out.

Now we are going to take up the Secretary of

Treasury's nomination.

Senator Baucus. Mr. Chairman, I move that the nomination be confirmed.

The Chairman. All right.

Those in favor, say aye.

[Chorus of ayes]

The Chairman. Those opposed, say no.

[No response]

The Chairman. The motion is unanimously approved with a quorum present. Thank you all very much.

Now, Senator Bunning and Senator Thomas wanted to say something in reaction to something that has been said here. I did have a statement on the Oman record that I will put in the record.

Senator Bunning. Mr. Chairman, since we have passed the Oman trade authority, I am not going to comment, because I am not for fast track and never have been. So my opinion on the objections would not be in order, since we have already passed it. Thank you.

The Chairman. All right. Thank you.

Senator Thomas wants to be recorded "present" on the vote on Mr. Paulson. "Present." So make a note, even though it was a voice vote, that Senator Thomas is voting "present" as opposed to voting "aye".

I thank you all very much for your cooperation.

Thank you.

[Whereupon, at 11:25 a.m. the meeting was concluded.]

I N D E X

DESCRIPTION OF THE CHAIRMAN'S MARK OF S. 1321, THE "TELEPHONE EXCISE TAX REPEAL ACT OF 2005" AND S. 832, THE "TAXPAYER PROTECTION AND ASSISTANCE ACT OF 2005"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
on June 28, 2006

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

June 26, 2006
JCX-25-06

CONTENTS

INTRODUCTION

The Senate Committee on Finance has scheduled a markup of S. 1321, the "Telephone Excise Tax Repeal Act of 2005" and S. 832, the "Taxpayer Protection and Assistance Act of 2005" for June 28, 2006. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's Mark of S. 1321 and S. 832.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of S. 1321, the "Telephone Excise Tax Repeal Act of 2005" and S. 832, the "Taxpayer Protection and Assistance Act of 2005"* (JCX-25-06), June 26, 2006.

I. REPEAL OF THE TELEPHONE EXCISE TAX

A. Repeal Excise Tax on Communications Services

Present Law

The Internal Revenue Code of 1986 (the "Code") imposes a three-percent Federal excise tax on amounts paid for communications services. Communications services are defined as "local telephone service," "toll telephone service," and "teletypewriter exchange service."[2] The person paying for the service (i.e., the consumer) is liable for payment of the tax. Service providers are required to collect the tax; however, if a consumer refuses to pay, the service provider is not liable for the tax and is not subject to penalty for failure to collect if reasonable efforts to collect have been made. Instead, the service provider must report the delinquent consumer's name and address to the IRS, which then must attempt to collect the tax.[3]

Local telephone service is defined as the provision of voice-quality telephone access to a local telephone system that provides access to substantially all persons having telephone stations constituting a part of the local system.[4]

Toll telephone service (which is essentially long distance telephone service) is defined as voice quality communication for which (1) there is a toll charge that varies with the distance and elapsed transmission time of each individual call and payment for which occurs in the United States, or (2) a service (such as a wide area telephone service, or "WATS") which, for a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), entitles the subscriber to an unlimited number of telephone calls to or from an area outside the subscriber's local system area.

Telephone companies have historically collected excise tax on a toll telephone service even if the toll charge on such service does not vary with both distance and elapsed transmission time. However, in several recent cases, the Courts of Appeals held that the Federal excise tax on communications services does not apply to long distance (i.e., toll telephone) services sold at flat

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[2] Sec. 4251. "Teletypewriter exchange service" refers to a data system that provides access from a teletypewriter or other data station to a teletypewriter exchange system and the privilege of intercommunication by that station with substantially all persons having teletypewriter or other data stations in the same exchange system. While it is understood that the system to which the definition was initially intended to apply is no longer in use, the definition may fit other services provided now or that may be provided in the future.

[3] In general, the amount of tax is based on the sum of charges for taxable services included in the bill. If the person who renders the bill groups individual items for purposes of rendering the bill and computing the tax, then the tax base with respect to each such group is the sum of all items within that group. The tax on any remaining items not included in any such group is based on the charge for each item separately. Sec. 4254(a).

[4] The access to substantially all persons having telephone stations constituting a part of the local system is sometimes referred to as access to the public switched telephone network.

per-minute rates for interstate, intrastate, and international calls. The courts concluded that the excise tax did not apply because a flat per-minute rate does not vary with both distance and transmission time as required by the statute.[5] In response to these court decisions, the Internal Revenue Service issued a notice that directs telephone companies to cease collecting and paying over tax on long distance services and bundled services that are billed after July 31, 2006.[6] The Federal excise tax on local-only telephone service remains in effect.

Description of Proposal

The proposal repeals the excise tax on communications services in its entirety.

Effective Date

The proposal applies to amounts paid pursuant to bills rendered more than 90 days after the date of enactment.

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[5] See, e.g., *Reese Bros. v. United States*, 2006 U.S. App. LEXIS 11468 (3d Cir. May 9, 2006); *Fortis v. United States*, U.S. App. LEXIS 10749 (2d Cir. Apr. 27, 2006); *American Bankers Insurance Group v. United States*, 408 F.3d 1328 (11th Cir. 2005); *Office Max, Inc. v. United States*, 428 F.3d 583 (6th Cir. 2005); *Nat'l R.R. Passenger Corp. v. United States*, 431 F.3d 374 (D.C. Cir. 2005).

[6] Notice 2006-50, 2006-50 I.R.B. 1141 (May 26, 2006). The notice defines long distance services as "telephonic quality communications with persons whose telephones are outside the local telephone system of the caller." Bundled services are defined as "local and long distance services provided under a plan that does not separately state the charge for the local telephone services."

II. TAXPAYER PROTECTION AND ASSISTANCE

A. Low-Income Taxpayer Clinics

Present Law

The Code provides that the Secretary is authorized to provide up to $6 million per year in matching grants to certain low-income taxpayer clinics.[7] Eligible clinics are those that charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or provide tax information to individuals for whom English is a second language ("controversy clinics"). No clinic can receive more than $100,000 per year.

A "controversy clinic" includes (1) a clinical program at an accredited law, business, or accounting school, in which students represent low-income taxpayers, or (2) an organization described in section 501(c) which either represents low-income taxpayers as described above or provides referrals to qualified representatives. A low-income taxpayer is an individual whose income does not exceed 250 percent of the poverty level, as determined in accordance with criteria established by the Director of the Office of Management and Budget.

Description of Proposal

The proposal authorizes $10 million in matching grants for low-income taxpayer return preparation clinics ("return preparation clinics"). Return preparation clinics are clinics that provide routine tax return preparation and filing services to low-income taxpayers for not more than a nominal fee. Under the proposal, return preparation clinics eligible to receive grants include eligible educational institutions as defined in section 529(e)(5) and organizations described in section 501(c).

The proposal prohibits the use of grants for overhead expenses at both controversy clinics and return preparation clinics. The proposal also authorizes the IRS to use mass communications, referrals, and other means to promote the benefits and encourage the use of low-income controversy clinics and return preparation clinics.

The authorization of $6 million for controversy clinics under present law is also increased to $10 million.

Effective Date

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

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[7] Sec. 7526.

B. Enrolled Agents

Present Law

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

Description of Proposal

The proposal permits the Secretary to promulgate regulations to regulate the conduct of enrolled agents in regard to their practice before the IRS, and to permit enrolled agents meeting the Secretary's qualifications to use the credentials or designation "enrolled agent," "EA," or "E.A."

Effective Date

The proposal is effective on the date of enactment.

C. Regulation of Federal Tax Return Preparers

Present Law

The Secretary is authorized to regulate the practice of representatives of persons before the Treasury.[8] The Secretary is also authorized to suspend or disbar from practice before the Treasury a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Treasury, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this proposal are contained in Circular 230. In general, the preparation and filing of tax returns (absent further involvement) has not been considered within the scope of the Circular 230 provisions.

Description of Proposal

The proposal expands the Secretary's authority to regulate the practice of representatives before the Treasury to include individuals preparing Federal tax returns and other submissions to the IRS for compensation ("compensated preparers"). The Secretary is required to issue regulations no later than one year after the date of enactment establishing eligibility requirements for compensated preparers. Practitioners authorized to practice before the IRS that are subject to oversight under regulations in effect on the date of enactment of the proposal are excluded from the regulations establishing eligibility requirements for compensated preparers.

The proposal requires the Secretary to develop and administer an examination to establish the competency of compensated preparers. Under the proposal, the examination shall be designed to test the preparer's knowledge of technical tax issues, including the earned income credit, and the ethical standards for the preparation of tax returns. The proposal authorizes the Secretary to contract for both the development and administration of the examination.

Under the proposal, the compensated preparer regulations shall also require compensated preparers to renew their eligibility every three years. As part of this renewal, compensated preparers shall be required to establish completion of continuing education requirements in a manner set forth by the Secretary in regulations. Compensated preparers failing to meet the eligibility requirements are subject to suspension or termination.

The proposal also establishes the Office of Professional Responsibility within the IRS under the supervision and direction of the Director, an official reporting directly to the Commissioner, IRS. The Director, Office of Professional Responsibility will be entitled to compensation at the same rate as the highest rate of basic pay established for the Senior Executive Service, or, if higher, at a rate fixed under the critical pay authority established under section 9503 of title 5.

The proposal authorizes the Secretary to appoint administrative law judges to conduct hearings of any action by the Office of Professional Responsibility to impose sanctions on

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[8] 31 U.S.C. sec. 330.

compensated preparers and other representatives practicing before the Treasury. Under the proposal, hearing records shall be open to the public. In addition, the Office of Professional Responsibility shall make public information regarding any sanction imposed on a representative, including the identity of the representative and the conduct which gave rise to the sanction.

Under the proposal, the Secretary may impose fees for the registration and renewal of compensated preparers. Such fees shall be made available to the Office of Professional Responsibility for the purpose of reimbursing the costs of administering and enforcing the rules and regulations regulating practice before the Treasury.

The proposal also provides that the Secretary shall conduct a public awareness campaign to encourage taxpayers to use competent professionals in the preparation of their tax returns and other Federal tax matters. The public awareness campaign shall be conducted in a manner to inform the public of the registration requirements imposed on compensated preparers and the general requirement that preparers must sign the return and provide their registration number on the return.

The proposal also increases the penalties on tax return preparers who fail to sign a return or fail to provide an identifying number on a return from $50 to $500 per return. In addition, amounts collected from the imposition of penalties under sections 6694 and 6695 or under the regulations promulgated under section 330 of title 31 shall be directed to the Office of Professional Responsibility for the administration of the public awareness campaign. The proposal also permits the Secretary to use any funds specifically appropriated for earned income credit compliance to improve compliance with the rules regulating practice before the Treasury.

Effective Date

The proposal is effective on the date of enactment.

D. Regulation of Refund Anticipation Loan Facilitators

Present Law

The Secretary is authorized to regulate the practice of representatives of persons before the Treasury.[9] The Secretary is also authorized to suspend or disbar from practice before the Treasury a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Treasury, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this proposal are contained in Circular 230. In general, the preparation and filing of tax returns (absent further involvement) has not been considered within the scope of these Circular 230 proposals.

Section 6103 generally provides that return and return information are confidential and cannot be disclosed unless authorized by title 26. The definition of return information is very broad, and includes, among other things, information with respect to the determination of the existence or possible existence of liability of any person for any penalty under the Code.

Description of Proposal

The proposal requires the annual registration with the Secretary of refund loan facilitators. A refund loan facilitator is any person who originates the electronic submission of income tax returns for another person and, in connection with the electronic submission, solicits, processes, or otherwise facilitates the making of a refund anticipation loan to the individual taxpayer on whose behalf the tax return is submitted. The annual registration shall include the name, address, and TIN of the refund loan facilitator applicant and a schedule of the applicant's fees for such year.

The proposal requires refund loan facilitators to disclose to taxpayers, both orally and in writing, that they may file an electronic tax return without applying for a refund anticipation loan and the cost of filing such an electronic return compared to the cost of the refund anticipation loan. In addition, the proposal requires refund loan facilitators to disclose to taxpayers all fees and interest charges associated with a refund anticipation loan and provide a comparison with fees and interest charges associated with other types of consumer credit, as well as fees and interest charges for similar refund anticipation loans. Refund loan facilitators also must disclose to taxpayers the expected time within which tax refunds are typically paid based on different filing options, the risk that the full amount of the refund may not be paid or received within the expected time, and additional costs the taxpayer may incur in connection with the refund anticipation loan if the tax refund is delayed or not paid.

In addition to the above disclosure requirements, refund loan facilitators must disclose to taxpayers whether the refund anticipation loan agreement includes a debt collection offset arrangement. Debt collection offsets are arrangements between refund loan facilitators and a taxpayer's creditor to offset the taxpayer's expected refund against an outstanding liability owed

[9] 31 U.S.C. sec. 330.

to the creditor. The Secretary is authorized to require refund loan facilitators to disclose any other information deemed necessary.

The proposal amends the Code to permit the Secretary to impose monetary penalties on refund loan facilitators who fail to meet the registration or disclosure requirements, unless such failure was due to reasonable cause. The penalty for failure to register is not to exceed the gross income derived from all refund anticipation loans during the period the refund loan facilitator was not registered. The penalty for failure to disclose the information required by the proposal is not to exceed the gross income derived from all refund anticipation loans with respect to which the refund loan facilitator failed to provide the required disclosure information.

The proposal also amends the privacy rules under the Code to permit the Secretary to disclose the name of any person with respect to whom a penalty has been imposed for failing to meet the registration or disclosure requirements of the proposal.

The proposal provides that the Secretary shall conduct a public awareness campaign to educate the public on the costs associated with refund anticipation loans, including the costs as compared to other forms of credit. The public awareness campaign shall be conducted in a manner that educates the public on making sound financial decisions with respect to refund anticipation loans. Amounts collected from the imposition of penalties on refund loan facilitators shall be directed to the IRS for the administration of the public awareness campaign.

Effective Date

The proposal is effective on the date that is one year after the date of enactment.

E. Taxpayer Access to Financial Institutions

Present Law

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

Description of Proposal

The proposal authorizes the Secretary of the Treasury to award demonstration project grants (totaling up to $10 million) to eligible entities to provide tax preparation assistance in connection with establishing an account in a Federally insured depositary institution for individuals that do not have such an account. Entities eligible to receive grants are: tax-exempt organizations described in section 501(c)(3), Federally insured depositary institutions, State or local governmental agencies, community development financial institutions, Indian tribal organizations, Alaska native corporations, native Hawaiian organizations, and labor organizations.

Under the proposal, the recipient of a grant may not use more than six percent of the total amount of such grant for administrative purposes. For each fiscal year in which a grant is awarded, the Secretary is required to submit a report to Congress describing the amount of grants distributed and the activities funded.

The proposal also requires the Secretary to conduct a study of the implementation of a program to deliver tax refunds through debit cards or other electronic means. The proposal requires the Secretary to submit a report to Congress on the results of such study no later than one year after the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

F. Use of Practitioner Fee

Present Law

The United States Tax Court ("Tax Court") is authorized to impose a fee of up to $30 per year on practitioners admitted to practice before the Tax Court.[10] These fees are to be used to employ independent counsel to pursue disciplinary matters.

Description of Proposal

The proposal provides that Tax Court fees imposed on practitioners also are available to provide services to *pro se* taxpayers (i.e., a taxpayer representing himself) that will assist such taxpayers in controversies before the Court. For example, fees could be used for programs to educate *pro se* taxpayers on the procedural requirements for contesting a tax deficiency before the Tax Court.

Effective Date

The proposal is effective on the date of enactment.

[10] Sec. 7475.

JOINT COMMITTEE ON TAXATION
June 26, 2006
JCX-26-06

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK OF S. 1321, THE "TELEPHONE EXCISE TAX REPEAL ACT OF 2005," AND S. 832, THE "TAXPAYER PROTECTION AND ASSISTANCE ACT OF 2005," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON JUNE 28, 2006

Fiscal Years 2007 - 2016

[Millions of Dollars]

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
I. Repeal Excise Tax on Communications Services	[1]	-721	-717	-713	-710	-706	-702	-698	-694	-690	-685	-3,566	-7,036
II. Taxpayer Protection and Assistance Provisions													
1. Low-income taxpayer clinics	gma DOE	*No Revenue Effect*											
2. Clarification of enrolled agent credentials	DOE	*No Revenue Effect*											
3. Regulation of tax return preparers [2]	DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
4. Contract authority for examinations of preparers	DOE	*No Revenue Effect*											
5. Regulation of refund anticipation loan facilitators [2]	1ya DOE	*No Revenue Effect*											
6. Taxpayer access to financial institutions [2]	DOE	*No Revenue Effect*											
7. Expanded use of tax court practice fees for pro se taxpayers	DOE	*No Revenue Effect*											
Total of Taxpayer Protection and Assistance Provisions		[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
NET TOTAL		-721	-717	-713	-710	-706	-702	-698	-694	-690	-685	-3,566	-7,036

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be July 1, 2006.

Legend for "Effective" column:
DOE = date of enactment
gma = grants made after
1ya = one year after

[1] Effective for bills first rendered more than 90 days after the date of enactment.
[2] Estimates of spending authority to be provided by Congressional Budget Office.
[3] Gain of less than $500,000.

JOINT COMMITTEE ON TAXATION
June 28, 2006
JCX-29-06

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS CONTAINED IN S. 1321, THE "TELEPHONE EXCISE TAX REPEAL ACT OF 2005," AND S. 832, THE "TAXPAYER PROTECTION AND ASSISTANCE ACT OF 2005," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON JUNE 28, 2006

Fiscal Years 2007 - 2016

[Millions of Dollars]

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
I. Provisions Included in the Chairman's Mark, as Modified													
A. Repeal Excise Tax on Communications Services	[1]	-721	-717	-713	-710	-706	-702	-698	-694	-690	-685	-3,566	-7,036
B. Taxpayer Protection and Assistance Provisions													
1. Low-income taxpayer clinics [2]	gma DOE	*No Revenue Effect*											
2. Clarification of enrolled agent credentials	DOE	*No Revenue Effect*											
3. Regulation of tax return preparers [2]	DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
4. Contract authority for examinations of preparers	DOE	*No Revenue Effect*											
5. Regulation of refund anticipation loan facilitators [2]	1ya DOE	*Negligible Revenue Effect*											
6. Taxpayer access to financial institutions [2]	DOE	*No Revenue Effect*											
7. Expanded use of Tax Court practice fees for pro se taxpayers	DOE	*No Revenue Effect*											
Total of Provisions Included in the Chairman's Mark, as Modified		**-721**	**-717**	**-713**	**-710**	**-706**	**-702**	**-698**	**-694**	**-690**	**-685**	**-3,566**	**-7,036**
II. Improvements in Tax Administration and Taxpayer Safeguards													
A. Waiver of user fee for installment agreements using automated withdrawals [2]	aeio/a 180da DOE	*No Revenue Effect*											
B. Termination of installment agreements	foo/a DOE	*Negligible Revenue Effect*											
C. Individuals held harmless on improper levy on individual retirement plan	lartia 12/31/05	*Negligible Revenue Effect*											
D. Office of Chief Counsel Review of offers-in-compromise	oicsopo/a DOE	*No Revenue Effect*											
E. Elimination of restriction on offsetting refunds from former residents	DOE	*No Revenue Effect*											
F. Revisions relating to termination of employment of IRS employees for misconduct	DOE	*Negligible Revenue Effect*											
G. Amend collection due process procedures for employment tax liabilities	lio/a 1/1/07	56	47	26	18	17	17	20	23	26	29	164	278
H. Extend time limit for contesting IRS levy to 2 years	[4]	*Negligible Revenue Effect*											
I. Permit the IRS to require increased electronic filing of returns prepared by paid return preparers	DOE	*No Revenue Effect*											
J. Require IRS to develop direct electronic filing [2]:													
1. Treasury to prevent FreeFile partners from marketing non-tax services	DOE	*No Revenue Effect*											

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
2. Provide a report to Congress on feasibility of linking FreeFile or efile system to State efile systems	DOE	*No Revenue Effect*											
K. Study of clarifying recordkeeping responsibilities	1ya DOE	*No Revenue Effect*											
L. Modification of TIGTA reporting requirements	DOE	*No Revenue Effect*											
M. Streamline reporting process for National Taxpayer Advocate	[5]	*No Revenue Effect*											
N. Whistleblower reforms [2]	DOE	3	8	20	31	42	54	66	79	94	102	103	499
O. Allow the Financial Management Service to retain transaction fees from levied amounts [2]	DOE	*No Revenue Effect*											
P. Authorize additional $300 million per year to the IRS to combat abusive tax avoidance transactions [2]	DOE	*No Revenue Effect*											
Q. Clarification of definition of church tax inquiry	DOE	*No Revenue Effect*											
R. Notification requirement for exempt entities not currently required to file	fapba 12/31/06	*Negligible Revenue Effect*											
S. Treat Indian tribal government charities as public charities	[7]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	1
T. Tax Court jurisdiction over equitable relief innocent spouse claims	DOE	*No Revenue Effect*											
U. Authorization of appropriations for tax law enforcement relating to human trafficking	DOE	*No Revenue Effect*											
V. Register payroll tax deposit agents with IRS and require bonding	DOE	*Negligible Revenue Effect*											
W. Extension of the statute of limitations to file claims for refunds relating to disability determinations by the Department of Veteran's Affairs	DOE	-8	-8	-9	-9	-10	-11	-9	-6	-4	-4	-43	-78
Total of Improvements in Tax Administration and Taxpayer Safeguards		**51**	**47**	**37**	**40**	**49**	**60**	**77**	**96**	**116**	**127**	**224**	**700**
III. Reform of Penalties and Interest													
A. Individual estimated tax	etpmf tyba 12/31/06	-97	-101	-105	-109	-113	-115	-117	-124	-131	-139	-524	-1,150
B. Simplify corporate estimated tax penalty by increasing exception for small amount of tax from $500 to $1,000	tyba 12/31/06	-45	1	1	1	1	1	1	1	1	1	-42	-38
C. Increase the amount of taxable income used to define large corporations for purposes of estimated tax payments from $1,000,000 to $1,500,000 in $50,000 increments from 2007 through 2016	tyba 12/31/06	-92	-91	-89	-86	-86	-87	-88	-88	-90	-92	-444	-889
D. Expansion of interest netting	iaa 12/31/10	---	---	---	---	-214	-222	-230	-237	-244	-251	-214	-1,398
E. Clarification of application of Federal tax deposit penalty	DOE	-1	-5	-5	-5	-6	-6	-6	-6	-7	-7	-22	-54
F. Frivolous tax submissions	[9]	3	3	3	3	3	3	3	3	3	3	15	30
G. Understatement of taxpayer's liability by tax return preparers	rpa DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	1	2
H. Penalty for aiding and abetting the understatement of tax liability	aoa DOE	*Negligible Revenue Effect*											
I. Increase the maximum criminal fraud penalty for individuals	uaoataoa DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
J. Double certain penalties, fines, and interest on underpayments related to certain offshore financial arrangements	oyo/a DOE	1	1	1	1	1	1	1	1	1	1	5	10
K. Increase in penalty for bad checks and money orders	comora DOE	[3]	2	2	2	2	2	2	2	2	2	8	18
L. Penalties relating to appraisers and substantial and gross overstatement of valuations of property:													
1. Substantial and gross overstatements of valuations of property	rfa DOE	2	2	2	2	2	2	3	4	4	5	10	28
2. Penalty on appraisers whose appraisals result in substantial or gross valuation misstatements	rfa DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	1	3
M. Increase the amount of certain penalty excise taxes imposed on public charities, social welfare organizations, and private foundations	tyba DOE	6	7	6	6	7	7	7	7	8	8	31	69
N. Increase the amount of penalty excise taxes for excess lobbying and political campaign activity of section 501(c)(3) organizations	tyba DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	1	2
O. Penalty on erroneous refund claims	DOE	*Presently Unavailable*											
Total of Reform of Penalties and Interest		**-223**	**-181**	**-184**	**-185**	**-403**	**-414**	**-424**	**-437**	**-453**	**-469**	**-1,174**	**-3,367**
IV. Confidentiality and Disclosure													
A. Disclosure to State officials of certain tax information related to certain section 501(c) organizations	DOE	*Negligible Revenue Effect*											
B. Collection activities with respect to a joint return disclosable based on oral request	rarma DOE	*No Revenue Effect*											
C. Prohibition of disclosure of taxpayer identification number with respect to disclosure of accepted offers-in-compromise	dma DOE	*No Revenue Effect*											
D. Compliance by contractors with confidentiality safeguards	dma DOE	*No Revenue Effect*											
E. Higher standards for requests for and consents to disclosure	[10]	*No Revenue Effect*											
F. Civil damages for unauthorized disclosure or inspection	180da DOE	*No Revenue Effect*											
G. Expanded disclosure in emergency circumstances	DOE	*No Revenue Effect*											
H. Disclosure of taxpayer identity for tax refund purposes	DOE	*No Revenue Effect*											
I. Treatment of public records	boaa DOE	*No Revenue Effect*											
J. Taxpayer identification number matching	DOE	*No Revenue Effect*											
K. Form 8300 disclosures	DOE	*No Revenue Effect*											
L. Expand definition of tax return preparer for purposes of sections 6713 and 7216	rpa DOE	*No Revenue Effect*											
M. Restrict the use and disclosure of taxpayer information by return preparers for nontax purposes and offshore disclosures	uada DOE	*No Revenue Effect*											
Total of Confidentiality and Disclosure		***No Revenue Effect***											
V. United States Tax Court Modernization	**various**	***Negligible Revenue Effect***											

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
VI. Miscellaneous Provisions													
A. Expensing of broadband internet access expenditures (sunset after 12/31/10)	eia 6/30/06	-120	-118	-154	-220	53	124	98	79	65	61	-559	-132
B. Modification of refunds for kerosene used in aviation for tax-exempt users of jet fuel	[11]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
C. Declaration by signer of corporate tax return that processes and procedures have been established to ensure that such return complies with the Internal Revenue Code of 1986	rfa DOE	*No Revenue Effect*											
D. Treatment of professional employer organizations as employers	1/1/08	---	-2	-2	-3	-4	-4	-4	-5	-5	-6	-11	-35
E. Require IRS to promote estimated tax payments through EFTPS	DOE	*No Revenue Effect*											
F. Study of report on use of voluntary withholding agreements	DOE	*No Revenue Effect*											
G. Offset of tax refunds against State court debts	DOE	*No Revenue Effect*											
H. Enhancing Tax Court security	DOE	*No Revenue Effect*											
I. Authorization of appropriations to combat the tax gap	DOE	*No Revenue Effect*											
J. Annual tax gap study	DOE	*No Revenue Effect*											
K. Authorization of appropriations for tax law enforcement relating to the hiring and continued employment of undocumented workers	DOE	*No Revenue Effect*											
L. Repeal dollar limit on contributions to qualified funeral trusts	cma 12/31/06	[3]	1	1	1	1	1	1	1	1	1	3	6
M. Administrative relief for late inter vivos QTIP elections	DOE [12]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	-1	-2
N. Exempt organization provisions:													
1. Disclosure of written determinations	wdia DOE	*Negligible Revenue Effect*											
2. Disclosure of internet web site and name under which an organization does business	rfa 12/31/06	*Negligible Revenue Effect*											
3. Modification to private foundation reporting of capital transactions	rfa 12/31/06	*Negligible Revenue Effect*											
4. Disclosure that Form 990 is publicly available	pomlora DOE	*No Revenue Effect*											
5. Expedited review process for certain tax-exemption applications	afa 12/31/06	*Negligible Revenue Effect*											
6. Extension of declaratory judgment procedures to non-501(c)(3) tax-exempt organizations	[6]	*Negligible Revenue Effect*											
7. Definition of convention or association of churches	DOE	*Negligible Revenue Effect*											
O. Include wireless telecommunications equipment in the definition of qualified technological equipment for purposes of determining the depreciation treatment for such equipment (sunset after 12/31/10) [13]	ppisa DOE	-80	-124	-148	-155	-124	-33	51	92	129	144	-630	-247
P. Simplification through elimination of inoperative provisions	DOE	*No Revenue Effect*											
Total of Miscellaneous Provisions		**-200**	**-243**	**-303**	**-377**	**-74**	**88**	**146**	**167**	**190**	**200**	**-1,198**	**-410**
VII. Revenue Offset Provisions													
A. Clarification of economic substance doctrine and related penalty provisions	tela DOE & ta DOE in tyea DOE	402	1,127	1,270	1,427	1,631	1,877	2,154	2,445	2,643	2,722	5,857	17,698

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
B. Tax treatment of certain inverted corporate entities.....	tyba 2005	137	86	92	99	107	115	123	133	143	153	521	1,188
Total of Revenue Offset Provisions		**539**	**1,213**	**1,362**	**1,526**	**1,738**	**1,992**	**2,277**	**2,578**	**2,786**	**2,875**	**6,378**	**18,886**
NET TOTAL		**-554**	**119**	**199**	**294**	**604**	**1,024**	**1,378**	**1,710**	**1,949**	**2,048**	**664**	**8,773**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment assumed to be October 1, 2006

Legend for "Effective" column:

aeio/a = agreements entered into on or after
afa = applications filed after
aoa = actions occurring after
boaa = before, on, and after
cma = contributions made after
comora = checks or money orders received after
dma = disclosures made after
DOE = date of enactment
eia = expenditures incurred after
etpmf = estimated tax payments made for
fapba = for annual periods beginning after
foo/a = failures occurring on or after
gma = grants made after
iaa = interest accrued after
iartia = levied amounts returned to individuals after
lio/a = levies issued on or after
oicsopo/a = offers in compromise submitted or pending on or after
oyo/a = open years on or after
pomiora = publications or materials issued or revised after
rarma = requests and reports made after
rfa = returns filed after
rpa = returns prepared after
tyba = taxable years beginning after
ta = transactions after
teia = transactions entered into after
uada = use and disclosures after
uaoataoa = underpayments and overpayments attributable to actions occurring after
wdia = written determinations issued after
180da = 180 days after
1ya = 1 year after

[1] Effective for bills first rendered more than 90 days after the date of enactment.
[2] Estimates of outlays and spending authority to be provided by Congressional Budget Office.
[3] Gain of less than $500,000.
[4] Effective with respect to levies made after the date of enactment and levies made on or before the date of enactment provided that the 9-month period has not expired as of the date of enactment.
[5] The provision combining the reports is effective for reports in 2007 and thereafter. The provision authorizing reports on significant issues affected taxpayer rights is effective on the date of enactment.
[6] Effective for pleadings filed with respect to determinations (or requests for determinations) made after December 13, 2006.
[7] Effective for support received, before, on, or after the date of enactment and for the determination of the status of any organization with respect to any taxable year beginning after the date of enactment.
[8] Loss of less than $500,000.
[9] Effective for submissions made and issues raised after the first list is prescribed under section 6702(c).
[10] Provision applies to requests and consents made three months after the date of enactment.
[11] Generally effective for kerosene sold after September 30, 2005. The special rule applicable to kerosene purchased prior to October 1, 2005 and used in aviation on a farm for farming purposes is effective on the date of enactment.
[12] Provision applies to requests for relief that relate to transfers made before, on, or after the date of enactment.
[13] Estimate is preliminary pending clarification of the definition of "commercial mobile radio service."

DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF S. 1321, THE "TELEPHONE EXCISE TAX REPEAL ACT OF 2005" AND S. 832, THE "TAXPAYER PROTECTION AND ASSISTANCE ACT OF 2005"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on June 28, 2006

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

June 28, 2006
JCX-28-06

CONTENTS

INTRODUCTION

The Senate Committee on Finance has scheduled a markup of S. 1321, the "Telephone Excise Tax Repeal Act of 2005" and S. 832, the "Taxpayer Protection and Assistance Act of 2005" for June 28, 2006. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification to the provisions of S. 1321 and S. 832.[2]

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of S. 1321, The "Telephone Excise Tax Repeal Act of 2005" and S. 832, the "Taxpayer Protection and Assistance Act of 2005"* (JCX-28-06), June 28, 2006.

[2] The provisions of the Chairman's mark of S. 1321 and S. 832 are described in Joint Committee on Taxation, *Description of the Chairman's Mark of S. 1321, the "Telephone Excise Tax Repeal Act of 2005" and S. 832, the "Taxpayer Protection and Assistance Act of 2005"* (JCX-25-06), June 26, 2006.

I. MODIFICATIONS TO THE CHAIRMAN'S MARK

A. Modifications to Regulation of Federal Tax Return Preparers (item II.C of the Chairman's Mark)

The modification requires the Secretary to accept the credentials of State licensing or registration programs for compensated preparers in lieu of testing by the Office of Professional Responsibility, to the extent that such State licensing or registration programs are comparable to the eligibility requirements established by the Secretary. In addition, the Office of Professional Responsibility shall coordinate with the appropriate State in order to collect information regarding practitioners that have been disciplined or suspended under State or local rules.

The modification also imposes a monetary penalty on any person preparing Federal tax returns and other tax submissions for compensation who has failed to meet the eligibility or renewal requirements for compensated preparers or who has otherwise been suspended from practice by the Office of Professional Responsibility. The penalty amount is equal to $1,000 for each tax return or other tax submission (e.g., an application for offer-in-compromise) prepared during the period such person was not authorized to practice before the Treasury. This penalty shall be in addition to other penalties that may be imposed under the Code, such as the penalty for failure to furnish an identifying number on a tax return.

The modification increases the penalties under section 6695 from $50 per return to the greater of $500 per return or $1,000. The modification also eliminates the $25,000 annual cap on such penalties.

The modification prohibits any practitioner authorized to practice before the Treasury from providing insurance to cover professional fees and other expenses incurred in responding to or defending a tax audit.

The modification requires jurats, signed under penalty of perjury, to be included on any form that can or must be submitted to the IRS separate from the taxpayer's signed tax return (e.g., reportable transaction disclosure statements and offer-in-compromise applications). Paid preparer information, if applicable, is also required on such forms under the modification.

B. Modification to Regulation of Refund Anticipation Loan Facilitators (item II.D of the Chairman's Mark)

The modification requires the Secretary to terminate the Debt Indicator program announced in Internal Revenue Service Notice 99-58.

II. IMPROVEMENTS IN TAX ADMINISTRATION AND TAXPAYER SAFEGUARDS

A. Waiver of User Fee for Installment Agreements Using Automated Withdrawals

Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed.[3] An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

The IRS charges a user fee if a request for an installment agreement is approved.

Description of Proposal

The proposal waives the user fee for installment agreements in which the parties agree to the use of automated installment payments (such as automated debits from a bank account).

Effective Date

The proposal applies to agreements entered into on or after the date which is 180 days after the date of enactment.

[3] Sec. 6159.

B. Termination of Installment Agreements

Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments, if the IRS determines that doing so will facilitate collection of the amounts owed.[4] An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

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

Description of Proposal

The proposal grants the IRS authority to terminate an installment agreement when a taxpayer fails to timely make a required Federal tax deposit or fails to timely file a tax return (including extensions). Under the proposal, the IRS may terminate an installment agreement even if the taxpayer remains current with payments under the installment agreement.

Effective Date

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

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[4] Sec. 6159.

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

C. 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 59½ or on account of certain other circumstances. Amounts withdrawn from an IRA due to a levy are not subject to the 10-percent early withdrawal tax, regardless of whether the amount is includible in income.

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

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

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 contribution has to be made to the same type of IRA from which the amounts were withdrawn.

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 and contributed to the IRA is treated as part of the distribution made from the IRA on account of the levy and is not includible in gross income. In addition, any tax attributable to an amount distributed from an IRA by reason of a levy is abated if the amount is recontributed to an IRA pursuant to the provision.

Effective Date

The proposal is effective for levied amounts (and interest thereon) returned to individuals after December 31, 2005.

D. Office of Chief Counsel Review of Offers-In-Compromise

Present Law

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. IRS regulations provide that such offers can be accepted if the taxpayer is unable to pay the full amount of the tax liability and it is doubtful that the tax, interest, and penalties can be collected or there is doubt as to the validity of the actual tax liability. Offers to compromise tax liabilities of $50,000 or more can only be accepted if the reasons for the acceptance are documented in detail and supported by a written opinion from the IRS Chief Counsel.[6]

Description of Proposal

The proposal repeals the requirement that offers to compromise liabilities of $50,000 or more must be supported by a written opinion from the IRS Chief Counsel. Under the proposal, written opinions must only be provided if the Secretary determines that an opinion from the IRS Chief Counsel is required with respect to a compromise.

Effective Date

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

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[6] Sec. 7122.

E. Elimination on Restriction on Offsetting Refunds From Former Residents

Present Law

Overpayments of Federal tax may be used to pay past-due child support and debts owed to Federal agencies, without the consent of the taxpayer.[7] Overpayments of Federal tax may also be used to pay specified past-due, legally enforceable State income tax debts, provided that the person making the Federal tax overpayment has shown on the Federal tax return for the taxable year of the overpayment an address that is within the State seeking the tax offset.

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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[7] Sec. 6402.

F. Revisions Relating to Termination of Employment of IRS Employees for Misconduct

Present Law

Section 1203 of the IRS Restructuring and Reform Act of 1998[8] requires the IRS to terminate the employment of an employee for certain proven violations committed by the employee in connection with the performance of official duties. The violations include: (1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets; (2) providing a false statement under oath material to a matter involving a taxpayer; (3) with respect to a taxpayer, taxpayer representative, or other IRS employee, the violation of any right under the U.S. Constitution, or any civil right established under Titles VI or VII of the Civil Rights Act of 1964, Title IX of the Educational Amendments of 1972, the Age Discrimination in Employment Act of 1967, the Age Discrimination Act of 1975, sections 501 or 504 of the Rehabilitation Act of 1973 and Title I of the Americans with Disabilities Act of 1990; (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or a taxpayer representative; (5) assault or battery on a taxpayer or other IRS employee, but only if there is a criminal conviction or a final judgment by a court in a civil case, with respect to the assault or battery; (6) violations of the Internal Revenue Code, Treasury Regulations, or policies of the IRS (including the Internal Revenue Manual) for the purpose of retaliating or harassing a taxpayer or other IRS employee; (7) willful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry; (8) willful failure to file any tax return required under the Code on or before the due date (including extensions) unless failure is due to reasonable cause; (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause; and (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

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

Description of Proposal

The proposal removes two items from the list of violations. These two items are: (1) the late filing of tax returns claiming an overpayment; and (2) employee versus employee assault or battery. The proposal also places the provisions of section 1203 in the Internal Revenue Code. The proposal also adds unauthorized inspection of returns and return information to the list of violations requiring termination.

Effective Date

The proposal is effective on the date of enactment.

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[8] Pub. L. No. 105-206.

G. Amend Collection Due Process Procedures for Employment Tax Liabilities

Present Law

Levy is the IRS's administrative authority to seize a taxpayer's property to pay the taxpayer's tax liability. The IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property. A Federal tax lien arises automatically where (1) a tax assessment has been made, (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment, and (3) the taxpayer has failed to pay the amount assessed within 10 days after the notice and demand.

In general, the IRS is required to notify taxpayers that they have a right to a fair and impartial collection due process ("CDP") hearing before levy may be made on any property or right to property.[9] Similar rules apply with respect to notices of tax liens, although the right to a hearing arises only on the filing of a notice.[10] The CDP hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. Under present law, taxpayers are not entitled to a pre-levy CDP hearing if a levy is issued to collect a Federal tax liability from a State tax refund or if collection of the Federal tax is in jeopardy. However, levies related to State tax refunds or jeopardy determinations are subject to post-levy review through the CDP hearing process.

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act ("FICA"), the tax under the Federal Unemployment Tax Act ("FUTA"), and the requirement that employers withhold income taxes from wages paid to employees ("income tax withholding").[11] Income tax 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 employee.

Description of Proposal

Under the proposal, levies issued to collect Federal employment taxes are excepted from the pre-levy CDP hearing requirement. Thus, under the proposal, taxpayers have no right to a CDP hearing before a levy is issued to collect employment taxes. As with the present-law procedures applicable to levies issued to collect a Federal tax liability from State tax refunds, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy. Collection by levy is permitted to continue during the CDP proceedings.

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[9] Sec. 6330(a).

[10] Sec. 6320.

[11] Secs. 3101-3128 (FICA), 3301-3311 (FUTA), and 3401-3404 (income tax withholding). FICA taxes consist of an employer share and an employee share, which the employer withholds from employees' wages.

Effective Date

The proposal is effective for levies issued on or after January 1, 2007.

H. Extend Time Limit for Contesting IRS Levy

Present Law

The IRS is authorized to return property that has been wrongfully levied upon.[12] In general, monetary proceeds from the sale of levied property 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 that such property was wrongfully levied upon may bring a civil action for wrongful levy in a district court of the United States.[13] Generally, an action for wrongful levy must be brought within nine months from the date of levy.[14]

Description of Proposal

The proposal extends from nine months to two years the period for returning 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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[12] Sec. 6343.

[13] Sec. 7426.

[14] Sec. 6532.

I. Permit the IRS to Require Increased Electronic Filing of Returns Prepared by Paid Return Preparers

Present Law

The Code authorizes the IRS to issue regulations specifying which returns must be filed electronically.[15] There are several limitations on this authority. First, it can only apply to persons required to file at least 250 returns during the year.[16] Second, the IRS is prohibited from requiring that income tax returns of individuals, estates, and trusts be submitted in any format other than paper (although these returns may be filed electronically by choice).

Description of Proposal

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

The proposal also imposes a monetary penalty on any person required to file a return electronically that fails to do so. The penalty is equal to the greater of $100 times the number of returns not filed electronically as required or $1,000.

Effective Date

The proposal is effective on the date of enactment.

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[15] Sec. 6011(e).

[16] Partnerships with more than 100 partners are required to file electronically.

J. Require IRS to Develop Direct Electronic Filing

Present Law

The IRS has entered into cooperative relationships with commercial return preparation services to provide free electronic filing services to eligible low-income or elderly taxpayers. This program is called "Free File." Presently, the IRS does not permit taxpayers to file their tax returns electronically without the use of an intermediary.

Description of Proposal

The proposal requires the Secretary to establish the "Direct e-file Program." The Direct e-file Program is a program that provides individual taxpayers with the ability to electronically file their Federal income tax returns through the IRS website without the use of an intermediary or with the use of an intermediary with which the IRS contracts to provide free universal access. The proposal requires the Secretary to implement the Direct e-file Program for filings for taxable years beginning after the date which is not later than three year after the date of enactment. Under the proposal, the IRS may develop its own electronic filing products in order to implement the Direct e-file Program.

Under the proposal, the Secretary is required to report to Congress every six months regarding the status of the implementation of the Direct e-file Program. In addition, the Secretary, in consultation with the National Taxpayer Advocate, is required to report to Congress annually on taxpayer usage of the Direct e-file Program.

The proposal also instructs the IRS to ensure that participating Free File companies do not advertise, market, or offer to sell products or services that are not directly related to the preparation of a tax return to any taxpayer utilizing Free File. The proposal also requires the IRS to establish procedures to encourage companies participating in the Free File Alliance to provide for accessible services for the blind.

The proposal requires the Secretary to provide a report to Congress on the feasibility of ensuring that the members of the Free File Alliance that have contracted separately with a State to provide free State preparation and filing also be required to provide free electronic filing and preparation for that State directly through the IRS Free File website. As part of that report, the IRS also should provide the most optimal way of alerting taxpayers on the IRS Free File website of those companies that will provide them with free State preparation and filing.

Effective Date

The proposal is effective on the date of enactment.

K. Study on Clarifying Recordkeeping Responsibilities

Present Law

Every person liable for Federal tax must keep records, provide statements, make returns, and comply with rules and regulations, as prescribed by the Secretary.[17] In general, taxpayers are required to keep records for as long as the statute of limitations may be open.

Description of Proposal

The proposal requires the Secretary of the Treasury to study:

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

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

Effective Date

The proposal is effective on the date of enactment.

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[17] Sec. 6001.

L. Modification of TIGTA Reporting Requirements

Present Law

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

Description of Proposal

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

- IRS compliance with the restrictions[18] on directly contacting taxpayers who have indicated that they prefer that their representatives be contacted.
- IRS compliance with the requirements relating to disclosure of collection information with respect to joint returns.
- IRS compliance with the fair debt collection provisions of the Code.

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

Effective Date

The proposal is effective on the date of enactment.

[18] Sec. 7521.

M. Streamline Reporting Process for National Taxpayer Advocate

Present Law

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

Description of Proposal

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

Effective Date

The proposal combining the reports is effective for reports in 2007 and thereafter. The proposal authorizing reports on significant issues affecting taxpayer rights is effective on the date of enactment.

N. Whistleblower Reforms

Present Law

The Code authorizes the IRS to pay such sums as deemed necessary for: "(1) detecting underpayments of tax; and (2) detecting and bringing to trial and punishment persons guilty of violating the Internal Revenue laws or conniving at the same."[19] Amounts are paid based on a percentage of tax, fines, and penalties (but not interest) actually collected based on the information provided. For specific information that caused the investigation and resulted in recovery, the IRS administratively has set the reward in an amount not to exceed 15 percent of the amounts recovered. For information, although not specific, that nonetheless caused the investigation and was of value in the determination of tax liabilities, the reward is not to exceed 10 percent of the amount recovered. For information that caused the investigation, but had no direct relationship to the determination of tax liabilities, the reward is not to exceed one percent of the amount recovered. The reward ceiling is $10 million (for payments made after November 7, 2002), and the reward floor is $100. No reward will be paid if the recovery was so small as to call for payment of less than $100 under the above formulas. Both the ceiling and percentages can be increased with a special agreement. The Code permits the IRS to disclose return information pursuant to a contract for tax administration services.[20]

Description of Proposal

The proposal reforms the reward program for individuals who provide information regarding violations of the tax laws to the Secretary. Generally, the proposal establishes a reward floor of 15 percent of the collected proceeds (including penalties, interest, additions to tax and additional amounts) if the IRS moves forward with an administrative or judicial action based on information brought to the IRS's attention by an individual. The proposal caps the available reward at 30 percent of the collected proceeds. The proposal permits awards of lesser amounts (but no less than 10 percent) if the action was based principally on allegations (other than information provided by the individual) resulting from a judicial or administrative hearing, government report, hearing, audit, investigation, or from the news media.

The proposal creates a Whistleblower Office within the IRS to administer the reward program. The Whistleblower Office may seek assistance from the individual providing information or from his or her legal representative, and may reimburse the costs incurred by any legal representative out of the amount of the reward. To the extent the disclosure of returns or return information is required to render such assistance, the disclosure must be pursuant to an IRS tax administration contract.

Effective Date

The proposal is effective for information provided on or after the date of enactment.

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[19] Sec. 7623.

[20] Sec. 6103(n).

O. Allow the Financial Management Service to Retain Transaction Fees from Levied Amounts

Present Law

To facilitate the collection of tax, the IRS can generally levy upon all property and rights to property of a taxpayer.[21] With respect to specified types of recurring payments, the IRS may impose a continuous levy of up to 15 percent of each payment, which generally continues in effect until the liability is paid.[22] Continuous levies imposed by the IRS on specified Federal payments are administered by the Financial Management Service (FMS) of the Department of the Treasury. FMS is generally responsible for making most non-defense related Federal payments. FMS is required to charge the IRS for the costs of developing and operating this continuous levy program. The IRS pays these FMS charges out of its appropriations.

Description of Proposal

The proposal allows FMS to retain a portion of funds levied under continuous levies as payment of FMS charges for the continuous levy program. The amount credited to the taxpayer's account is not, however, reduced by the amount retained by FMS.

Effective Date

The proposal is effective on the date of enactment.

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[21] Sec. 6331.

[22] Sec. 6331(h).

P. Authorization of Appropriations for Tax Law Enforcement

Present Law

There is no explicit authorization of appropriations to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

Description of Proposal

The proposal includes an authorization of an additional $300 million to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

Effective Date

The proposal is effective on the date of enactment.

Q. Clarification of Definition of Church Tax Inquiry

Present Law

Under present law, the IRS may begin a church tax inquiry only if an appropriate high-level Treasury official reasonably believes, on the basis of the facts and circumstances recorded in writing, that an organization (1) may not qualify for tax exemption as a church, (2) may be carrying on an unrelated trade or business, or (3) otherwise may be engaged in taxable activities.[23] A church tax inquiry is defined as any inquiry to a church (other than an examination) that serves as a basis for determining whether the organization qualified for tax exemption as a church or whether it is carrying on an unrelated trade or business or otherwise is engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records, other than routine requests for information or inquiries regarding matters that do not primarily concern the tax status or liability of the church itself.

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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[23] Sec. 7611.

R. Notification Requirement for Exempt Entities Not Currently Required to File an Annual Information Return

Present Law

Under present law, the requirement that an exempt organization file an annual nformation return does not apply to several categories of exempt organizations. Organizations xcepted from the filing requirement include organizations (other than private foundations), the ross receipts of which in each taxable year normally are not more than $25,000.[24] Also exempt rom the requirement are churches, their integrated auxiliaries, and conventions or associations f churches; the exclusively religious activities of any religious order; section 501(c)(1) nstrumentalities of the United States; section 501(c)(21) trusts; an interchurch organization of ocal units of a church; certain mission societies; certain church-affiliated elementary and high chools; certain State institutions whose income is excluded from gross income under section 15; certain governmental units and affiliates of governmental units; and other organizations that ne IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.

Description of Proposal

The proposal requires organizations that are excused from filing an information return by eason of normally having gross receipts below a certain specified amount (generally, under 25,000) to furnish to the Secretary annually, in electronic form, the legal name of the rganization, any name under which the organization operates or does business, the rganization's mailing address and Internet web site address (if any), the organization's taxpayer lentification number, the name and address of a principal officer, and evidence of the rganization's continuing basis for its exemption from the generally applicable information turn filing requirements. Upon such organization's termination of existence, the organization required to furnish notice of such termination.

The proposal provides that if an organization fails to provide the required notice for three nsecutive years, the organization's tax-exempt status is revoked. In addition, if an ganization that is required to file an annual information return under section 6033(a) (Form 90) fails to file such an information return for three consecutive years, the organization's tax-exempt status is revoked. If an organization fails to meet its filing obligation to the IRS for three nsecutive years in cases where the organization is subject to the information return filing quirement in one or more years during a three-year period and also is subject to the notice quirement for one or more years during the same three-year period, the organization's tax-exempt status is revoked.

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[24] Sec. 6033(a)(2); Treas. Reg. sec. 1.6033-2(a)(2)(i); Treas. Reg. sec. 1.6033-2(g)(1). Sec. 33(a)(2)(A)(ii) provides a $5,000 annual gross receipts exception from the annual reporting quirements for certain exempt organizations. In Announcement 82-88, 1982-25 I.R.B. 23, the IRS ercised its discretionary authority under section 6033 to increase the gross receipts exception to 5,000, and enlarge the category of exempt organizations that are not required to file Form 990.

A revocation under the proposal is effective from the date that the Secretary determines was the last day the organization could have timely filed the third required information return or notice. To again be recognized as tax-exempt, the organization must apply to the Secretary for recognition of tax-exemption, irrespective of whether the organization was required to make an application for recognition of tax-exemption in order to gain tax-exemption originally.

If, upon application for tax-exempt status after a revocation under the proposal, the organization shows to the satisfaction of the Secretary reasonable cause for failing to file the required annual notices or returns, the organization's tax-exempt status may, in the discretion of the Secretary, be reinstated retroactive to the date of revocation. An organization may not challenge under the Code's declaratory judgment procedures (section 7428) a revocation of tax-exemption made pursuant to the proposal.

There is no monetary penalty for failure to file the notice under the proposal. The proposal requires that the notices be made available to the public under the public disclosure and inspection rules generally applicable to exempt organizations. The proposal does not affect an organization's obligation under present law to file required information returns or existing penalties for failure to file such returns.

The Secretary is required to notify every organization that is subject to the notice filing requirement of the new filing obligation in a timely manner. Notification by the Secretary shall be by mail, in the case of any organization the identity and address of which is included in the list of exempt organizations maintained by the Secretary, and by Internet or other means of outreach, in the case of any other organization. In addition, the Secretary is required to publicize in a timely manner in appropriate forms and instructions and other means of outreach the new penalty imposed for consecutive failures to file the information return.

The Secretary is authorized to publish a list of organizations whose exempt status is revoked under the proposal.

Effective Date

The proposal is effective for notices and returns with respect to annual periods beginning after 2006.

S. Treat Funds from Indian Tribal Governments as Public Support for Purposes of the Public Charity-Private Foundation Classification

Present Law

Organizations described in section 501(c)(3) are classified either as public charities or private foundations. The public charity classification generally is based on an organization's sources of support. Support from governmental entities is considered as public support in determining whether an organization is publicly or privately supported and thus is classified as a public charity or a private foundation. Support from an Indian Tribal Government is not treated as support from a governmental entity.

Description of Proposal

The proposal provides that support from an Indian Tribal Government is treated as support from a State for purposes of determining whether an organization described in section 501(c)(3) is classified as a public charity or a private foundation.

Effective Date

The proposal applies to support received before, on, or after the date of enactment and to the determination of the status of any organization with respect to any taxable year beginning after the date of enactment.

T. Innocent Spouse

Present Law

Generally, a husband and wife are liable jointly and individually for the entire tax on a joint return. Under certain circumstances, a spouse may be entitled to relief from joint and several liability, "innocent spouse relief." Generally, the spouse must elect the form of innocent spouse relief no later than two years after the date the IRS began collection activities against the electing spouse.

There are three types of relief, general innocent spouse relief, relief for spouses no longer married or legally separated (separation of liabilities), and equitable relief.

For general relief, the electing spouse must have

- Filed a joint return which has an understatement of tax due to the erroneous items of the other spouse,
- Establish that at the time of signing the return the electing spouse did not know or have reason to know there was an understatement of tax, and
- Taking into account all the facts and circumstances, show that it is inequitable to hold the electing spouse liable for the deficiency in tax.

For separation of liabilities relief, the electing spouse

- Must have filed a joint return and,
- Either (1) is no longer married to or is legally separated from the spouse with whom the return was filed or (2) must not have been a member of the same household with the spouse for a 12-month period.

If an individual fails to qualify under the preceding two options, such individual may still be able to obtain equitable relief. To obtain equitable relief, the IRS must determine that taking into account all of the facts and circumstances, it is inequitable to hold the electing spouse liable for any unpaid tax or any deficiency in tax (or any portion or either).

In the case of an individual against whom a deficiency has been asserted and elects to have the general relief provisions or the separation of liabilities relief provisions apply, such individual may petition the Tax Court to review the IRS's determinations.

Description of Proposal

The proposal clarifies that the Tax Court has jurisdiction over equitable relief claims, even if the individual does not elect to have the general relief or separation of liabilities relief provisions apply. The proposal also suspends collection activity during the period a request for equitable relief is pending.

Effective Date

The proposal applies to requests for equitable relief with respect to liability for taxes which are unpaid on or after the date of enactment.

U. Authorization of Appropriations for Tax Law Enforcement Relating to Human Trafficking

Present Law

IRS undercover operations are statutorily exempt from the generally applicable restrictions controlling the use of Government funds (which generally provide that all receipts must be deposited in the general fund of the Treasury and all expenses be paid out of appropriated funds). In general, the Code permits the IRS to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation, through 2006. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations.

There is no explicit authorization of appropriations to the Internal Revenue Service to be used to combat tax crimes where the underlying income is derived from sex trafficking crimes.

Description of Proposal

The proposal authorizes the IRS to use $2 million toward the establishment of an office in IRS Criminal Investigation to investigate unlawful sex traffickers for violations of tax laws. The Committee intends that the office will coordinate closely with the existing task forces in the Department of Justice that are focused on sex trafficking offenders. The proposal allows the office to use amounts collected from human sex traffickers for violations of tax laws for additional enforcement activities. It is the committee's intent that the IRS will focus on the employer/employee relationship in these cases and the resulting failure of the trafficker to file information reporting returns required under the existing rules applicable to employers and other payors.

The proposal requires the Secretary to report to Congress within one year of the date of enactment on enforcement activities related to tax violations of sex traffickers.

The proposal also modifies the whistleblower reward provisions so that the victims of human trafficking will be eligible to participate in the program.

Effective Date

The proposal is effective on the date of enactment.

V. Regulation of Payroll Tax Deposit Agents

Present Law

Taxpayers may choose to fulfill their payroll tax obligations using payroll tax deposit agents. In general, these payroll tax deposit agents are not required to register or post bonds with the IRS. Persons required to collect and pay over taxes to the IRS who fail to do so are subject to penalty.

Description of Proposal

First, the proposal requires the annual registration of payroll tax deposit agents with the IRS. The annual registration fee shall not exceed $100. A payroll tax deposit agent is defined as any person which provides payroll processing or tax filing and deposit services to one or more employers (other than an employer working on its own behalf) if such person has the contractual authority to access such employer's funds for the purpose of making employment tax deposits. A payroll tax deposit agent does not include a person who only transfers such funds (regardless of whether they have the right to determine the amount of such transfer) and does not have the authority to impound such funds for such purpose.

Second, the proposal also provides that payroll tax deposit agents must elect either to: (1) post a reasonable bond or (2) submit to an annual audit. If the payroll tax deposit agent elects to post a bond, then the amount of such bond shall not be less than $50,000 nor more than $500,000 and shall be determined with respect to each payroll tax deposit agent under regulations. Any bond or security shall be in such form and with such surety or sureties as may be prescribed by regulations. If the payroll tax deposit agent elects to submit to an annual audit, then the audit shall be performed by an independent third party and shall be based on such audit principles as the Secretary deems necessary. In all cases the audits shall confirm that: (1) the escrow account in which the payroll tax deposit agent holds the employers' taxes is balanced annually to the total of the quarterly reconciliation statements; (2) the escrow account funds are not commingled with the agent's operating funds; (3) no escrow account funds are used to pay the agent's operating expenses; and (4) there is receipt evidence that the agent paid the required taxes for the employers to the proper government employment tax authorities.

Third, the proposal directs the Secretary to require payroll tax deposit agents to disclose to each potential and existing client: (1) the client's continuing liability for payment of all Federal and State employment taxes notwithstanding any contractual relationship with a payroll tax deposit agent; (2) the mechanisms available to the client to verify the amount and date of payment of all tax deposits made by the payroll tax deposit agent on behalf of such client; and (3) such information that the Secretary determines necessary or appropriate to assist employers in the selection and use of payroll tax deposit agents. These disclosures are required prior to or at the time of contracting for payroll services.

Fourth, the proposal requires payroll tax deposit agents to ensure the direct notification of the employer(s) by any Federal or State employment tax authority regarding the nonpayment of such employment taxes.

Fifth, the proposal provides penalties (not to exceed $10,000) for unregistered agents acting as payroll tax deposit agents with respect to Federal tax deposits for each 90 days of noncompliance.

Sixth, the proposal provides that only persons registered as payroll tax deposit agents may: (1) make Federal tax deposits on behalf of an employer; (2) sign and file Federal employment tax returns of behalf of a taxpayer; and (3) have access to confidential tax information relating to such employer.

Finally, the proposal clarifies that the penalty for failure to collect and pay over tax applies to payroll agents and is not dischargeable in bankruptcy.

The Secretary is directed to issue such guidance as necessary to carry out these provisions.

Effective Date

Generally the provisions are effective on January 1, 2007. The provision relating to penalties for failure to collect and pay over tax is effective for failures occurring after December 31, 2006.

W. Extension of the Statute of Limitations to File Claims for Refunds Relating to Disability Determinations by the Department of Veteran's Affairs

Present Law

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

Generally, military retirement benefits based on length of service are included in income, whereas veterans' benefits based on a service-connected disability are excluded from income. If an individual receives includible retirement benefits and is later retroactively determined to be eligible for service-connected disability benefits, the portion of the retirement benefits attributable to the disability is retroactively excluded from income. In that case, the individual may claim a refund of the tax paid on the retroactively excluded benefits, subject to the statute of limitations on filing a refund claim.

Description of Proposal

The proposal extends the time period for filing refund claims for retired military personnel who receive disability determinations from the Department of Veterans Affairs (e.g. determinations after the tax return is filed). Specifically, the proposal extends the period for filing such a refund claim until one year after the date of the disability determination (if later than the time periods allowed under present law). The proposal applies to any taxable year which begins 5 years before the date of the determination or thereafter. In the case of a determination after December 31, 2000, and on or before the date of enactment, the period for filing a refund claim is extended until one year after the date of enactment (if later than the time periods allowed under present law).

Effective Date

The proposal is effective for claims for refunds filed after the date of enactment.

III. REFORM OF PENALTIES AND INTEREST

A. Increase Estimated Tax Threshold

Present Law

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

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

Description of Proposal

The threshold for imposing the penalty for failure to pay estimated tax is increased from $1,000 to $2,000.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2006.

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

Present Law

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

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

Description of Proposal

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

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2006.

2. Provide that underpayment balances are cumulative

Present Law

Section 6654(b)(1) defines "underpayment" as the amount of an installment due over the amount of any installment paid (including withholding) on or before the due date of the installment. In determining an underpayment penalty for a calendar year taxpayer, the period of underpayment runs for each underpayment from the payment's due date through the earlier of the date on which any portion of the payment is made or the 15th day of the fourth month following the close of the taxable year. Underpayment balances are not cumulative and must be tracked separately for each estimated tax underpayment period.

Description of Proposal

The definition of "underpayment" is modified to allow existing underpayment balances to be used in underpayment calculations for succeeding estimated payment periods. Under the proposal, taxpayers calculate a cumulative underpayment at the end of each underpayment period.

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2006.

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

Present Law

Under current IRS procedures, taxpayers with outstanding underpayment balances that extend from a leap year through a non-leap year are required to make separate calculations solely to account for the different number of days in the two different years. For example, if a taxpayer has an underpayment outstanding from September 15, 2008, through January 15, 2009, then the taxpayer is required to account for the period from September 15, 2008 through December 31, 2008, using a 366-day formula.[25] The taxpayer then is required to account for the period from January 1, 2009, through January 15, 2009, under a 365-day formula. This calculation is required regardless of whether the interest rate changes on January 1, 2009.

Description of Proposal

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

Effective Date

The proposal is effective for estimated tax payments made for taxable years beginning after December 31, 2006.

[25] The year 2008 is a leap year, the year 2009 is not.

B. Corporate Estimated Tax

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability.[26] An exception to this requirement applies if the amount of tax for the taxable year is less than $500.

Description of Proposal

The proposal increases the threshold amount of tax for requiring corporate estimated tax payments to $1,000.

Effective Date

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

[26] Sec. 6655.

C. Increase in Large Corporation Threshold for Estimated Tax Payments

Present Law

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

Description of Proposal

The proposal increases the $1 million threshold defining large corporations (for purposes of quarterly estimated tax) by $50,000 every year beginning after 2006 until it reaches $1.5 million.

Effective Date

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

D. Expansion of Interest Netting

Present Law

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

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

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

Description of Proposal

In the case of any taxpayer (whether an individual or corporation or other), the interest netting rules with respect to tax underpayments and overpayments are applied without regard to the 45-day period in which the Secretary may refund an overpayment of tax without the payment of interest under section 6611(e). Solely for the purpose of the interest netting computation, the portion of the 45-day period before repayment of the overpayment is considered as a period for which overpayment interest was allowable at a zero rate. The proposal does not modify the period for which interest is payable or allowable for any other purpose.

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

Effective Date

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

E. Clarification of Application of Federal Tax Deposit Penalty

Present Law

In many instances, taxpayers are required to make deposits of Federal taxes.[27] Failure to do so is subject to a penalty.[28] The amount of that penalty depends on the length of time that the deposit was not made. The penalty is two percent of the underpayment if the failure to deposit is for not more than five days, 5 percent for six through 15 days, and 10 percent for more than 15 days. The IRS applies the 10 percent penalty rate automatically if a deposit is not made in the manner required.

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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[27] Sec. 6302.

[28] Sec. 6656.

F. Frivolous Tax Submissions

Present Law

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of $500 imposed by the IRS (sec. 6702). The Code also permits the Tax Court[29] to impose a penalty of up to $25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in a proceeding is frivolous or groundless (sec. 6673(a)).

Description of Proposal

The proposal modifies the penalty on frivolous returns by increasing the amount of the penalty to up to $5,000 and by applying it to all taxpayers and to all types of Federal taxes.

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

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

Effective Date

The proposal applies to submissions made and issues raised after the date on which the Secretary first prescribes the required list of frivolous positions.

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[29] Because in general the Tax Court is the only pre-payment forum available to taxpayers, it addresses most of the frivolous, groundless, or dilatory arguments raised in tax cases.

G. Understatement of Taxpayer's Liability by Tax Return Preparers

Present Law

An income tax return preparer is defined as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of an income tax return or claim for refund.[30] Under present law, the definition of an income tax return preparer does not include a person preparing non-income tax returns, such as estate and gift, excise, or employment tax returns.

Income tax return preparers are required to sign and include their taxpayer identification numbers on income tax returns and income return-related documents prepared for compensation. Under section 6695, penalties are imposed on any income tax return preparer who, in connection with the preparation of an income tax return, fails to (1) furnish a copy of a return or claim for refund to the taxpayer, (2) sign the return or claim for refund, (3) furnish his or her identifying number, (4) retain a copy of the completed return or a list of the taxpayers for whom a return was prepared, (5) file a correct information return, and (6) comply with certain due diligence requirements in determining a taxpayer's eligibility for the earned income credit.[31] Generally, the penalty is $50 for each failure and the total penalties imposed for any single type of failure for any calendar year are limited to $25,000. The penalty for failing to comply with the due diligence requirements for determining a taxpayer's eligibility for the earned income credit is $100. An income tax return preparer who endorses or negotiates a check issued to a taxpayer (other than the income tax return preparer) is liable for a penalty of $500 with respect to each such check.

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to an undisclosed position for which there was not a realistic possibility of being sustained on its merits, or a frivolous position, is liable for a first-tier penalty of $250, provided the preparer knew or reasonably should have known of the position. For purposes of the penalty, an understatement is generally defined as any understatement with respect to any tax imposed by subtitle A (i.e., income taxes). An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing an income tax return is liable for a second-tier penalty of $1,000.

Description of Proposal

The proposal broadens the scope of the present-law preparer penalties to include preparers of estate and gift tax, employment tax, and excise tax returns, and returns of exempt organizations.

The proposal alters the standards of conduct that must be met to avoid imposition of the penalties for preparing a return with respect to which there is an understatement of tax. First, the

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[30] Sec. 7701(a)(36)(A).

[31] Sec. 6695.

proposal replaces the realistic possibility standard for undisclosed positions with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The proposal replaces the not-frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

The proposal also imposes a penalty on a tax return preparer who prepares the portion of a claim for refund or credit that is disallowed if there is no reasonable basis for the claimed tax treatment of the disallowed portion of such claim for refund or credit.

The proposal also increases the first-tier penalty from $250 to the greater of $1,000 or 50 percent of the tax preparer's fee. The proposal increases the second-tier penalty from $1,000 to the greater of $5,000 or 50 percent of the tax preparer's fee.

Effective Date

The proposal is effective for tax returns prepared after the date of enactment.

H. Penalty for Aiding and Abetting the Understatement of Tax Liability

Present Law

A penalty is imposed on a person who: (1) aids or assists in, procures, or advises with respect to a tax return or other document; (2) knows (or has reason to believe) that such document will be used in connection with a material tax matter; and (3) knows that this would result in an understatement of tax of another person. In general, the amount of the penalty is $1,000. If the document relates to the tax return of a corporation, the amount of the penalty is $10,000.

Description of Proposal

The proposal expands the scope of the aiding and abetting penalty in several ways. First, it applies the penalty to aiding or abetting with respect to tax liability reflected in a tax return. Second, it applies the penalty separately to each instance of aiding or abetting. Third, it increases the amount of the penalty to a maximum of 100 percent of the gross income derived (or to be derived) from the aiding or abetting. Fourth, if more than one person is liable for the penalty, all such persons are jointly and severally liable for the penalty. Fifth, the penalty, as well as amounts paid to settle or avoid the imposition of the penalty, is not deductible for tax purposes.

Effective Date

The proposal is effective for activities occurring after the date of enactment.

I. Increase in Criminal Monetary Penalty Limitation for the Underpayment or Overpayment of Tax Due to Fraud

Present Law

Attempt to evade or defeat tax

In general, section 7201 imposes a criminal penalty on persons who willfully attempt to evade or defeat any tax imposed by the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than five years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Willful failure to file return, supply information, or pay tax

In general, section 7203 imposes a criminal penalty on persons required to make estimated tax payments, pay taxes, keep records, or supply information under the Code who willfully fail to do so. Upon conviction, the Code provides that the penalty is up to $25,000 or imprisonment of not more than one year (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $100,000.

Fraud and false statements

In general, section 7206 imposes a criminal penalty on persons who make fraudulent or false statements under the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than three years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Uniform sentencing guidelines

Under the uniform sentencing guidelines established by 18 U.S.C. 3571, a defendant found guilty of a criminal offense is subject to a maximum fine that is the greatest of: (a) the amount specified in the underlying proposal, (b) for a felony[32] $250,000 for an individual or $500,000 for an organization, or (c) twice the gross gain if a person derives pecuniary gain from the offense. This Title 18 proposal applies to all criminal proposals in the United States Code, including those in the Internal Revenue Code. For example, for an individual, the maximum fine under present law upon conviction of violating section 7206 is $250,000 or, if greater, twice the amount of gross gain from the offense.

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[32] Section 7206 provides that the making of fraudulent or false statements is a felony. In addition, this offense is a felony pursuant to the classification guidelines of 18 U.S.C. 3559(a)(5).

Description of Proposal

Attempt to evade or defeat tax

The proposal increases the criminal penalty under section 7201 for individuals to $500,000 and for corporations to $1,000,000. The proposal increases the maximum prison sentence to ten years.

Willful failure to file return, supply information, or pay tax

The proposal increases the criminal penalty under section 7203 for individuals from $25,000 to $50,000 and, in the case of an "aggravated failure to file" (defined as a failure to file a return for a period of three or more consecutive taxable years if the aggregated tax liability for such period is at least $100,000 or any failure to file a return where the underlying income or payment is attributable to activities that are felonies under Federal or State criminal law), changes the crime from a misdemeanor to a felony and increases the maximum prison sentence to ten years. The proposal clarifies that the aggravated failure to file penalty may be applied in addition to other criminal tax penalties.

Fraud and false statements

The proposal increases the criminal penalty for making fraudulent or false statements to $500,000 for individuals and $1,000,000 for corporations. The proposal increases the maximum prison sentence for making fraudulent or false statements to five years. The proposal provides that in no event shall the amount of the monetary penalty under the proposal be less than the amount of the underpayment or overpayment attributable to fraud.

Effective Date

The proposal is effective for actions and failures to act occurring after the date of enactment.

J. Doubling of Certain Penalties, Fines, and Interest on Underpayments Related to Certain Offshore Financial Arrangements

Present Law

In general

The Code contains numerous civil penalties, such as the delinquency, accuracy-related, fraud, and assessable penalties. These civil penalties are in addition to any interest that may be due as a result of an underpayment of tax. If all or any part of a tax is not paid when due, the Code imposes interest on the underpayment, which is assessed and collected in the same manner as the underlying tax and is subject to the respective statutes of limitations for assessment and collection.

Delinquency penalties

Failure to file

Under present law, a taxpayer who fails to file a tax return on a timely basis is generally subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent. An exception from the penalty applies if the failure is due to reasonable cause. In the case of fraudulent failure to file, the penalty is increased to 15 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 75 percent. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

Failure to pay

Taxpayers who fail to pay their taxes are subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent. If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return. If an income tax return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of $100 or 100 percent of the amount required to be shown on the return. For any month in which an installment payment agreement with the IRS is in effect, the rate of the penalty is half the usual rate (0.25 percent instead of 0.5 percent), provided that the taxpayer filed the tax return in a timely manner (including extensions).

Failure to make timely deposits of tax

The penalty for the failure to make timely deposits of tax consists of a four-tiered structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. A depositor is subject to a penalty equal to two percent of the amount of the underpayment if the failure is corrected on or before the date that is five days after the prescribed due date. A depositor is subject to a penalty equal to five percent of the amount of the underpayment if the failure is corrected after the date that is five days after the prescribed due

date but on or before the date that is 15 days after the prescribed due date. A depositor is subject to a penalty equal to 10 percent of the amount of the underpayment if the failure is corrected after the date that is 15 days after the due date but on or before the date that is 10 days after the date of the first delinquency notice to the taxpayer (under sec. 6303). Finally, a depositor is subject to a penalty equal to 15 percent of the amount of the underpayment if the failure is not corrected on or before earlier of 10 days after the date of the first delinquency notice to the taxpayer and 10 days after the date on which notice and demand for immediate payment of tax is given in cases of jeopardy.

An exception from the penalty applies if the failure is due to reasonable cause. In addition, the Secretary may waive the penalty for an inadvertent failure to deposit any tax by specified first-time depositors.

Accuracy-related penalties

In general

The accuracy-related penalties are imposed at a rate of 20 percent of the portion of any underpayment that is attributable, in relevant part, to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, and (4) any reportable transaction understatement. The penalty for a substantial valuation misstatement is doubled for certain gross valuation misstatements. In the case of a reportable transaction understatement for which the transaction is not disclosed, the penalty rate is 30 percent. These penalties are coordinated with the fraud penalty. This statutory structure operates to eliminate any stacking of the penalties.

No penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith, and in the case of a reportable transaction understatement the relevant facts of the transaction have been disclosed, there is or was substantial authority for the taxpayer's treatment of such transaction, and the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

Negligence or disregard for the rules or regulations

If an underpayment of tax is attributable to negligence, the negligence penalty applies only to the portion of the underpayment that is attributable to negligence. Negligence means any failure to make a reasonable attempt to comply with the provisions of the Code. Disregard includes any careless, reckless, or intentional disregard of the rules or regulations.

Substantial understatement of income tax

Generally, an understatement is substantial if the understatement exceeds the greater of (1) 10 percent of the tax required to be shown on the return for the tax year, or (2) $5,000. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return.

Substantial valuation misstatement

A penalty applies to the portion of an underpayment that is attributable to a substantial valuation misstatement. Generally, a substantial valuation misstatement exists if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis. The amount of the penalty for a substantial valuation misstatement is 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis. If the value or adjusted basis claimed is 400 percent or more of the correct value or adjusted basis, then the overvaluation is a gross valuation misstatement.

Reportable transaction understatement

A penalty applies to any item that is attributable to any listed transaction, or to any reportable transaction (other than a listed transaction) if a significant purpose of such reportable transaction is tax avoidance or evasion.

Fraud penalty

The fraud penalty is imposed at a rate of 75 percent of the portion of any underpayment that is attributable to fraud. The accuracy-related penalty does not to apply to any portion of an underpayment on which the fraud penalty is imposed.

Assessable penalties

In addition to the penalties described above, the Code imposes a number of additional penalties, including, for example, penalties for failure to file (or untimely filing of) information returns with respect to foreign trusts, and penalties for failure to disclose any required information with respect to a reportable transaction.

Interest provisions

Taxpayers are required to pay interest to the IRS whenever there is an underpayment of tax. An underpayment of tax exists whenever the correct amount of tax is not paid by the last date prescribed for the payment of the tax. The last date prescribed for the payment of the income tax is the original due date of the return.

Different interest rates are provided for the payment of interest depending upon the type of taxpayer, whether the interest relates to an underpayment or overpayment, and the size of the underpayment or overpayment. Interest on underpayments is compounded daily.

Offshore Voluntary Compliance Initiative

In January 2003, Treasury announced the Offshore Voluntary Compliance Initiative ("OVCI") to encourage the voluntary disclosure of previously unreported income placed by taxpayers in offshore accounts and accessed through credit card or other financial arrangements. A taxpayer had to comply with various requirements in order to participate in the OVCI, including sending a written request to participate in the program by April 15, 2003. This request

had to include information about the taxpayer, the taxpayer's introduction to the credit card or other financial arrangements and the names of parties that promoted the transaction. A taxpayer entering into a closing agreement under the OVCI is not liable for the civil fraud penalty, the fraudulent failure to file penalty, or the civil information return penalties. Such a taxpayer is responsible for back taxes, interest, and certain accuracy-related and delinquency penalties.[33]

Voluntary disclosure policy

A taxpayer's timely, voluntary disclosure of a substantial unreported tax liability has long been an important factor in deciding whether the taxpayer's case should ultimately be referred for criminal prosecution. The voluntary disclosure must be truthful, timely, and complete. The taxpayer must show a willingness to cooperate (as well as actual cooperation) with the IRS in determining the correct tax liability. The taxpayer must make good-faith arrangements with the IRS to pay in full the tax, interest, and any penalties determined by the IRS to be applicable. A voluntary disclosure does not guarantee immunity from prosecution. It creates no substantive or procedural rights for taxpayers.[34] The IRS treats participation in the OVCI as a voluntary disclosure.[35]

Description of Proposal

The proposal doubles the amounts of civil penalties, interest, and fines related to taxpayers' underpayments of U.S. income tax liability through the direct or indirect use of certain offshore financial arrangements. The proposal applies to taxpayers who did not (or do not) voluntarily disclose such arrangements through the OVCI or otherwise. Under the proposal, the determination of whether any civil penalty is to be applied to such underpayment is made without regard to whether a return has been filed, whether there was reasonable cause for such underpayment, and whether the taxpayer acted in good faith.

The proscribed financial arrangements include, but are not limited to, the use of certain foreign leasing corporations for providing domestic employee services,[36] certain arrangements whereby the taxpayer may hold securities trading accounts through offshore banks or other financial intermediaries, certain arrangements whereby the taxpayer may access funds through the use of offshore credit, debit, or charge cards, and offshore annuities or trusts.

The Secretary of the Treasury is granted the authority to waive the application of the proposal if the use of the offshore financial arrangements is incidental to the transaction and, in

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[33] Rev. Proc. 2003-11, 2003-4 C.B. 311.

[34] Internal Revenue News Release 2002-135, IR-2002-135 (December 11, 2002).

[35] Rev. Proc. 2003-11, 2003-4 C.B. 311.

[36] These arrangements were described and classified as listed transactions in Notice 2003-22, 2003-1 C.B. 851.

the case of a trade or business, such use is conducted in the ordinary course of the type of trade or business in which the taxpayer is engaged.

Effective Date

The proposal generally is effective with respect to a taxpayer's open tax years on or after the date of enactment.

K. Increase in Penalty for Bad Checks and Money Orders

Present Law

The Code[37] imposes a penalty for bad checks and money orders on the person who tendered it. The penalty is two percent of the amount of the bad check or money order, with a minimum penalty of $15 (or, if less, the amount of the check).

Description of Proposal

The proposal increases the minimum penalty for bad checks and money orders to $25 (or, if less, the amount of the check).

Effective Date

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

[37] Sec. 6657.

L. Proposals Relating to Appraisers and Substantial and Gross Overstatement of Valuations of Property

Present Law

Taxpayer penalties

Present law imposes accuracy-related penalties on a taxpayer in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax.[38] For this purpose, a substantial valuation misstatement generally means a value claimed that is at least twice (200 percent or more) the amount determined to be the correct value, and a gross valuation misstatement generally means a value claimed that is at least four times (400 percent or more) the amount determined to be the correct value.

The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement and rises to 40 percent for a gross valuation misstatement. No penalty is imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Under present law, no penalty is imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment. Special rules apply to tax shelters.

Present law also imposes an accuracy-related penalty on substantial or gross estate or gift tax valuation understatements.[39] In general, there is a substantial estate or gift tax understatement if the value of any property claimed on any return is 50 percent or less of the amount determined to be the correct amount, and a gross estate or gift tax understatement if such value is 25 percent or less of the amount determined to be the correct amount.

In addition, the accuracy-related penalties do not apply if a taxpayer shows there was reasonable cause for an underpayment and the taxpayer acted in good faith.[40]

Penalty for aiding and abetting understatement of tax

A penalty is imposed on a person who: (1) aids or assists in or advises with respect to a tax return or other document; (2) knows (or has reason to believe) that such document will be used in connection with a material tax matter; and (3) knows that this would result in an understatement of tax of another person. In general, the amount of the penalty is $1,000. If the document relates to the tax return of a corporation, the amount of the penalty is $10,000.

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[38] Sec. 6662(b)(3) and (h).

[39] Sec. 6662(g) and (h).

[40] Sec. 6664(c).

Qualified appraisals

Present law requires a taxpayer to obtain a qualified appraisal for donated property with a value of more than $5,000, and to attach an appraisal summary to the tax return.[41] Treasury Regulations state that a qualified appraisal means an appraisal document that, among other things: (1) relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property and not later than the due date (including extensions) of the return on which a deduction is first claimed under section 170; (2) is prepared, signed, and dated by a qualified appraiser; (3) includes (a) a description of the property appraised; (b) the fair market value of such property on the date of contribution and the specific basis for the valuation; (c) a statement that such appraisal was prepared for income tax purposes; (d) the qualifications of the qualified appraiser; and (e) the signature and taxpayer identification number of such appraiser; and (4) does not involve an appraisal fee that violates certain prescribed rules.[42]

Qualified appraisers

Treasury Regulations define a qualified appraiser as a person who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis, is qualified to make appraisals of the type of property being valued (as determined by the appraiser's background, experience, education and membership, if any, in professional appraisal associations), is independent, and understands that an intentionally false or fraudulent overstatement of the value of the appraised property may subject the appraiser to civil penalties.[43]

Appraiser oversight

The Secretary is authorized to regulate the practice of representatives of persons before the Department of the Treasury ("Department").[44] After notice and hearing, the Secretary is authorized to suspend or disbar from practice before the Department or the Internal Revenue Service ("IRS") a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Department or the IRS, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented).

The Secretary also is authorized to bar from appearing before the Department or the IRS, for the purpose of offering opinion evidence on the value of property or other assets, any individual against whom a civil penalty for aiding and abetting the understatement of tax has been assessed. Thus, an appraiser who aids or assists in the preparation or presentation of an

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[41] Sec. 170(f)(11).

[42] Treas. Reg. sec. 1.170A-13(c)(3).

[43] Treas. Reg. sec. 1.170A-13(c)(5)(i).

[44] 31 U.S.C. sec. 330.

appraisal will be subject to disciplinary action if the appraiser knows that the appraisal will be used in connection with the tax laws and will result in an understatement of the tax liability of another person. The Secretary has authority to provide that the appraisals of an appraiser who has been disciplined have no probative effect in any administrative proceeding before the Department or the IRS.

Description of Proposal

Taxpayer penalties

The proposal lowers the thresholds for imposing accuracy-related penalties on a taxpayer. Under the proposal, a substantial valuation misstatement exists when the claimed value of any property is 150 percent or more of the amount determined to be the correct value. A gross valuation misstatement occurs when the claimed value of any property is 200 percent or more of the amount determined to be the correct value.

The proposal tightens the thresholds for imposing accuracy-related penalties with respect to the estate or gift tax. Under the proposal, a substantial estate or gift tax valuation misstatement exists when the claimed value of any property is 65 percent or less of the amount determined to be the correct value. A gross estate or gift tax valuation misstatement exists when the claimed value of any property is 40 percent or less of the amount determined to be the correct value.

Under the proposal, the reasonable cause exception to the accuracy-related penalty does not apply in the case of gross valuation misstatements.

Appraiser oversight

Appraiser penalties

The proposal establishes a civil penalty on any person who prepares an appraisal that is to be used to support a tax position if such appraisal results in a substantial or gross valuation misstatement. The penalty is equal to the greater of $1,000 or 10 percent of the understatement of tax resulting from a substantial or gross valuation misstatement, up to a maximum of 125 percent of the gross income derived from the appraisal. Under the proposal, the penalty does not apply if the appraiser establishes that it was "more likely than not" that the appraisal was correct.

Disciplinary proceeding

The proposal eliminates the requirement that the Secretary assess against an appraiser the civil penalty for aiding and abetting the understatement of tax before such appraiser may be subject to disciplinary action. Thus, the Secretary is authorized to discipline appraisers after notice and hearing. Disciplinary action may include, but is not limited to, suspending or barring an appraiser from: preparing or presenting appraisals on the value of property or other assets to the Department or the IRS; appearing before the Department or the IRS for the purpose of offering opinion evidence on the value of property or other assets; and providing that the appraisals of an appraiser who has been disciplined have no probative effect in any administrative proceeding before the Department or the IRS.

Qualified appraisers

The proposal defines a qualified appraiser as an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements to be determined by the IRS in regulations; (2) regularly performs appraisals for which he or she receives compensation; (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed; (4) has not been prohibited from practicing before the IRS by the Secretary at any time during the three years preceding the conduct of the appraisal; and (5) is not excluded from being a qualified appraiser under applicable Treasury regulations.

Qualified appraisals

The proposal defines a qualified appraisal as an appraisal of property prepared by a qualified appraiser (as defined by the proposal) in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

Effective Date

The proposal amending the accuracy-related penalty applies to returns filed after the date of enactment. The proposal establishing a civil penalty that may be imposed on any person who prepares an appraisal that is to be used to support a tax position if such appraisal results in a substantial or gross valuation misstatement applies to appraisals prepared with respect to returns or submissions filed after the date of enactment. The proposals relating to appraiser oversight apply to appraisals prepared with respect to returns or submissions filed after the date of enactment.

M. Increase the Amounts of Excise Taxes Imposed on Public Charities, Social Welfare Organizations, and Private Foundations

Present Law

Public charities and social welfare organizations

The Code imposes excise taxes on excess benefit transactions between disqualified persons (as defined in section 4958(f)) and charitable organizations (other than private foundations) or social welfare organizations (as described in section 501(c)(4)).[45] An excess benefit transaction generally is a transaction in which an economic benefit is provided by a charitable or social welfare organization directly or indirectly to or for the use of a disqualified person, if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

The excess benefit transaction tax is imposed on the disqualified person and, in certain cases, on the organization manager, but is not imposed on the exempt organization. An initial tax of 25 percent of the excess benefit amount is imposed on the disqualified person that receives the excess benefit. An additional tax on the disqualified person of 200 percent of the excess benefit applies if the violation is not corrected. A tax of 10 percent of the excess benefit (not to exceed $10,000 with respect to any excess benefit transaction) is imposed on an organization manager that knowingly participated in the excess benefit transaction, if the manager's participation was willful and not due to reasonable cause, and if the initial tax was imposed on the disqualified person.[46] If more than one person is liable for the tax on disqualified persons or on management, all such persons are jointly and severally liable for the tax.[47]

Private foundations

Self-dealing by private foundations

Excise taxes are imposed on acts of self-dealing between a disqualified person (as defined in section 4946) and a private foundation.[48] In general, self-dealing transactions are any direct or indirect: (1) sale or exchange, or leasing, of property between a private foundation and a disqualified person; (2) lending of money or other extension of credit between a private foundation and a disqualified person; (3) the furnishing of goods, services, or facilities between a private foundation and a disqualified person; (4) the payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; (5) the transfer to,

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[45] Sec. 4958. The excess benefit transaction tax is commonly referred to as "intermediate sanctions," because it imposes penalties generally considered to be less punitive than revocation of the organization's exempt status.

[46] Sec. 4958(d)(2). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[47] Sec. 4958(d)(1).

[48] Sec. 4941.

or use by or for the benefit of, a disqualified person of the income or assets of the private foundation; and (6) certain payments of money or property to a government official.[49] Certain exceptions apply.[50]

An initial tax of five percent of the amount involved with respect to an act of self-dealing is imposed on any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. If such a tax is imposed, a 2.5-percent tax of the amount involved is imposed on a foundation manager who participated in the act of self-dealing knowing it was such an act (and such participation was not willful and was due to reasonable cause) up to $10,000 per act. Such initial taxes may not be abated.[51] Such initial taxes are imposed for each year in the taxable period, which begins on the date the act of self-dealing occurs and ends on the earliest of the date of mailing of a notice of deficiency for the tax, the date on which the tax is assessed, or the date on which correction of the act of self-dealing is completed. A government official (as defined in section 4946(c)) is subject to such initial tax only if the official participates in the act of self-dealing knowing it is such an act. If the act of self-dealing is not corrected, a tax of 200 percent of the amount involved is imposed on the disqualified person and a tax of 50 percent of the amount involved (up to $10,000 per act) is imposed on a foundation manager who refused to agree to correcting the act of self-dealing. Such additional taxes are subject to abatement.[52]

Tax on failure to distribute income

Private nonoperating foundations are required to pay out a minimum amount each year as qualifying distributions. In general, a qualifying distribution is an amount paid to accomplish one or more of the organization's exempt purposes, including reasonable and necessary administrative expenses.[53] Failure to pay out the minimum results in an initial excise tax on the foundation of 15 percent of the undistributed amount. An additional tax of 100 percent of the undistributed amount applies if an initial tax is imposed and the required distributions have not been made by the end of the applicable taxable period.[54] A foundation may include as a qualifying distribution the salaries, occupancy expenses, travel costs, and other reasonable and necessary administrative expenses that the foundation incurs in operating a grant program. A qualifying distribution also includes any amount paid to acquire an asset used (or held for use) directly in carrying out one or more of the organization's exempt purposes and certain amounts

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[49] Sec. 4941(d)(1).

[50] See sec. 4941(d)(2).

[51] Sec. 4962(b).

[52] Sec. 4961.

[53] Sec. 4942(g)(1)(A).

[54] Sec. 4942(a) and (b). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

set-aside for exempt purposes.[55] Private operating foundations are not subject to the payout requirements.

Tax on excess business holdings

Private foundations are subject to tax on excess business holdings.[56] In general, a private foundation is permitted to hold 20 percent of the voting stock in a corporation, reduced by the amount of voting stock held by all disqualified persons (as defined in section 4946). If it is established that no disqualified person has effective control of the corporation, a private foundation and disqualified persons together may own up to 35 percent of the voting stock of a corporation. A private foundation shall not be treated as having excess business holdings in any corporation if it owns (together with certain other related private foundations) not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock in that corporation. Similar rules apply with respect to holdings in a partnership ("profits interest" is substituted for "voting stock" and "capital interest" for "nonvoting stock") and to other unincorporated enterprises (by substituting "beneficial interest" for "voting stock"). Private foundations are not permitted to have holdings in a proprietorship. Foundations generally have a five-year period to dispose of excess business holdings (acquired other than by purchase) without being subject to tax.[57] This five-year period may be extended an additional five years in limited circumstances.[58]

The initial tax is equal to five percent of the value of the excess business holdings held during the foundation's applicable taxable year. An additional tax is imposed if an initial tax is imposed and at the close of the applicable taxable period, the foundation continues to hold excess business holdings. The amount of the additional tax is equal to 200 percent of such holdings.

Tax on jeopardizing investments

Private foundations and foundation managers are subject to tax on investments that jeopardize the foundation's charitable purpose.[59] In general, an initial tax of five percent of the amount of the investment applies to the foundation and to foundation managers who participated in the making of the investment knowing that it jeopardized the carrying out of the foundation's exempt purposes. The initial tax on foundation managers may not exceed $5,000 per investment. If the investment is not removed from jeopardy (e.g., sold or otherwise disposed of), an additional tax of 25 percent of the amount of the investment is imposed on the foundation and five percent of the amount of the investment on a foundation manager who refused to agree to

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[55] Secs. 4942(g)(1)(B) and 4942(g)(2). In general, an organization is permitted to adjust the distributable amount in those cases where distributions during the five preceding years have exceeded the payout requirements. Sec. 4942(i).

[56] Sec. 4943. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[57] Sec. 4943(c)(6).

[58] Sec. 4943(c)(7).

[59] Sec. 4944. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

removing the investment from jeopardy. The additional tax on foundation managers may not exceed $10,000 per investment. An investment, the primary purpose of which is to accomplish a charitable purpose and no significant purpose of which is the production of income or the appreciation of property, is not considered a jeopardizing investment.[60]

Tax on taxable expenditures

Certain expenditures of private foundations are subject to tax.[61] In general, taxable expenditures are expenses: (1) for lobbying; (2) to influence the outcome of a public election or carry on a voter registration drive (unless certain requirements are met); (3) as a grant to an individual for travel, study, or similar purposes unless made pursuant to procedures approved by the Secretary; (4) as a grant to an organization that is not a public charity or exempt operating foundation unless the foundation exercises expenditure responsibility[62] with respect to the grant; or (5) for any non-charitable purpose. For each taxable expenditure, a tax is imposed on the foundation of 10 percent of the amount of the expenditure, and an additional tax of 100 percent is imposed on the foundation if the expenditure is not corrected. A tax of 2.5 percent of the expenditure (up to $5,000) also is imposed on a foundation manager who agrees to making a taxable expenditure knowing that it is a taxable expenditure. An additional tax of 50 percent of the amount of the expenditure (up to $10,000) is imposed on a foundation manager who refuses to agree to correction of such expenditure.

Lobbying and political activities

Lobbying

Under present law, an organization described in section 501(c)(3) may not engage in more than a substantial amount of lobbying. Organizations may make an election to limit their lobbying expenditures in accordance with specific rules and excise taxes.[63] Organizations not making such an election are subject to an excise tax if, as a result of lobbying expenditures during a taxable year, the organization is not described in section 501(c)(3).[64] The excise tax is five percent of the lobbying expenditures for such taxable year. In addition, a tax is imposed on an organization manager if the manager agreed to the making of a lobbying expenditure, knowing that the expenditure likely would result in the organization not being described in

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[60] Sec. 4944(c).

[61] Sec. 4945. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[62] In general, expenditure responsibility requires that a foundation make all reasonable efforts and establish reasonable procedures to ensure that the grant is spent solely for the purpose for which it was made, to obtain reports from the grantee on the expenditure of the grant, and to make reports to the Secretary regarding such expenditures. Sec. 4945(h).

[63] Secs. 501(h) and 4911.

[64] Sec. 4912. The excise tax does not apply to churches, certain other religious organizations, and private foundations. Sec. 4912(c)(2). Private foundations separately are subject to an excise tax for certain lobbying expenditures. Sec. 4945(d)(1).

section 501(c)(3), unless such agreement is not willful and is due to reasonable cause. The tax is five percent of the amount of any such expenditure.

Political activities

Organizations described in section 501(c)(3) may not participate or intervene in any political campaign on behalf of (or in opposition) to any candidate for public office. This ban on political activities by section 501(c)(3) organizations may result in loss of tax exempt status. Political expenditures, i.e., amounts paid or incurred by a section 501(c)(3) organization for such participation or intervention, also are subject to an excise tax.[65] An initial tax of 10 percent of the amount of the expenditure is imposed on the organization; and an initial tax of 2.5 percent of the expenditure (not to exceed $5,000) is imposed on an organization manager who agrees to the making of a political expenditure, knowing that it is a political expenditure if such agreement is not willful and is due to reasonable cause. Additional taxes apply to the organization and the organization manager if the political expenditure is not corrected. Such additional tax on the organization manager may not exceed $10,000.

Description of Proposal

Self-dealing and excess benefit transaction initial taxes and dollar limitations

For acts of self-dealing other than the payment of compensation by a private foundation to a disqualified person, the proposal increases the initial tax on the self-dealer from five percent of the amount involved to 10 percent of the amount involved. The proposal increases the initial tax on foundation managers from 2.5 percent of the amount involved to five percent of the amount involved and increases the dollar limitation on the amount of the initial and additional taxes on foundation managers per act of self-dealing from $10,000 per act to $20,000 per act. Similarly, the proposal doubles the dollar limitation on organization managers of public charities and social welfare organizations for participation in excess benefit transactions from $10,000 per transaction to $20,000 per transaction.

Failure to distribute income, excess business holdings, jeopardizing investments, and taxable expenditures

The proposal doubles the amounts of the initial taxes and the dollar limitations on foundation managers with respect to the private foundation excise taxes on the failure to distribute income, excess business holdings, jeopardizing investments, and taxable expenditures.

Specifically, for the failure to distribute income, the initial tax on the foundation is increased from 15 percent of the undistributed amount to 30 percent of the undistributed amount.

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[65] Sec. 4955. In the case of an organization which is formed primarily for purposes of promoting the candidacy (or prospective candidacy) of an individual for public office, political expenditures also include certain other amounts. Sec. 4955(d)(2).

For excess business holdings, the initial tax on excess business holdings is increased from five percent of the value of such holdings to 10 percent of such value.

For jeopardizing investments, the initial tax of five percent of the amount of the investment that is imposed on the foundation and on foundation managers is increased to 10 percent of the amount of the investment. The dollar limitation on the initial tax on foundation managers of $5,000 per investment is increased to $10,000 and the dollar limitation on the additional tax on foundation managers of $10,000 per investment is increased to $20,000.

For taxable expenditures, the initial tax on the foundation is increased from 10 percent of the amount of the expenditure to 20 percent, the initial tax on the foundation manager is increased from 2.5 percent of the amount of the expenditure to five percent, the dollar limitation of the initial tax on foundation managers is increased from $5,000 to $10,000, and the dollar limitation of the additional tax on foundation managers is increased from $10,000 to $20,000.

Lobbying and political activities

The proposal increases the rate of tax on lobbying expenditures imposed under section 4912 on the organization and on the organization manager from five percent to 10 percent of the amount of the expenditure.

For political expenditures, the proposal increases the rate of the initial tax on the organization from five percent of the amount of the expenditure to 10 percent. The proposal increases the rate of the initial tax on the organization manager from 2.5 percent to five percent. In addition, the dollar limitation on the initial tax on organization mangers is increased from $5,000 to $10,000, and the dollar limitation on the additional tax on foundation managers is increased from $10,000 to $20,000.

Effective Date

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

N. Penalty for Filing Erroneous Refund Claims

Present Law

Present law imposes accuracy-related penalties on a taxpayer in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax.[66] For this purpose, a substantial valuation misstatement generally means a value claimed that is at least twice (200 percent or more) the amount determined to be the correct value, and a gross valuation misstatement generally means a value claimed that is at least four times (400 percent or more) the amount determined to be the correct value.

The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement and rises to 40 percent for a gross valuation misstatement. No penalty is imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Under present law, no penalty is imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment. Special rules apply to tax shelters.

Description of Proposal

The proposal imposes a penalty on any taxpayer filing an erroneous claim for refund or credit. The penalty is equal to 20 percent of the disallowed portion of the claim for refund or credit for which there is no reasonable basis for the claimed tax treatment.

Effective Date

The proposal is effective for claims for refund or credit filed after the date of enactment or for claims for refund or credit submitted prior to the date of enactment that are not withdrawn within 30 days after the date of enactment.

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[66] Sec. 6662(b)(3) and (h).

IV. CONFIDENTIALITY AND DISCLOSURE

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

Present Law

In the case of organizations that are described in section 501(c)(3) and exempt from tax under section 501(a) or that have applied for exemption as an organization so described, present law (sec. 6104(c)) requires the Secretary to notify the appropriate State officer of (1) a refusal to recognize such organization as an organization described in section 501(c)(3), (2) a revocation of a section 501(c)(3) organization's tax-exempt status, and (3) the mailing of a notice of deficiency for any tax imposed under section 507, chapter 41, or chapter 42.[67] In addition, at the request of such appropriate State officer, the Secretary is required to make available for inspection and copying, such returns, filed statements, records, reports, and other information relating to the above-described disclosures, as are relevant to any State law determination. An appropriate State officer is the State attorney general, State tax officer, or any State official charged with overseeing organizations of the type described in section 501(c)(3).

In general, returns and return information (as such terms are defined in section 6103(b)) are confidential and may not be disclosed or inspected unless expressly provided by law.[68] Present law requires the Secretary to keep records of disclosures and requests for inspection[69] and requires that persons authorized to receive returns and return information maintain various safeguards to protect such information against unauthorized disclosure.[70] Willful unauthorized disclosure or inspection of returns or return information is subject to a fine and/or imprisonment.[71] The knowing or negligent unauthorized inspection or disclosure of returns or return information gives the taxpayer a right to bring a civil suit.[72] Such present-law protections against unauthorized disclosure or inspection of returns and return information do not apply to the disclosures or inspections, described above, that are authorized by section 6104(c).

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

[68] Sec. 6103(a).

[69] Sec. 6103(p)(3).

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

[71] Secs. 7213 and 7213A.

[72] Sec. 7431.

Description of Proposal

The proposal provides that upon written request by an appropriate State officer, the Secretary may disclose: (1) a notice of proposed refusal to recognize an organization as a section 501(c)(3) organization; (2) a notice of proposed revocation of tax-exemption of a section 501(c)(3) organization; (3) the issuance of a proposed deficiency of tax imposed under section 507, chapter 41, or chapter 42; (4) the names, addresses, and taxpayer identification numbers of organizations that have applied for recognition as section 501(c)(3) organizations; and (5) returns and return information of organizations with respect to which information has been disclosed under (1) through (4) above.[73] Disclosure or inspection is permitted for the purpose of, and only to the extent necessary in, the administration of State laws regulating section 501(c)(3) organizations, such as laws regulating tax-exempt status, charitable trusts, charitable solicitation, and fraud. Such disclosure or inspection may be made only to or by an appropriate State officer or to an officer or employee of the State who is designated by the appropriate State officer, and may not be made by or to a contractor or agent. The Secretary also is permitted to disclose or open to inspection the returns and return information of an organization that is recognized as tax-exempt under section 501(c)(3), or that has applied for such recognition, to an appropriate State officer if the Secretary determines that disclosure or inspection may facilitate the resolution of Federal or State issues relating to the tax-exempt status of the organization. For this purpose, appropriate State officer means the State attorney general, the State tax officer, and any other State official charged with overseeing organizations of the type described in section 501(c)(3).

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

In addition, the proposal provides that any returns and return information disclosed under section 6104(c) may be disclosed in civil administrative and civil judicial proceedings pertaining to the enforcement of State laws regulating the applicable tax-exempt organization in a manner prescribed by the Secretary. Returns and return information are not to be disclosed under section

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

6104(c), or in such an administrative or judicial proceeding, to the extent that the Secretary determines that such disclosure would seriously impair Federal tax administration. The proposal makes disclosures of returns and return information under section 6104(c) subject to the disclosure, recordkeeping, and safeguard provisions of section 6103, including the requirements that the Secretary maintain a permanent system of records of requests for disclosure (sec. 6103(p)(3)), and that the appropriate State officer maintain various safeguards that protect against unauthorized disclosure (sec. 6103(p)(4)). The proposal provides that the willful unauthorized disclosure of returns or return information described in section 6104(c) is a felony subject to a fine of up to $5,000 and/or imprisonment of up to five years (sec. 7213(a)(2)), the willful unauthorized inspection of returns or return information described in section 6104(c) is subject to a fine of up to $1,000 and/or imprisonment of up to one year (sec. 7213A), and provides the taxpayer the right to bring a civil action for damages in the case of knowing or negligent unauthorized disclosure or inspection of such information (sec. 7431(a)(2)).

Effective Date

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

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

Present Law

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

In response to concerns that former spouses were not able to obtain information regarding collection activities relating to a joint return, the Taxpayer Bill of Rights 2 added section 6103(e)(8).[74] When a deficiency is assessed with respect to a joint return and the individuals are no longer married or no longer reside in the same household, upon request in writing by either of such individuals, the IRS is required to disclose: (1) whether the IRS has attempted to collect such deficiency from the other individual; (2) the general nature of such collection activities; and (3) the amount collected.[75]

The Treasury Inspector General for Tax Administration conducts semiannual reports involving a review and certification of whether the Secretary is complying with the requirements of disclosing information to an individual filing a joint return on collection activity involving the other individual filing the return.[76]

Description of Proposal

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

Effective Date

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

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[74] "The IRS does not routinely disclose collection information to a former spouse that relates to tax liabilities attributable to a joint return that was filed when married." Joint Committee on Taxation, *General Explanation of Taxation Legislation Enacted in the 104th Congress* (JCS-12-96), December 18, 1996 at 29.

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

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

C. Prohibition of Disclosure of Taxpayer Identification Information with Respect to Disclosure of Accepted Offers-in-Compromise

Present Law

Section 6103 permits the IRS to disclose return information to members of the general public to permit inspection of accepted offers in compromise.[77] For one year after the date of execution, a copy of the Form 7249, "Offer Acceptance Report," for each accepted offer in compromise with respect to any liability for a tax imposed by Title 26 is made available for inspection and copying in the location designated by the Compliance Area Director or Compliance Services Field Director within the Small Business and Self-Employed Division of the taxpayer's geographic area of residence.[78] Currently, this form contains the taxpayer identification number of the taxpayer, e.g., the social security number in the case of an individu taxpayer, along with the taxpayer's name and full address.

Description of Proposal

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

Effective Date

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

[77] Sec. 6103(k)(l).

[78] Treas. Reg. sec. 601.702(d)(8).

D. Compliance By Contractors with Confidentiality Safeguards

Present Law

Section 6103 permits the disclosure of returns and return information to State agencies, as well as to other Federal agencies for specified purposes. Section 6103(p)(4) requires, as conditions of receiving returns and return information, that State agencies (and others) provide safeguards as prescribed by the Secretary of the Treasury by regulation to be necessary or appropriate to protect the confidentiality of returns or return information.[79] It also requires that a report be furnished to the Secretary at such time and containing such information as prescribed by the Secretary regarding the procedures established and utilized for ensuring the confidentiality of returns and return information.[80] After an administrative review, the Secretary may take such actions as are necessary to ensure these requirements are met, including the refusal to disclose returns and return information.[81]

Under present law, employees of a State tax agency may disclose returns and return information to contractors for tax administration purposes.[82] These disclosures can be made only to the extent necessary to procure contractually equipment, other property, or the providing of services, related to tax administration.[83]

The contractors can make redisclosures of returns and return information to their employees as necessary to accomplish the tax administration purposes of the contract, but only to contractor personnel whose duties require disclosure.[84] Treasury regulations prohibit redisclosure to anyone other than contractor personnel without the written approval of the IRS.[85]

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

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

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

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

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

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

[85] Treas. Reg. sec. 301.6103(n)-1(a).

By regulation, all contracts must provide that the contractor will comply with all applicable restrictions and conditions for protecting confidentiality prescribed by regulation, published rules or procedures, or written communication to the contractor.[86] Failure to comply with such restrictions or conditions may cause the IRS to terminate or suspend the duties under the contract or the disclosures of returns and return information to the contractor.[87] In addition, the IRS can suspend disclosures to the State tax agency until the IRS determines that the conditions are or will be satisfied.[88] The IRS may take such other actions as deemed necessary to ensure that such conditions or requirements are or will be satisfied.[89]

Description of Proposal

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

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

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

Effective Date

The proposal is effective for disclosures made after the date of enactment. The first certification is required to be made with respect to the portion of calendar year 2006 following the date of enactment.

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[86] Treas. Reg. sec. 301.6103(n)-1(d).

[87] Treas. Reg. sec. 301.6103(n)-1(d)(1).

[88] Treas. Reg. sec. 301.6103(n)-1(d)(2).

[89] Treas. Reg. sec. 301.6103(n)-1(d).

E. Higher Standards for Requests for and Consents to Disclosure

Present Law

In general

As a general rule, returns and return information are confidential and cannot be disclosed unless authorized by Title 26.[90] Under section 6103(c), a taxpayer may designate in a request or consent to the disclosure by the IRS of his or her return or return information to a third party. Treasury regulations set forth the requirements for such consent.[91] The request or consent may be written or nonwritten form. The Treasury regulations require that the taxpayer sign and date a written consent. At the time the consent is signed and dated by the taxpayer, the written document must indicate (1) the taxpayer's taxpayer identity information; (2) the identity of the person to whom disclosure is to be made; (3) the type of return (or specified portion of the return) or return information (and the particular data) that is to be disclosed; and (4) the taxable year covered by the return or return information. The regulations also require that the consent be submitted within 60 days of the date signed and dated, however, at the time of submission, the IRS generally is unaware of whether a consent form was completed or dated after the taxpayer signs it. Present law does not require that a recipient receiving returns or return information by consent maintain the confidentiality of the information received. Under present law, the recipient is also free to use the information for purposes other than for which the information was solicited from the taxpayer.

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

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

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

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[90] Sec. 6103(a).

[91] Treas. Reg. sec. 301.6103(c)-1.

allows the form to be submitted to the IRS at a later date, often months or years later, for purposes of mortgage resale.

Criminal penalties

Under section 7206, it is a felony to willfully make and subscribe any document that contains or is verified by a written declaration that it is made under penalties of perjury and which such person does not believe to be true and correct as to every material matter.[92] Upon conviction, such person may be fined up to $100,000 ($500,000 in the case of a corporation) or imprisoned up to 3 years, or both, together with the costs of prosecution.

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

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

Civil damage remedies for unauthorized disclosure or inspection

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

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

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

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[92] Sec. 7206(1).

Description of Proposal

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

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

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

Effective Date

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

F. Civil Damage Remedies for Unauthorized Disclosure or Inspection

Present Law

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

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

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

Description of Proposal

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

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

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

As part of its public report on disclosures, the proposal requires the Secretary to furnish information regarding the willful unauthorized disclosure and inspection of returns and return

information. Such information includes the number, status, and results of: (1) administrative investigations, (2) civil lawsuits brought under section 7431 (including the amounts for which such lawsuits were settled and the amounts of damages awarded), and (3) criminal prosecutions.

Effective Date

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

G. Expanded Disclosure in Emergency Circumstances

Present Law

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

H. Disclosure of Taxpayer Identity for Tax Refund Purposes

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.[93] Section 6103(m) allows the IRS to give the press taxpayer identity information for this purpose.[94] Taxpayer identity includes name, mailing address, taxpayer identification number or combination thereof.

The IRS believes that the current statutory framework of "press and other media" does not permit disclosures via the Internet. The 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. It limits the amount of return information that may be disclosed to a taxpayer's name, and the city, State, and zip code of the taxpayer's mailing address.

Effective Date

The proposal is effective upon date of enactment.

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

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

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

I. Treatment of Public Records

Present Law

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

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

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

Description of Proposal

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

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[95] Sec. 6103(a).

[96] Sec. 7431.

[97] See, e.g., sec. 7461 regarding the publicity of U.S. Tax Court proceedings.

[98] See sec. 6323(f) regarding where to file notices of Federal tax lien.

Effective Date

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

J. Taxpayer Identification Number Matching

Present Law

A taxpayer identification number (TIN) is an identification number used by the IRS for purposes of tax administration. A TIN must be furnished on all returns, statements, or other tax related documents.[99] The Code imposes information reporting requirements upon payors of income. The Code provides that a person (the payor) required to make a return with respect to another person (the payee) must ask the payee for the identifying number prescribed for securing the proper identification of the payee and include that number in the return.[100] Typically, if there is an error with the name/TIN combination furnished by the payee, the disclosure of such error to the payor is permitted when the reportable payment is already subject to backup withholding.[101]

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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[99] Sec. 6109(a)(1).

[100] Sec. 6109(a)(3).

[101] Sec. 3406.

K. Form 8300 Disclosures

Present Law

Under the Code, any person engaged in a trade or business who receives more than $10,000 in cash in one transaction (or in two or more related transactions) is required to report the receipt of cash to the IRS and the Financial Crimes Enforcement Network (FinCEN) on Form 8300 (Report of Cash Payments Over $10,000 Received in a Trade or Business).[102] Any Federal agency, State or local government agency, or foreign government agency may have access, upon written request, to the information contained in returns filed under section 6050I. The Code provides that disclosures of information from Form 8300 be made on the same basis and subject to the same conditions as apply to disclosures of information filed on Currency Transaction Reports under the Bank Secrecy Act.[103] This proposal however, cannot be used to obtain disclosures for tax administration purposes. The general safeguard requirements of the Code apply to such disclosures.[104] For example, as a condition of disclosure, requesting agencies must file with the IRS a report describing the procedures established and utilized by the agency for ensuring the confidentiality of return information.

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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[102] Sec. 6050I and 31 U.S.C. sec. 5331.

[103] 31 U.S.C. sec. 5313.

[104] Sec. 6103(p)(4).

L. Expanded Definition of Return Preparer for Purposes of Sections 6713 and 7216

Present Law

Section 7216 imposes criminal penalties on return preparers of income tax returns who knowingly or recklessly make unauthorized disclosures or use information furnished to them in connection with the preparation of an income tax return. A violation of section 7216 is punishable by a fine of not more than $1,000, one year of imprisonment, or both, together with the costs of prosecution. The penalties do not apply to disclosures authorized by the Code or made pursuant to an order of a court. The penalties also do not apply to the use of information in the preparation of State and local tax returns and declarations of estimated tax of the person to whom the information relates. Finally, the penalties do not apply to any disclosure or use permitted under the applicable Treasury regulations.

In addition, tax return preparers are subject to civil penalties under section 6713 for disclosure or use of tax return information unless an exception under the rules of section 7216 applies to the disclosure or use. The civil penalty is $250 for each unauthorized disclosure or use, but the total amount imposed on a person for any calendar year cannot exceed $10,000.

Under present law Treasury regulations, "tax return preparer" means any person:

- who is engaged in the business of preparing tax returns,
- who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns,
- who is remunerated for preparing, or assisting in preparing, a tax return for any other person, or
- who, as part of his duties or employment with any person described in (1), (2) or (3) above, performs services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.[105]

A person is engaged in the business of preparing tax returns if, in the course of his business, he holds himself out to taxpayers as a person who prepares tax returns, whether or not tax return preparation is his sole business activity and whether or not he charges a fee for such services. A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns if, in the course of his business, he holds himself out to tax return preparers or taxpayers as a person who performs such auxiliary services, whether or not providing auxiliary services is his sole business activity and whether or not he charges a fee for such services. For example, a person part or all of whose business is to provide a computerized tax return processing service based on tax return information furnished by another person is a tax return preparer.

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[105] Treas. Reg. 301.7216-1(b)(2).

A person is not a tax return preparer merely because he leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, or otherwise performs some service which only incidentally relates to the preparation of tax returns.

Description of Proposal

The proposal expands the return preparer penalties beyond income tax returns to other tax returns, including estate and gift tax returns, employment tax, and excise tax returns.

The proposal modifies the regulatory definition of tax return preparer to include any person who assists in preparing tax returns for compensation or holds himself out to tax return preparers or taxpayers as a person who assists in preparing tax returns, regardless of whether tax return preparation is the person's sole business activity and regardless of whether the person charges a fee for tax return preparation services. The proposal also specifically includes as a tax return preparer, a person who develops software that is used to prepare or file a tax return, electronic return originators/authorized IRS e-file providers, as well as contractors of the tax return preparer performing services in connection with tax return preparation.

Effective Date

The proposal is effective for returns prepared after the date of enactment.

M. Restrict the Use and Disclosure of Taxpayer Information by Return Preparers for Nontax Purposes and Offshore Disclosures

Present Law

Section 7216 imposes criminal penalties on return preparers of income tax returns who knowingly or recklessly make unauthorized disclosures or use information furnished to them in connection with the preparation of an income tax return. The criminal penalties do not apply to disclosures authorized by the Code or made pursuant to an order of a court. The penalties also do not apply to the use of information in the preparation of State and local tax returns and declarations of estimated tax of the person to whom the information relates. Finally, the penalties do not apply to any disclosure or use permitted under the applicable Treasury regulations.

The Treasury regulations set forth circumstances under which a tax return preparer may disclose or use a taxpayer's tax return information without first obtaining the taxpayer's consent and those circumstances for which the formal consent of the taxpayer is required.

Disclosure or use without formal consent of taxpayer

Disclosure or use of information in the case of related taxpayers

Taxpayer consent is not required for the disclosure or use of information in the case of a related taxpayers. A tax return preparer may use, in preparing a tax return of a second taxpayer, and may disclose to such second taxpayer in the form in which it appears on such return, any tax return information which the preparer obtained from a first taxpayer if

The second taxpayer is related to the first taxpayer,

- The first taxpayer's tax interest in such information is not adverse to the second taxpayer's tax interest in such information, and
- The first taxpayer has not expressly prohibited such disclosure or use.

One taxpayer is related to another taxpayer if they have any one of the following relationships: husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations.

Other permissible disclosures without consent

Consent of the taxpayer also is not required for the following disclosures:

- Disclosures pursuant to an order of a court or a Federal or State agency.
- Disclosures for use in revenue investigations or court proceedings. Disclosure for use in revenue investigations or court proceedings in connection with investigations of the return preparer by the IRS or for use in connection with proceedings involving such return preparer before a court or grand jury.

- Certain disclosures by lawyers and accountants to other members or employees of the firm.[106]
- Corporate fiduciaries. A trust company, trust department of a bank or other corporate fiduciary which prepares a tax return for a taxpayer to or for who it renders fiduciary, investment, or other custodial or management services may (1) disclose or use the tax return information in the ordinary course of rendering services to or for the taxpayer or (2) with the express or implied consent of the taxpayer, make such information available to the taxpayer's attorney, accountant, or investment advisor.
- Disclosure to the taxpayer's fiduciary. If the taxpayer dies, becomes incompetent, insolvent or bankrupt, or his assets are placed in conservatorship or receivership after furnishing tax return information to a tax return preparer, the tax return preparer may disclosure such information to the duly appointed fiduciary of the taxpayer or his estate, or to the duly authorized agent of such fiduciary.
- Disclosure by tax return preparer to tax return processor. A tax return preparer may disclose tax return information to another tax return preparer for the purpose of having the second tax return preparer transfer that information to and compute the tax liability on, a tax return of such taxpayer by means of electronic, mechanical, or other form of tax return processing service.
- Disclosure by one officer, employee or member to another. Transfers of tax return information between officers, employees and members of the same firm for the purpose of performing services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer by or for whom the information was furnished.
- Identical information obtained from other sources. No restrictions are placed on identical tax return information if obtained other than in connection with the preparation of, or providing auxiliary services in connection with the preparation of, a tax return.
- Disclosure or use of information in the preparation or audit of State returns.

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[106] Tax return preparers who are lawyers or accountants may disclose such information to another member or employee of the preparer's firm who may use it to render other legal or accounting services to the taxpayer; and may (1) take such return information into account and may act upon it in the course of performing legal or accounting services for a client other than the taxpayer or (2) disclose such information to another employee or member of the preparer's law or accounting firm to enable that other employee or member to take information into account and act upon it in the course of performing legal or accounting services for a client other than the taxpayer when such information is or may be relevant to the subject matter of such legal or accounting services for the other client and its consideration by those performing the services is necessary for the proper performance by them of such services. However, such information may not be disclosed to a person who is not a member or employee of the law or accounting firm unless such disclosure is authorized by another provision.

- Retention of records. A tax return preparer may retain tax return information of the taxpayer and may use such information in connection with the preparation of other returns of the taxpayer or in connection with an audit by the IRS of any tax return.
- Lists for solicitation of tax return business. A tax return preparer may compile and maintain a list of client taxpayer names and addresses for the sole purpose of contacting the taxpayers on the list for the purpose of offering tax information or additional tax return preparation services to such taxpayers. The compiler of the list may not transfer such list except in conjunction with the sale or other disposition of the tax return preparation business of such compiler.
- Disclosures to report a crime. Disclosures to report a commission of a crime to the proper Federal, State or local official does not require consent.
- Disclosure or use of information for quality or peer reviews. Tax return information may be disclosed for the purpose of a quality or peer review to the extent necessary to accomplish the review.
- Disclosure of tax return information due to a tax return preparer's incapacity or death. In the event of incapacity or death of a tax return preparer, disclosure of tax return information may be made for the purpose of assisting the tax return preparer or his legal representative (or the representative of a deceased preparer's estate) in operating the business.

Disclosure or use requiring the consent of the taxpayer

Use of tax return information by an affiliated group

Present law Treasury regulations allow a tax return preparer to solicit a taxpayer's consent to use tax return information for services or facilities (unrelated to tax preparation) currently offered by the tax return preparer or member of the tax return preparer's affiliated group. The consent may not be made later than the time the taxpayer receives his completed tax return from the tax return preparer. A tax return preparer may not request a consent again after a taxpayer has once before refused to provide such consent.

The form of the consent is prescribed in the regulations. A separate written consent, signed by the taxpayer or his duly authorized agent or fiduciary, must be obtained for each separate use or disclosure and must contain:

- The name of the tax return preparer,
- The name of the taxpayer,
- The purpose for which the consent is being furnished,
- The date on which such consent is signed,
- A statement that the tax return information may not be disclosed or used by the tax return preparer for any purpose other than that stated in the consent, and
- A statement by the taxpayer, or his agent or fiduciary that he consents to the disclosure or use of such information.

Consent to disclose tax return information to any third party

Under the Treasury regulations, if a tax return preparer has obtained from a taxpayer a consent in the form described above, the tax return preparer may disclose the tax return information of such taxpayer to such third persons as the taxpayer may direct.

Present law does not require a tax return preparer to obtain the written consent of the taxpayer before disclosing such information to another tax return preparer located outside of the United States.

Description of Proposal

The proposal permits disclosure by consent only for tax preparation purposes (regardless of whether the disclosure or use is by an affiliate of the tax return preparer or a third party). Under the proposal, taxpayer consents to use or disclose tax return information other than for tax purposes are not permitted. The proposal also prohibits the sale of taxpayer return information except in conjunction with the sale of the taxpayer's business. The renting of client taxpayer lists also is prohibited under the proposal. The proposal does not alter the circumstances under which a taxpayer's return information may be disclosed or used without consent.

The proposal also requires that a tax return preparer notify a taxpayer and obtain the taxpayer's consent before providing the taxpayer's tax return information to a person located outside of the United States. The proposal directs the Secretary to prescribe a consent form that provides, among other information deemed appropriate by the Secretary, a clear statement that the taxpayer's tax return information will be disclosed to a tax return preparer located outside of the United States and that Federal tax law may not protect the taxpayer from unauthorized use or disclosure by such persons.

Effective Date

The proposal is effective for disclosures and uses made after the date of enactment.

V. UNITED STATES TAX COURT MODERNIZATION

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

Present Law

In general, the Internal Revenue Service ("IRS") is required to notify taxpayers that they have a right to a fair and impartial hearing before levy may be made on any property or right to property.[107] Similar rules apply with respect to liens.[108] The hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. The appeal must be brought to the United States Tax Court (the "Tax Court"), unless the Tax Court does not have jurisdiction over the underlying tax liability. If that is the case, then the appeal must be brought in the district court of the United States.[109] If a court determines that an appeal was not made to the correct court, the taxpayer has 30 days after such determination to file with the correct court.

The Tax Court is established under Article I of the United States Constitution[110] and is a court of limited jurisdiction.[111] The Tax Court only has the jurisdiction that is expressly conferred on it by statute.[112] For example, the jurisdiction of the Tax Court includes the authority to hear disputes concerning notices of income tax deficiency, certain types of declaratory judgment, and worker classification status, among others, but does not include jurisdiction over most excise taxes imposed by the Internal Revenue Code. Thus, the Tax Court may not have jurisdiction over the underlying tax liability with respect to an appeal of a due process hearing relating to a collections matter. As a practical matter, many cases involving appeals of a due process hearing (whether within the jurisdiction of the Tax Court or a district court) do not involve the underlying tax liability.

Description of Proposal

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

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[107] Sec. 6330(a).

[108] Sec. 6320.

[109] Sec. 6330(d).

[110] Sec. 7441.

[111] Sec. 7442.

[112] Sec. 7442.

Effective Date

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

B. Confirmation of Tax Court Authority to Apply Equitable Recoupment

Present Law

Equitable recoupment is a common-law equitable principle that permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[113] In *Estate of Mueller v. Commissioner*,[114] the Court of Appeals for the Sixth Circuit held that the United States Tax Court (the "Tax Court") may not apply the doctrine of equitable recoupment. More recently, the Court of Appeals for the Ninth Circuit, in *Branson v. Commissioner*,[115] held that the Tax Court may apply the doctrine of equitable recoupment.

Description of Proposal

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

Effective Date

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

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[113] See *Stone v. White*, 301 U.S. 532 (1937); *Bull v. United States*, 295 U.S. 247 (1935).

[114] 153 F.3d 302 (6th Cir.), *cert. den.*, 525 U.S. 1140 (1999).

[115] 264 F.3d 904 (9th Cir.), *cert. den.*, 2002 U.S. LEXIS 1545 (U.S. Mar. 18, 2002).

C. Extend Authority for Special Trial Judges to Hear and Decide Certain Employment Status Cases

Present Law

In connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (1) one or more individuals performing services for that person are employees of that person or (2) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court has jurisdiction to determine whether the IRS is correct and the proper amount of employment tax under such determination.[116] Any redetermination by the Tax Court has the force and effect of a decision of the Tax Court and is reviewable.

An election may be made by the taxpayer for small case procedures if the amount of the employment taxes in dispute is $50,000 or less for each calendar quarter involved.[117] The decision entered under the small case procedure is not reviewable in any other court and should not be cited as authority.

The chief judge of the Tax Court may assign proceedings to special trial judges. The Code enumerates certain types of proceedings that may be so assigned and may be decided by a special trial judge. In addition, the chief judge may designate any other proceeding to be heard by a special trial judge.[118]

Description of Proposal

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

Effective Date

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

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[116] Sec. 7436.

[117] Sec. 7436(c).

[118] Sec. 7443A.

D. Appointment of Tax Court Employees

Present Law

The Tax Court is a legislative court established by the Congress pursuant to Article I of the U.S. Constitution (an "Article I" court).[119] The Tax Court is authorized to appoint employees, subject to the rules applicable to employment with the Executive Branch of the Federal Government (generally referred to as "competitive service"), as administered by the Office of Personnel Management.[120]

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

Description of Proposal

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

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

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

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[119] Sec. 7441.

[120] Sec. 7471.

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

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

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

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

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

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

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

Effective Date

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

E. Tax Court Filing Fee

Present Law

The Tax Court is authorized to impose a fee of up to $60 for the filing of any petition for the redetermination of a deficiency or for declaratory judgments relating to the status and classification of 501(c)(3) organizations, the judicial review of final partnership administrative adjustments, and the judicial review of partnership items if an administrative adjustment request is not allowed in full.[121] The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest or for failure to award administrative costs and other areas of jurisdiction for which a petition may be filed. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[122]

Description of Proposal

The proposal provides that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition. No negative inference should be drawn as to whether the Tax Court has the authority under present law to impose a filing fee for any case commenced by the filing of a petition.

Effective Date

The proposal is effective on the date of enactment.

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[121] Sec. 7451.

[122] See Rule 20(b) of the Tax Court Rules of Practice and Procedure.

VI. MISCELLANEOUS

A. Expensing of Broadband Internet Access Expenditures

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS") (sec. 168). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs (sec. 179). Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2009, is $100,000 of the cost of qualifying property placed in service for the taxable year. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation for taxable years beginning after 2003 and before 2010. In general, under section 179, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400L(f)), an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (section 1400N). Recapture rules generally apply with respect to property that ceases to be qualified property.

Description of Proposal

The proposal provides an election to treat any qualified broadband expenditure paid or incurred by the taxpayer as not chargeable to capital account, but rather, as a deduction. The deduction is allowed in the first taxable year in which either current generation, or next generation, broadband services are provided through qualified equipment to qualified subscribers. Expenditures are eligible for this election only for qualified equipment, the original use of which commences with the taxpayer. The proposal applies for qualified broadband expenditures incurred after June 30, 2006, and before January 1, 2011.

Current generation broadband services are defined as the transmission of signals at a rate of at least 5 million bits per second to the subscriber and at a rate of at least 1 million bits per second from the subscriber. Next generation broadband services are defined as the transmission of signals at a rate of at least 50 million bits per second to the subscriber and at a rate of at least 10 million bits per second from the subscriber.

Qualified broadband expenditures means the direct or indirect costs properly taken into account for the taxable year for the purchase or installation of qualified equipment (including upgrades) and the connection of the equipment to a qualified subscriber. The term does not include costs of launching satellite equipment.

Qualified broadband expenditures include only the portion of the purchase price paid by the lessor, in the case of leased equipment, that is attributable to otherwise qualified broadband expenditures by the lessee. In the case of property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was originally placed in service, the property is treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

A qualified subscriber, with respect to current generation broadband services, means any nonresidential subscriber maintaining a permanent place of business in a rural area or underserved area, or any residential subscriber residing in a rural area or underserved area that is not a saturated market. A qualified subscriber, with respect to next generation broadband services, means any nonresidential subscriber maintaining a permanent place of business in a rural area or underserved area, or any residential subscriber.

For this purpose, a rural area means any census tract not within 10 miles of an incorporated or census-designated place with more than 25,000 people and not with in a county with overall population density of more than 500 people per square mile. An underserved area means a census tract located in an empowerment zone or enterprise community designated under section 1391 or the District of Columbia Enterprise Zone, or any census tract the poverty level of which is at least 30 percent and the median family income of which does not exceed (1) for a tract in a metropolitan statistical area, 70 percent of the greater of the metropolitan area median family income or the statewide median family income, and (2) for a tract that is not in a metropolitan statistical area, 70 percent of the nonmetropolitan statewide median family income.

A saturated market, for this purpose, means any census tract in which, as of the date of enactment, current generation broadband services have been provided by a single provider to 85 percent or more of the total potential residential subscribers. The services must be usable at least a majority of the time during periods of maximum demand, and usable in a manner substantially the same as services provided through equipment not eligible for the deduction under this proposal.

If current, or next, generation broadband services can be provided through qualified equipment to both qualified subscribers and to other subscribers, the proposal provides that the expenditures with respect to the equipment are allocated among subscribers to determine the amount of qualified broad broadband expenditures that may be deducted under the proposal.

Qualified equipment means equipment that provides current, or next, generation broadband services at least a majority of the time during periods of maximum demand to each subscriber, and in a manner substantially the same as such services are provided by the provider to subscribers through equipment with respect to which no deduction is allowed under the provision. Limitations are imposed under the provision on equipment depending on where it

extends, and on certain packet switching equipment, and on certain mulitplexing and demultiplexing equipment.

Effective Date

The proposal applies to expenditures incurred after June 30, 2006, and before January 1, 2011.

B. Exempt Use of Kerosene for Aviation Purposes

Present Law

Nontaxable uses of kerosene

In general, if kerosene on which tax has been imposed is used by any person for a nontaxable use, a refund in an amount equal to the amount of tax imposed may be obtained either by the purchaser, or in specific cases, the registered ultimate vendor of the kerosene.[123] However, the 0.1 cent per gallon representing the Leaking Underground Storage Tank Trust Fund financing rate generally is not refundable, except for exports.[124]

A nontaxable use is any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of a prior imposition of tax.[125] Nontaxable uses of kerosene include:

- Use on a farm for farming purposes;[126]
- Use in foreign trade or trade between the United States and any of its possessions;[127]
- Use as a fuel in vessels and aircraft owned by the United States or any foreign nation and constituting equipment of the armed forces thereof;[128]
- Exclusive use of a state or local government;[129]
- Export or shipment to a possession of the United States;[130]
- Exclusive use of a nonprofit educational organization;[131]
- Use as a fuel in an aircraft museum for the procurement, care, or exhibition of aircraft of the type used for combat or transport in World War II;[132] and

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[123] Sec. 6427(l).

[124] Sec. 6430.

[125] Sec. 6427(l)(2).

[126] Sec. 4041(f).

[127] Sec. 4041(g)(1)

[128] Id.

[129] Sec. 4041(g)(2).

[130] Sec. 4041(g)(3).

[131] Sec. 4041(g)(4).

[132] Sec. 4041(h).

- Use as a fuel in (a) helicopters engaged in the exploration for or the development or removal of hard minerals, oil, or gas and in timber (including logging) operations if the helicopters neither take off from nor land at a facility eligible for Airport Trust Fund assistance or otherwise use federal aviation services during flights or (b) any air transportation for the purpose of providing emergency medical services (1) by helicopter or (2) by a fixed-wing aircraft equipped for and exclusively dedicated on that flight to acute care emergency medical services.[133]
- Off-highway business use.

Claims for refund of kerosene used in aviation

"Commercial aviation" is the use of an aircraft in a business of transporting persons or property for compensation or hire by air, with certain exceptions.[134] All other aviation is noncommercial aviation.

For fuel not removed directly into the wing of an airplane, the Safe, Accountable, Flexible, Efficient, Transportation Equity Act: A Legacy for Users ("SAFETEA") changed the rate of taxation for aviation-grade kerosene from 21.8 cents per gallon to the general kerosene and diesel rate of 24.3 cents per gallon.[135] In order to preserve the aviation rate for fuel actually used in aviation, the 21.8 cent rate of taxation (or as the case may be, the 4.3 cent commercial aviation rate, or the nontaxable use rate) is achieved through a refund when the fuel is sold in aviation (a refund of 2.5 cents for taxable noncommercial aviation, 20 cents in the case of commercial aviation, and 24.3 cents for nontaxable uses).[136] These changes became effective on October 1, 2005.

Prior to October 1, 2005, if fuel that was previously taxed was used in noncommercial aviation for a nontaxable use, generally, the ultimate purchaser of such fuel (other than for the exclusive use of a State or local government, or for use on a farm for farming purposes) could claim a refund for the tax that was paid. SAFETEA eliminated the ability of a purchaser to file for a refund with respect to fuel used in noncommercial aviation. Instead, the registered ultimate vendor is the exclusive party entitled to a refund with respect to kerosene used in noncommercial aviation.[137] An ultimate vendor is the person who sells the kerosene to an ultimate purchaser for use in noncommercial aviation. If the fuel was used for a nontaxable use, the vendor may make

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[133] Secs. 4041(l), 4261(f) and (g).

[134] "Commercial aviation" does not include aircraft used for skydiving, small aircraft on nonestablished lines or transportation for affiliated group members.

[135] Sec. 11161 of Pub. L. No. 109-59 (2005).

[136] Sec. 6427(l)(5).

[137] Sec. 6427(l)(5)(B)

a claim for 24.3 cents per gallon, otherwise, the vendor is permitted to claim 2.5 cents per gallon for kerosene sold for use in noncommercial aviation.[138]

For commercial aviation, the ultimate purchaser has the option of filing a claim itself, or waiving the right to refund to its ultimate vendor if the vendor agrees to file on behalf of the purchaser.[139]

A separate special rule also applies to kerosene sold to a State or local government, regardless of whether the kerosene was sold for aviation or other purposes.[140] In general, this rule makes the registered ultimate vendor the appropriate party for filing refund claims on behalf of a State or local government. Special rules apply for credit card sales.[141]

Description of Proposal

In general

The proposal allows purchasers that use kerosene for an exempt aviation purpose (other than in the case of a State or local government) to make a claim for refund of the tax that was paid on such fuel or waive their right to claim a refund to their registered ultimate vendors. As a result, under the proposal, crop-dusters, air ambulances, aircraft engaged in foreign trade and other exempt users may either make the claim for refund of the 24.3 cents per gallon themselves or waive the right to their vendors.

General noncommercial aviation use (which is entitled to a refund of 2.5-cents per gallon) remains an exclusive ultimate vendor rule. The rules for State and local governments also are unchanged.

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[138] Sec. 6427(l)(5)(A). Under this provision, of the 24.4 cents of tax imposed on kerosene used in taxable noncommercial aviation, the 0.1 cent for the Leaking Underground Storage Tank Trust Fund financing rate and 21.8 cents of the tax imposed on kerosene cannot be refunded. The limitations of sec. 6427(l)(5)(A) on the amount that cannot be refunded do not apply to uses exempt from tax. However, sec. 6430 prevents a refund of the Leaking Underground Storage Tank Trust Fund financing rate in all cases except export. Sec. 6427(l)(5)(B) requires that all amounts that would have been paid to the ultimate purchaser pursuant to sec. 6427(l)(1) are to paid to the ultimate registered vendor, therefore the ultimate registered vendor is the only claimant for both nontaxable and taxable use of kerosene in noncommercial aviation.

[139] Sec. 6427(l)(4)(B).

[140] Sec. 6427(l)(6).

[141] If certain conditions are met, a registered credit card issuer may make the claim for refund in place of the ultimate vendor. If the diesel fuel or kerosene is purchased with a credit card issued to a State but the credit card issuer is not registered with the IRS (or does not meet certain other conditions) the credit card issuer must collect the amount of the tax and the State is the proper claimant.

Special rule for purchases of kerosene used in aviation on a farm for farming purposes

For kerosene used in aviation on a farm for farming purposes that was purchased after December 31, 2004, and before October 1, 2005, the Secretary is to pay to the ultimate purchaser (without interest) an amount equal to the aggregate amount of tax imposed on such fuel, reduced by any payments made to the ultimate vendor of such fuel. Such claims must be filed within 3 months of the date of enactment and may not duplicate claims filed under section 6427(l).

Effective Date

In general

The proposal is effective for kerosene sold after September 30, 2005. For kerosene used for an exempt aviation purpose eligible for the waiver rule created by the proposal, the ultimate purchaser is treated as having waived the right to payment and as having assigned such right to the ultimate vendor if the vendor meets the requirements of subparagraph (A), (B) or (D) of section 6416(a)(1). The rule of the preceding sentence applies to kerosene sold after September 30, 2005, and before the date of enactment.

Special rule for kerosene used in aviation on a farm for farming purposes

The special rule for kerosene used in aviation on a farm for farming purposes is effective on the date of enactment.

C. Declarations on Federal Corporate Income Tax Returns

Present Law

The Code requires[142] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[143] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[144] ($500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

Description of Proposal

The proposal requires that a corporation's Federal income tax return include a declaration signed under penalties of perjury that the corporation has in place processes and procedures to ensure that the return complies with the Code and that the CEO was provided reasonable assurance of the accuracy of all material aspects of the return. The proposal does not change present law rules as to who is required to sign the return.

Effective Date

The proposal is effective for Federal tax returns for taxable years ending after the date of enactment.

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[142] Sec. 6062.

[143] Sec. 7206.

[144] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

D. Treatment of Professional Employer Organizations as Employers

Present Law

In general

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act ("FICA"), the taxes under the Railroad Retirement Tax Act ("RRTA"), the tax under the Federal Unemployment Tax Act ("FUTA"), and the requirement that employers withhold income taxes from wages paid to employees ("income tax withholding").[145]

FICA tax consists of two parts: (1) old age, survivor, and disability insurance ("OASDI"), which correlates to the Social Security program that provides monthly benefits after retirement, disability, or death; and (2) Medicare hospital insurance ("HI"). The OASDI tax rate is 6.2 percent on both the employee and employer (for a total rate of 12.4 percent). The OASDI tax rate applies to wages up to the OASDI wage base ($94,200 for 2006). The HI tax rate is 1.45 percent on both the employee and the employer (for a total rate of 2.9 percent). Unlike the OASDI tax, the HI tax is not limited to a specific amount of wages, but applies to all wages.

RRTA taxes consist of tier 1 taxes and tier 2 taxes. Tier 1 taxes parallel the OASDI and HI taxes applicable to employers and employees. Tier 2 taxes consist of employer and employee taxes on railroad compensation up to the tier 2 wage base. For 2006, the tier 2 employer rate is 12.6 percent, the employee rate is 4.4 percent, and the tier 2 wage base is $69,900.

Under FUTA, employers must pay a tax of 6.2 percent of wages up to the FUTA wage base of $7,000. An employer may take a credit against its FUTA tax liability for its contributions to a State unemployment fund and, in certain cases, an additional credit for contributions that would have been required if the employer had been subject to a higher contribution rate under State law. For purposes of the credit, contributions means payments required by State law to be made by an employer into an unemployment fund, to the extent the payments are made by the employer without being deducted or deductible from employees' remuneration.

Employers are required to withhold income taxes from wages paid to employees. 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 employee.

Wages paid to employees, and FICA, RRTA, and income taxes withheld from the wages, are required to be reported on employment tax returns and on Forms W-2.[146]

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[145] Secs. 3101-3128 (FICA), 3201-3241 (RRTA), 3301-3311 (FUTA), and 3401-3404 (income tax withholding).

[146] Secs. 6011 and 6051.

Employment taxes generally apply to all remuneration paid by an employer to an employee. However, various exceptions apply to certain types of remuneration or certain types of services.[147] In addition, as discussed above, certain employment taxes apply only on amounts up to a specified wage base. If an employee works for multiple employers during a year, separate wage bases generally apply to each employer. However, a single OASDI or FUTA wage base applies in certain cases in which an employer (a "successor" employer) takes over the business of another employer (the "predecessor" employer) and employs the employees of the predecessor employer.

Responsibility for employment tax compliance

Employment tax responsibility generally rests with the person who is the employer of an employee under a common-law test that has been incorporated into Treasury regulations.[148] Under the regulations, an employer-employee relationship generally exists if the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer, not only as to what is to be done, but also as to how it is to be done. It is not necessary that the employer actually control the manner in which the services are performed, rather it is sufficient that the employer have a right to control. Whether the requisite control exists is determined on the basis of all the relevant facts and circumstances. The test of whether an employer-employee relationship exists often arises in determining whether a worker is an employee or an independent contractor. However, the same test applies in determining whether a worker is an employee of one person or another.[149]

In some cases, a person other than the common-law employer (a "third party") may be liable for employment taxes. For example, if wages are paid to an employee by a third party and the third party, rather than the employer, has control of the payment of the wages, the third party is the statutory employer responsible for complying with applicable employment tax requirements.[150] In addition, an employer may designate a reporting agent to be responsible for

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[147] See, e.g., secs. 3121(a) and (b), 3231(e), 3306(b) and (c), and 3401(a).

[148] Treas. Reg. secs. 31.3121(d)-1(c)(1), 31.3306(i)-1(a), and 31.3401(c)-1.

[149] Issues relating to the classification of workers as employees or independent contractors are discussed in Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986* (JCS-3-01), April 2001, at Vol. II, Part XV.A, at 539-550.

[150] Sec. 3401(d)(1) (for purposes of income tax withholding, if the employer does not have control of the payment of wages, the person having control of the payment of such wages is treated as the employer); *Otte v. United States*, 419 U.S. 43 (1974) (the person who has the control of the payment of wages is treated as the employer for purposes of withholding the employee's share of FICA from wages); *In re Armadillo Corporation*, 561 F.2d 1382 (10th Cir. 1977), and *In re The Laub Baking Company v. United States*, 642 F.2d 196 (6th Cir. 1981) (the person who has control of the payment of wages is the employer for purposes of the employer's share of FICA and FUTA). The mere fact that wages are paid by a person other than the employer does not necessarily mean that the payor has control of the payment

FICA tax and income tax withholding compliance,[151] including filing employment tax returns and issuing Forms W-2 to employees.[152] In that case, the reporting agent and the employer are jointly and severally liable for compliance.[153]

Employer credit for FICA tax paid on tips

An employer may take an income tax credit for FICA taxes paid by the employer on certain tips received by an employee.[154] The tips taken into account for purposes of the credit are tips from customers in connection with providing, delivering, or serving food or beverages for consumption if customers' tipping employees delivering or serving food or beverages is customary. The amount of such tips taken into account for purposes of the credit is tips that (1) are deemed to be paid to the employee by the employer for FICA purposes and (2) exceed the amount by which wages (excluding tips) paid to the employee by the employer are less than the total amount payable to the employee at the minimum wage rate.

Reporting by large food and beverage establishments

Certain reporting requirements apply to tips. In the case of a large food or beverage establishment, an employer is generally required to report the following information each calendar year: (1) the gross receipts of the establishment from the provision of food and beverages (other than certain receipts); (2) the aggregate amount of charge receipts (other than certain receipts); (3) the aggregate amount of charged tips on the charge receipts; (4) the sum of the aggregate amount of tips reported to the employer by employees and certain amounts required to be reported by the employer on employees' Form W-2s; and (5) with respect to each employee, the amount of tips allocated to the employee based on the receipts of the establishment.[155]

User fees

User fees apply to requests to the IRS for ruling letters, opinion letters, determination letters, and similar requests.[156] The user fees that apply are determined by the IRS and are

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of the wages. Rather, control depends on the facts and circumstances. See, e.g., *Consolidated Flooring Services v. United States*, 38 Fed. Cl. 450 (1997), and *Winstead v. United States*, 109 F. 2d 989 (4th Cir. 1997).

[151] The designated reporting agent rules do not apply for purposes of FUTA compliance.

[152] Sec. 3504. Form 2678 is used to designate a reporting agent.

[153] For administrative convenience, an employer may also use a payroll service to handle payroll and employment tax filings on its behalf, but the employer, not the payroll service, continues to be responsible for employment tax compliance.

[154] Sec. 45B.

[155] Sec. 6053(c).

[156] Sec. 7528.

generally required to be determined after taking into account the average time and difficulty involved in a request.

Description of Proposal

Treatment of certified professional employer organization as employer for employment tax purposes

Under the proposal, if certain requirements are met, for purposes of employment taxes and other obligations under the employment tax rules, a certified professional employer organization is treated as the employer of any work site employee performing services for any customer of the certified professional employer organization, but only with respect to remuneration remitted to the work site employee by the certified professional employer organization.[157] In addition, no other person is treated as the employer for employment tax purposes with respect to remuneration remitted by the certified professional employer organization.

The proposal does not apply in the case of a customer who is related to the certified professional employer organization.[158] In addition, the proposal does not apply with respect to an individual with net earnings from self-employment derived from a customer's trade or business (i.e., a self-employed individual), including a customer who is a sole proprietor or a partner of a customer that is a partnership.

As discussed more fully below, a work site employee is an individual who performs services (1) for a customer pursuant to a contract between the customer and the certified professional employer organization that meets certain requirements and (2) at a work site that meets certain requirements. Thus, if the contract or work site fails to meet these requirements, the individual is not a work site employee. However, the proposal applies also in the case of an individual (other than a self-employed individual) who is not a work site employee, but who performs services under a contract the meets the specified requirements.

In general, the wage and employment exceptions that would apply if the certified professional employer organization were not treated as the employer under the proposal generally continue to apply. However, the proposal provides rules under which, on entering into a service contract with a customer, a certified professional employer organization is treated as a successor employer and the customer is treated as the predecessor employer. Similarly, on termination of a service contract, the customer is treated as a successor employer and the certified professional employer organization is treated as the predecessor employer. Thus, wages

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[157] Nothing contained in the proposal is to be construed to create any inference with respect to the determination of who is an employee or employer (1) for Federal tax purposes (other than the purposes set forth in the proposal), or (2) for purposes of any other provision of law.

[158] Whether a customer and a certified professional employer organization are related is determined under the rules of section 267(b) or 707(b), but applied by substituting 10 percent for 50 percent.

paid by the customer and the certified professional employer organization are subject to a single OASDI or FUTA wage base.

A certified professional employer organization is eligible for the FUTA credit with respect to payments made to a State unemployment fund with respect to a work site employee by the certified professional employer organization or a customer. An additional FUTA credit may be claimed by a certified professional employer organization if, under State law, a certified professional employer organization is permitted to collect and remit contributions with respect to a work site employee to the State unemployment fund.

The Secretary of the Treasury is directed to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal.

Certified professional employer organization

A certified professional employer organization is a person who applies to be treated as a certified professional employer organization and has been certified by the Secretary of the Treasury as meeting certain requirements. These requirements are met if the person–

- demonstrates that the person (and any owner, officer, and such other persons as may be specified in regulations) meets requirements established by the Secretary with respect to tax status, background, experience, business location, and annual financial audits;
- represents that it will satisfy the bond and independent financial review requirements (described below) on an ongoing basis;
- represents that it will satisfy reporting obligations imposed by the Secretary;
- computes its taxable income using an accrual method of accounting unless the Secretary approves another method;
- agrees to verify the continuing accuracy of any previously provided representations and information on a periodic basis as prescribed by the Secretary; and
- agrees to notify the Secretary in writing of any change that materially affects the continuing accuracy of any previously provided representation or information.

Under the bond requirement, a certified professional employer organization must post a bond for the payment of employment taxes in a minimum amount and in a form acceptable to the Secretary. The minimum amount is determined for the period April 1 of any calendar year through March 31 of the following calendar year and is the greater of (1) five percent of the employment taxes for which the certified professional organization is liable under the proposal during the preceding calendar year (but not to exceed $1,000,000), or (2) $50,000.

Under the independent financial review requirements, a certified professional employer organization must: (1) have, as of the most recent audit date (i.e., six months after the completion of the certified professional employer organization's fiscal year), caused to be prepared and provided to the Secretary an opinion of an independent certified public accountant as to whether the certified professional employer organization's financial statements are

presented fairly in accordance with generally accepted accounting principles; and (2) provide to the Secretary, not later than the last day of the second month beginning after the end of each calendar quarter, from an independent certified public accountant an assertion regarding Federal employment tax payments and an examination level attestation on the assertion. The assertion must state that the certified professional employer organization has withheld and made deposits of all required FICA, RRTA, and withheld income taxes for the calendar quarter, and the attestation must state that the assertion is fairly stated in all material respects. If a certified professional employer organization fails to file the required assertion and attestation with respect to any calendar quarter, the independent financial review requirements are treated as not satisfied for the period beginning on the due date for the attestation.

For purposes of the bond and independent financial review requirements, all professional employer organizations that are members of a controlled group are treated as a single organization. The Secretary may suspend or revoke the certification of a person's certified professional employer organization status if the Secretary determines that the person does not satisfy the representations or other requirements for certification or fails to satisfy the applicable accounting, reporting, payment, or deposit requirements.

Work site employee

A work site employee is an individual who: (1) performs services for a customer of a certified professional employer organization pursuant to a contract between the customer and the certified professional employer organization that meets certain requirements (described below); and (2) performs services at a work site meeting certain requirements (described below).

The contract between the customer and the certified professional employer organization must be in writing and, with respect to an individual performing services for the customer, must provide that the certified professional employer organization will–

- assume responsibility for payment of wages to the individual, without regard to the receipt or adequacy of payment from the custom;
- assume responsibility for reporting, withholding, and paying any employment taxes with respect to the individual's wages, without regard to the receipt or adequacy of payment from the customer;
- assume responsibility for any employee benefits that the contract may require the certified professional employer organization to provide, without regard to the receipt or adequacy of payment from the customer;
- assume responsibility for hiring, firing, and recruiting workers in addition to the customer's responsibility for hiring, firing and recruiting workers;
- maintain employee records relating to the individual; and
- agree to be treated as a certified professional employer organization for employment tax purposes with respect to such individual.

For purposes of whether an individual is a work site employee, the work site where the individual performs services meets the applicable requirements if at least 85 percent of the

individuals performing services for the customer at the work site are subject to one or more contracts with the certified professional employer organization that meet the above requirements. For this purpose, certain individuals are not taken into account, such as employees who are under age 21 or have not completed six months of service.

Other rules

Employer credit for FICA taxes paid on tips

Under the proposal, if a certified professional employer organization is treated for employment tax purposes as the employer of a work site employee, any credit for FICA taxes paid on tips of the employee applies to the customer (not to the certified professional employer organization) and, for purposes of the credit, the customer is to take into account any remuneration or taxes remitted by the certified professional employer organization.

Reporting by large food and beverage establishments

Under the proposal, if a certified professional employer organization is treated for employment tax purposes as the employer of a work site employee, the customer for whom the work site employee performs services is the employer for purposes of the reporting required with respect to a large food or beverage establishment. The certified professional employer organization is required to furnish the customer with any information necessary to complete the required reporting.

User fees

Under the proposal, the user fee charged under the program for certifying a professional employer organization may not exceed $500.

Effective Date

The proposal is effective on January 1 of the first calendar year beginning more than 12 months after the date of enactment of the proposal. The Secretary of the Treasury is directed to establish the certification program for professional employer organizations not later than six months before the proposal becomes effective.

E. Require IRS to Promote Estimated Tax Payments Through EFTPS

Present Law

To the extent that tax is not collected through withholding, taxpayers are required to make quarterly estimated payments of tax. If an individual fails to make the required estimated tax payments under the rules, a penalty is imposed under section 6654. The amount of the penalty is determined by applying the underpayment interest rate to the amount of the underpayment for the period of the underpayment.

The Code imposes a penalty on employers who fail to deposit employment taxes within the required time and in the proper manner. The Code also requires the IRS to collect at least 94 percent of these taxes through the Electronic Funds Transfer Payment System (EFTPS).[159]

Description of Proposal

The proposal requires the Secretary to study increased collection of estimated tax payments through the EFTPS. The proposal requires the Secretary to report the results of such study within one year of the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

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[159] Sec. 6302(h).

F. Study of Use of Voluntary Withholding Agreements

Present Law

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act ("FICA"), the tax under the Federal Unemployment Tax Act ("FUTA"), and the requirement that employers withhold income taxes from wages paid to employees ("income tax withholding").[160] Income tax 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 employee.

Description of Proposal

The proposal requires the Secretary to study the use of voluntary withholding agreements between independent contractors and service recipients. The proposal requires the Secretary to report the results of such study, including any necessary statutory changes, within one year of the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

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[160] Secs. 3101-3128 (FICA), 3301-3311 (FUTA), and 3401-3404 (income tax withholding). FICA taxes consist of an employer share and an employee share, which the employer withholds from employees' wages.

G. Offset of Tax Refunds Against State Court Debts

Present Law

Overpayments of Federal tax may be used to pay past-due child support and debts owed to Federal agencies, without the consent of the taxpayer.[161] Overpayments of Federal tax may also be used to pay specified past-due, legally enforceable State income tax debts, provided that the person making the Federal tax overpayment has shown on the Federal tax return for the taxable year of the overpayment an address that is within the State seeking the tax offset.

Description of Proposal

The proposal permits State courts to use overpayments of Federal tax may be used to pay past-due court-ordered debts. The State court debts would have lower priority than other debts that may be offset under present law.

Effective Date

The proposal is effective on the date of enactment.

[161] Sec. 6402.

H. Enhancing Tax Court Security

Present Law

The Tax Court is established under Article I of the United States Constitution[162] and is a court of limited jurisdiction.[163] The U.S. Marshal's Service does not have responsibility to provide security to the Tax Court.

Description of Proposal

The proposal authorizes additional security for the Tax Court similar to that now provided to other Federal courts. The proposal requires the U. S. Marshal's Service to provide security to the Tax Court, including personal protection of the Tax Court judges, court officer, witnesses, and other threatened persons.

Effective Date

The proposal is effective on the date of enactment.

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[162] Sec. 7441.

[163] Sec. 7442.

I. Authorization of Appropriations to Combat the Tax Gap

Present Law

There is no explicit authorization of appropriations to the Internal Revenue Service to be used to combat the tax gap.

The IRS has promulgated IRS Notice 2006-50 relating to the $13 billion telephone excise tax refund program.

Description of Proposal

Tax gap

The proposal includes an authorization of an additional $732 million dollars to the Internal Revenue Service to be used to combat the tax gap, including educational programs designed to improve taxpayer compliance.

Telephone excise tax refund program

The proposal includes an authorization of an additional $49 million dollars to the Internal Revenue Service to implement the telephone excise tax refund program under IRS Notice 2006-50. The authorization is intended to cover such costs as form revisions, taxpayer assistance, processing and enforcement.

Effective Date

The proposals are effective on the date of enactment.

J. Annual Tax Gap Study

Present Law

There is no requirement that the Department of the Treasury produce a study for the tax-writing committees on its activities to close the tax gap.

Description of Proposal

The proposal requires the Department of the Treasury to submit an annual report to the tax-writing committees not later than September 30 of each year on activities the Treasury Department is undertaking to close the tax gap. The report should include a comprehensive set of strategies to: achieve a simpler tax Code; achieve more complete income reporting; improve tax-law enforcement; and improve customer service. The report should also include a detailed analysis of the elements of the tax gap, a list of measures designed to reduce the tax gap, goals for reducing the tax gap, and timelines to achieve those goals. Finally, the report should include specific administrative actions taken to reduce the tax gap and proposed legislative recommendations to improve taxpayer compliance.

Effective Date

The proposal is effective on the date of enactment.

K. Authorization of Appropriations for Tax Law Enforcement Relating to the Hiring and Continued Employment of Undocumented Workers

Present Law

IRS undercover operations are statutorily exempt from the generally applicable restrictions controlling the use of Government funds (which generally provide that all receipts must be deposited in the general fund of the Treasury and all expenses be paid out of appropriated funds). In general, the Code permits the IRS to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation, through 2006. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations.

There is no explicit authorization of appropriations to the Internal Revenue Service to be used to prosecute employers for the violations of tax laws relating to the hiring and continued employment of undocumented workers.

Description of Proposal

The proposal authorizes the IRS to use $2 million toward the establishment of an office in IRS Criminal Investigation to prosecute employers for the violations of tax laws relating to the hiring and continued employment of undocumented workers.

Effective Date

The proposal is effective on the date of enactment.

L. Repeal of Dollar Limit on Contributions to Qualified Funeral Trusts

Present Law

A qualified funeral trust is a taxable trust that arises as a result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services, and which meets certain other requirements.[164] A qualified funeral trust must have as its sole purpose holding, investing, and reinvesting funds in the trust, and using such funds solely to make payments for the above-described services or property for the benefit of the beneficiaries of the trust. A qualified funeral trust may have as beneficiaries only individuals with respect to whom the above-described services or property are to be provided at death, and the trust may only accept contributions by or for the benefit of such beneficiaries. In addition, to qualify, the trust must be one that, but for the making of a required election, would be treated under the grantor trust rules as owned by the purchaser of the funeral or burial contract. Because a qualified funeral trust is not treated as a grantor trust, the trust (rather than the purchaser of the contract) is taxed on income from the trust.

A trust is not a qualified funeral trust if it accepts aggregate contributions by or for the benefit of an individual in excess of a statutory dollar limit, which is $8,500 for 2006 (and which periodically is adjusted for inflation).

Description of Proposal

The proposal repeals the dollar limit on contributions to qualified funeral trusts.

Effective Date

The proposal is effective for contributions made after December 31, 2006.

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[164] Sec. 685(b).

M. Permit Administrative Relief for Certain Late Qualified Terminable Interest Property Elections

Present Law

A 100-percent marital deduction generally is permitted for the value of property transferred between spouses. Transfers of "qualified terminable interest property" also are eligible for the marital deduction. "Qualified terminable interest property" (or "QTIP") is property: (1) that passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) with respect to which a timely election has been made. A "qualifying income interest for life" exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or has the right to use the property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

A QTIP transfer may occur by way of a lifetime gift (i.e., an *inter vivos* QTIP transfer) or at death. In the event of a QTIP transfer made at a decedent's death, the QTIP election must be made by the decedent's executor on the estate tax return. In the event of an *inter vivos* QTIP transfer, the QTIP election generally must be made on the gift tax return for the calendar year in which the interest is transferred, and the election must be made within the time prescribed for filing such return. A QTIP election, once made, is irrevocable.

The IRS, under certain circumstances, has granted relief for late QTIP elections for estate tax purposes by granting an extension of time to make such an election. In the event a taxpayer fails to make an *inter vivos* QTIP election within the prescribed timeframe, the extent of the IRS's authority to grant similar relief is unclear.

Description of Proposal

The proposal directs the Secretary to issue regulations prescribing the circumstances and procedures under which extensions of time will be granted to make an *inter vivos* QTIP election, including elections with respect to transfers that occurred prior to the effective date of the proposal. The proposal provides that in determining whether to grant an extension of time, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief, the proposal provides that the time specified in the Code for making an *inter vivos* QTIP election shall be disregarded.

Effective Date

The proposal applies to requests for relief with respect to transfers made before, on, or after the date of enactment.

N. Exempt Organization Provisions

1. Disclosure of written determinations

Present Law

In general

Three provisions of present law govern the disclosure of information relating to tax-exempt organizations. First, section 6103 provides a general rule that tax returns and return information generally are not subject to disclosure unless authorized by the Code.[165] Second, in order to allow the public to scrutinize the activities of tax-exempt organizations, section 6104 grants an exception to the confidentiality rule of section 6103 for certain categories of tax-exempt organization documents and information. Third, section 6110 provides that written determinations by the IRS and related background file documents generally are open to public inspection in redacted form. Section 6110 does not apply to any matter to which section 6104 applies.[166]

Disclosure of applications for recognition of tax exemption and annual information returns

Under present law, the IRS is required to make approved applications for recognition of tax-exempt status (and certain related documents)[167] and annual information returns (Form 990 or Form 990-PF) available for public inspection, except that the IRS is not authorized to disclose the names and addresses of contributors (other than contributors to a private foundation).

The Secretary may withhold disclosure of certain information described in an organization's application for tax-exempt status if disclosure would: (1) divulge a trade secret, patent, process, style of work, or apparatus of the organization, and the Secretary determines that such disclosure would harm the organization; or (2) that the Secretary determines would harm the national defense.[168] The organization must apply to the Commissioner for a determination that the disclosure would violate one of these criteria. The organization will be given 15 days to contest an adverse determination before the information is made available for public inspection.[169]

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[165] Sec. 6103(a).

[166] Sec. 6110(l)(1).

[167] Section 6104(a)(1)(A) provides that "any papers submitted in support of" an application for tax-exempt status must be available for inspection. Treasury regulations limit the definition of supporting documents to papers submitted by the organization. Treas. Reg. sec. 301.6104(a)-1(e).

[168] Sec. 6104(a)(1)(D).

[169] Treas. Reg. sec. 301.6104(a)-5(a)(1).

Disclosure of written determinations

Section 6110 provides that the text of any written determination by the IRS and related background file document is open to public inspection.[170] The term "written determination" means a ruling, determination letter, technical advice memorandum, or Chief Counsel advice. Closing agreements, which are final and conclusive written agreements entered into by the IRS and a taxpayer in order to settle the taxpayer's tax liability with respect to a taxable year, do not constitute written determinations.[171]

Before releasing any written determination or background file document, the IRS must delete identifying details of the person about whom the written determination pertains and certain other private information.[172]

The application of section 6110 to guidance relating to tax-exempt organizations is limited to written determinations unrelated to an organization's tax-exempt status. Section 6110(l)(1) provides, "this section shall not apply to any matter to which section 6104 applies." The regulations under section 6110 clarify which matters are within the ambit of section 6104 and, therefore, are not subject to disclosure under section 6110:

[a]ny application filed with the Internal Revenue Service with respect to the qualification or exempt status of an organization . . .; any document issued by the Internal Revenue Service in which the qualification or exempt status of an organization is . . . granted, denied or revoked or the portion of any document in which technical advice with respect thereto is given to a district director; . . . the portion of any document issued by the Internal Revenue Service in which is discussed the effect on the qualification or exempt status of an organization . . . of proposed transactions by such organization . . . ; and any document issued by the Internal Revenue Service in which is discussed the qualification or status of a [private foundation or private operating foundation].[173]

In addition, the regulations under section 6104 provide that some documents relating to tax exemption that are not open to public inspection under section 6104(a)(1)(A) are nevertheless "within the ambit" of section 6104 for purposes of the disclosure provisions of section 6110.[174]

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[170] Sec. 6110(a). A background file document includes the request for a written determination, any written material submitted by the taxpayer in support of the request, and any communications between the IRS and other persons in connection with the written determination received before issuance of the written determination. Sec. 6110(b)(2).

[171] Sec. 6103(b)(2)(D); sec. 6110(b)(1)(B).

[172] Sec. 6110(c).

[173] Treas. Reg. sec. 301.6110-1(a).

[174] Treas. Reg. sec. 301.6104(a)-1(i).

The regulation explains that the following documents are, therefore, not available for public inspection under either section 6104 or 6110:

- unfavorable rulings or determination letters issued in response to applications for tax exemption;
- rulings or determination letters revoking or modifying a favorable determination letter;
- technical advice memoranda relating to a disapproved application for tax exemption or the revocation or modification of a favorable determination letter;
- any letter or document filed with or issued by the IRS relating to whether a proposed or accomplished transaction is a prohibited transaction under section 503;
- any letter or document filed with or issued by the IRS relating to an organization's status as a private foundation or private operating foundation, unless the letter or document relates to the organization's application for tax exemption; and
- any other letter or document filed with or issued by the IRS which, although it relates to an organization's tax exempt status as an organization described in section 501(c), does not relate to that organization's application for tax exemption.[175]

Under the regulations, such written determinations relating to exempt status issues are not released, even in redacted form. Pursuant to a decision of the D.C. Circuit Court of Appeals, however, the IRS is required to disclose written determinations relating to denials and revocations of exempt status – a decision in which the IRS acquiesced.[176]

Description of Proposal

The proposal provides that the provisions of section 6110 apply to written determinations and related background file documents relating to an organization described in section 501(c) or (d) (including any written determination denying an organization exempt status under such subsection), or to a political organization described in section 527, that are not required to be disclosed by section 6104(a)(1)(A).

Effective Date

The proposal is effective for written determinations issued after the date of enactment.

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[175] *Id.*

[176] *Tax Analysts v. Internal Revenue Service*, 350 F.3d 100 (D.C. Cir. 2003); A.O.D. 2004-02.

2. Disclosure of internet web site and name under which organization does business

Present Law

Most types of tax-exempt organizations are required to file annually an information return.[177] The Internal Revenue Code does not specifically require an exempt organization to furnish on the applicable information return any name under which the organization operates or does business, if such name differs from the legal name of the organization, or the organization's Internet web site address, if any.[178]

Description of Proposal

The proposal requires a tax-exempt organization subject to reporting requirements under section 6033(a) to include on its annual return any name under which such organization operates or does business, and the Internet web site address (if any) of such organization.

Effective Date

The proposal applies to returns filed after December 31, 2006.

3. Modification to reporting of capital transactions

Present Law

Private foundations are required to file an annual information return (Form 990-PF).[179] Part IV of the Form 990-PF requires that private foundations report detailed information regarding the gain or loss from the sale or other disposition of property, including a description of the property sold, how it was acquired (purchase or donation), the date acquired, the date sold, the gross sales price, the amount of depreciation allowed or allowable, and the cost or other basis plus expenses of the sale. Such information generally is required for the IRS to calculate the tax on the private foundation's net investment income. The Form 990-PF is required to be made available to the public.

Description of Proposal

The proposal requires that any information regarding capital gains and losses from the sale or disposition of stock or securities that are listed on an established securities market that is required to be furnished by private foundations in order to calculate the tax on net investment income be furnished also in summary form.

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[177] Sec. 6033(a).

[178] The IRS requires disclosure of an organization's Internet web site address and business name on Forms 990 and 990-EZ but not on Form 990-PF.

[179] Sec. 6033(a).

In addition, information regarding capital gains and losses from the sale or disposition of stock or securities that are listed on an established securities market that is required to be filed with the IRS but that is not in summary form is not required to be made available to the public by the IRS or by the private foundation except by the explicit request of a member of the public to the IRS or to the foundation. A member of the public may request disclosure of such information from the Secretary, who shall prescribe the manner of making such request and the manner of disclosure. A member of the public also may request disclosure of the private foundation, which must be made in person or in writing. If the request is made in person, the foundation shall provide a copy of the information immediately and, if the request is made in writing, the foundation shall provide the information within 30 days.

The proposal also provides that private foundations are required to state on the furnished summary that the more detailed description is available upon request.

Effective Date

The proposal applies to returns filed after December 31, 2006.

4. Disclosure that form 990 is publicly available

Present Law

Under present law, there is no requirement that the IRS notify the public that the Form 990 is publicly available.

Description of Proposal

The proposal requires the IRS to notify the public in appropriate publications and other materials of the extent to which Form 990, Form 990-EZ, or Form 990-PF are publicly available.

Effective Date

The proposal applies to publications or other materials issued or revised after the date of enactment.

5. Expedited review process for certain tax-exemption applications

Present Law

Most organizations that seek tax-exempt status as a charitable organization are required to file an Application for Recognition of Exemption (Form 1023) with the IRS.[180] Organizations that are not required to file Form 1023 include churches, their integrated auxiliaries, and conventions or associations of churches, and any organization (other than a private foundation) that normally has gross receipts of $5,000 or less in a taxable year. Organizations that file Form

[180] Sec. 508(a).

1023 within 15 months of the end of the month of the organization's formation will, if the application is approved, be recognized as tax-exempt from the date of formation. The IRS will automatically grant an organization's request for an additional 12-month extension of the 15-month period. Otherwise, exemption normally will be recognized as of the date the application was received by the IRS. In appropriate circumstances, upon written request, the IRS will expedite consideration of applications for tax-exemption. For example, organizations formed to provide relief to victims of disasters or other emergencies often receive expedited consideration.

Description of Proposal

The proposal provides that the Secretary or his delegate shall adopt procedures to expedite consideration of applications for exempt status by organizations that are organized and operated for the primary purpose of providing social services. To be eligible, the organization must: (1) be seeking a contract or grant under a Federal, State, or local program that provides funding for social service programs; (2) establish that tax-exempt status is a condition of applying for such contract or grant; (3) include a completed copy of the contract or grant application with the application for exemption; and (4) meet such other criteria as the Secretary may provide. Organizations that meet the eligibility requirements described above (except for the requirement that tax-exempt status is a condition of the contract or grant application), and that certify that the organization's average annual gross receipts over the four year period preceding the application was not more than $50,000 (or, in the case of an organization in existence less than four years, is not expected to be more than $50,000 during the organization's first four years) are entitled to a waiver of any fee for application of tax-exempt status.

For this purpose, social services is defined as services directed at helping people in need, reducing poverty, improving outcomes of low-income children, revitalizing low-income communities, and empowering low-income families and low-income individuals to become self-sufficient, including: (1) child care services, protective services for children and adults, services for children and adults in foster care, adoption services, services related to the management and maintenance of the home, day care services for adults, and services to meet the special needs of children, older individuals, and individuals with disabilities (including physical, mental, or emotional disabilities); (2) transportation services; (3) job training and related services, and employment services; (4) information, referral, and counseling services; (5) the preparation and delivery of meals, and services related to soup kitchens or food banks; (6) health support services; (7) literacy and mentoring programs; (8) services for the prevention and treatment of juvenile delinquency and substance abuse, services for the prevention of crime and the provision of assistance to the victims and the families of criminal offenders, and services related to the intervention in, and prevention of, domestic violence; and (9) services related to the provision of assistance for housing under Federal law. Social services does not include a program having the purpose of delivering educational assistance under the Elementary and Secondary Education Act of 1965 or under the Higher Education Act of 1965.

Effective Date

The proposal applies to applications for tax-exempt status filed after December 31, 2006.

6. Extension of declaratory judgment procedures to non-501(c)(3) tax-exempt organizations

Present Law

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

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

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

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

years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

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

Description of Proposal

The proposal extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) and 501(d) determinations. The proposal limits jurisdiction over controversies involving such other determinations to the United States Tax Court.[181]

Effective Date

The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations is effective for pleadings filed with respect to determinations (or requests for determinations) made after December 31, 2006.

7. Definition of convention or association of churches

Present Law

Under present law, an organization that qualifies as a "convention or association of churches" (within the meaning of sec. 170(b)(1)(A)(i)) is not required to file an annual return,[182] is subject to the church tax inquiry and church tax examination provisions applicable to organizations claiming to be a church,[183] and is subject to certain other provisions generally applicable to churches.[184] The Internal Revenue Code does not define the term "convention or association of churches."

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

[182] Sec. 6033(a)(2)(A)(i).

[183] Sec. 7611(h)(1)(B).

[184] See, e.g., Sec. 402(g)(8)(B) (limitation on elective deferrals); sec. 403(b)(9)(B) (definition of retirement income account); sec. 410(d) (election to have participation, vesting, funding, and certain other provisions apply to church plans); sec. 414(e) (definition of church plan); sec. 415(c)(7) (certain contributions by church plans); sec. 501(h)(5) (disqualification of certain organizations from making the sec. 501(h) election regarding lobbying expenditure limits); sec. 501(m)(3) (definition of commercial-type insurance); sec. 508(c)(1)(A) (exception from requirement to file application seeking recognition of exempt status); sec. 512(b)(12) (allowance of up to $1,000 deduction for purposes of determining

Description of Proposal

The proposal provides that an organization that otherwise is a convention or association of churches does not fail to so qualify merely because the membership of the organization includes individuals as well as churches, or because individuals have voting rights in the organization.

Effective Date

The proposal is effective on the date of enactment.

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unrelated business taxable income); sec. 514(b)(3)(E) (definition of debt-financed property); sec. 3121(w)(3)(A) (election regarding exemption from social security taxes); sec. 3309(b)(1) (application of federal unemployment tax provisions to services performed in the employ of certain organizations); sec. 6043(b)(1) (requirement to file a return upon liquidation or dissolution of the organization); and sec. 7702(j)(3)(A) (treatment of certain death benefit plans as life insurance).

O. Wireless Telecommunications Property Treated as Qualified Technological Equipment

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS") (sec. 168). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

Under MACRS, qualified technological equipment is depreciated over a five-year recovery period using the 200-percent declining balance method. Qualified technological equipment includes any computer or peripheral equipment, any technology station equipment installed on a customer's premises, and any high technology equipment.

The recovery periods under MACRS for various asset classes are prescribed by Revenue Procedure 87-56.[185] Under IRS guidance, assets used to provide cellular telephone service fall within asset classes 48.12 (Telephone Central Office Equipment, 10-year recovery period), 48.121 (Computer-based Telephone Central Office Switching Equipment, 5-year recovery period), 48.13 (Telephone Station Equipment, 7 year recovery period), and 48.14 (Telephone Distribution Plants, 15 year recovery period).[186] Switching, transmission, and reception equipment located at either the mobile telephone switching office (MTSO) or cell sites are described in asset class 48.12. Computer-based switching equipment located at either the MTSO or cell sites is described in asset class 48.121. Transmission and reception assets are qualified technology equipment with a 5-year recovery period if they qualify as computer or peripheral equipment.

Description of Proposal

Under the proposal, wireless telecommunications equipment placed in service before January 1, 2011, is treated as qualified technological equipment and therefore is eligible for the five-year recovery period applicable to such property. Wireless telecommunications equipment is defined as equipment used in the transmission, reception, coordination, or switching of wireless telecommunications service. Wireless telecommunications equipment does not include towers, buildings, T-1 lines, or other cabling that connects cell sites to mobile switching centers.

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[185] 1987-2 C.B. 674.

[186] Technical Advice Memorandum 9825003 (Jan. 30, 1998).

For this purpose, wireless telecommunications service includes any commercial mobile radio service as defined in title 47 of the Code of Federal Regulations ("CFR").[187]

Effective Date

The proposal applies to property placed in service after the date of enactment and before January 1, 2011.

[187] Under the CFR, a commercial mobile radio service is "a mobile service that is: (a)(1) provided for profit, i.e., with the intent of receiving compensation or monetary gain; (2) an interconnected service; and (3) available to the public, or to such classes of eligible users as to be effectively available to a substantial portion of the public; or (b) the functional equivalent of such a mobile service described in paragraph (a) of this section." (47 C.F.R. §20.3.)

Under the CFR, a mobile service is "a radio communication service carried on between mobile stations or receivers and land stations, and by mobile stations communicating among themselves, and includes: (a) Both one-way and two-way radio communications services; (b) A mobile service which provides a regularly interacting group of base, mobile, portable, and associated control and relay stations (whether licensed on an individual, cooperative, or multiple basis) for private one-way or two-way land mobile radio communications by eligible users over designated areas of operation; and (c) Any service for which a license is required in a personal communications service under part 24 of this chapter." (47 C.F.R. §20.3.)

P. Simplification Through Elimination of Inoperative Provisions

Present Law

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

Description of Proposal

The proposal contains numerous amendments to the Code repealing obsolete provisions. The proposal simplifies the Code by deleting "deadwood" without making substantive changes in the tax law.

Effective Date

The proposal takes effect on the date of enactment.

VII. REVENUE OFFSET PROVISIONS

A. Economic Substance Doctrine

1. Clarification of the economic substance doctrine

Present Law

In general

The Code provides specific rules regarding the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss and deduction. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, invocation of these doctrines can be seen as at odds with an objective, "rule-based" system of taxation. Nonetheless, courts have applied the doctrines to deny tax benefits arising from certain transactions.[188]

A common-law doctrine applied with increasing frequency is the "economic substance" doctrine. In general, this doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax.[189]

Economic substance doctrine

Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations – notwithstanding that the purported activity actually occurred. The tax court has described the doctrine as follows:

"The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic

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[188] See, e.g., *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'g* 73 T.C.M. (CCH) 2189 (1997), *cert. denied* 526 U.S. 1017 (1999).

[189] Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the "sham transaction doctrine" and the "business purpose doctrine". See, e.g., *Knetsch v. United States*, 364 U.S. 361 (1960) (denying interest deductions on a "sham transaction" whose only purpose was to create the deductions).

substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings."[190]

Business purpose doctrine

Another common law doctrine that overlays and is often considered together with (if not part and parcel of) the economic substance doctrine is the business purpose doctrine. The business purpose test is a subjective inquiry into the motives of the taxpayer – that is, whether the taxpayer intended the transaction to serve some useful non-tax purpose. In making this determination, some courts have bifurcated a transaction in which independent activities with non-tax objectives have been combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[191]

Application by the courts

Elements of the doctrine

There is a lack of uniformity regarding the proper application of the economic substance doctrine.[192] Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to survive judicial scrutiny.[193] A narrower approach used by some courts is to conclude that either a business purpose or economic substance is sufficient to respect the transaction).[194] A third approach regards economic

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[190] *ACM Partnership v. Commissioner*, 73 T.C.M. at 2215.

[191] *ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48.

[192] "The casebooks are glutted with [economic substance] tests. Many such tests proliferate because they give the comforting illusion of consistency and precision. They often obscure rather than clarify." *Collins v. Commissioner*, 857 F.2d 1383, 1386 (9th Cir. 1988).

[193] See, e.g., *Pasternak v. Commissioner*, 990 F.2d 893, 898 (6th Cir. 1993) ("The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction.").

[194] See, e.g., *Rice's Toyota World v. Commissioner*, 752 F.2d 89, 91-92 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and, second, that the transaction has no economic substance because no reasonable possibility of a profit exists."); *IES Industries v. United States*, 253 F.3d 350, 358 (8th Cir. 2001) ("In determining whether a transaction is a sham for tax purposes [under the Eighth Circuit test], a transaction will be characterized as a sham if it is not motivated by any economic purpose out of tax considerations (the business purpose test), and if it is without economic substance because no real potential for profit exists (the economic substance test)."). As noted earlier, the economic substance doctrine and the sham transaction doctrine are similar and sometimes are applied interchangeably. For a more detailed discussion of the sham transaction doctrine, see, e.g., Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section*

substance and business purpose as "simply more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[195]

Recently, the Court of Federal Claims questioned the continuing viability of the doctrine.[196] The court also stated that "the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers."[197]

Nontax economic benefits

There also is a lack of uniformity regarding the type of non-tax economic benefit a taxpayer must establish in order to satisfy economic substance. Several courts have denied tax benefits on the grounds that the subject transactions lacked profit potential.[198] In addition, some courts have applied the economic substance doctrine to disallow tax benefits in transactions in which a taxpayer was exposed to risk and the transaction had a profit potential, but the court concluded that the economic risks and profit potential were insignificant when compared to the tax benefits.[199] Under this analysis, the taxpayer's profit potential must be more than nominal. Conversely, other courts view the application of the economic substance doctrine as requiring an objective determination of whether a "reasonable possibility of profit" from the transaction existed apart from the tax benefits.[200] In these cases, in assessing whether a reasonable

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3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters) (JCS-3-99) at 182.

[195] See, e.g., *ACM Partnership v. Commissioner*, 157 F.3d at 247; *James v. Commissioner*, 899 F.2d 905, 908 (10th Cir. 1995); *Sacks v. Commissioner*, 69 F.3d 982, 985 (9th Cir. 1995) ("Instead, the consideration of business purpose and economic substance are simply more precise factors to consider . . . We have repeatedly and carefully noted that this formulation cannot be used as a 'rigid two-step analysis'.").

[196] *Coltec Industries, Inc. v. United States*, 62 Fed. Cl. 716 (2004) (slip opinion at 123-124). The court also found, however, that the doctrine was satisfied in that case. *Id.* at 128.

[197] *Id.* at 128.

[198] See, e.g., *Knetsch*, 364 U.S. at 361; *Goldstein v. Commissioner*, 364 F.2d 734 (2d Cir. 1966) (holding that an unprofitable, leveraged acquisition of Treasury bills, and accompanying prepaid interest deduction, lacked economic substance).

[199] See, e.g., *Goldstein v. Commissioner*, 364 F.2d at 739-40 (disallowing deduction even though taxpayer had a possibility of small gain or loss by owning Treasury bills); *Sheldon v. Commissioner*, 94 T.C. 738, 768 (1990) (stating that "potential for gain . . . is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions").

[200] See, e.g., *Rice's Toyota World v. Commissioner*, 752 F.2d at 94 (the economic substance inquiry requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits); *Compaq Computer Corp. v. Commissioner*, 277 F.3d at 781

possibility of profit exists, it is sufficient if there is a nominal amount of pre-tax profit as measured against expected net tax benefits.

Financial accounting benefits

In determining whether a taxpayer had a valid business purpose for entering into a transaction, at least one court has concluded that financial accounting benefits arising from tax savings do not qualify as a non-tax business purpose.[201] However, based on court decisions that recognize the importance of financial accounting treatment, taxpayers have asserted that financial accounting benefits arising from tax savings can satisfy the business purpose test.[202]

Description of Proposal

The proposal clarifies and enhances the application of the economic substance doctrine. The proposal provides that, in a case in which a court determines that the economic substance doctrine is relevant to a transaction (or a series of transactions), such transaction (or series of transactions) has economic substance (and thus satisfies the economic substance doctrine) only if the taxpayer establishes that (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-tax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose.[203]

The proposal does not change current law standards used by courts in determining when to utilize an economic substance analysis.[204] Also, the proposal does not alter the court's ability

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(applied the same test, citing *Rice's Toyota World*); *IES Industries v. United States*, 253 F.3d 350, 354 (8th Cir. 2001).

[201] See, *American Electric Power, Inc. v. U.S.*, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio 2001); *aff'd* 326 F.3d.737 (6th Cir. 2003).

[202] See, e.g., Joint Committee on Taxation, *Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations* (JSC-3-03) February, 2003 ("Enron Report"), Volume III at C-93, 289. Enron Corporation relied on *Frank Lyon Co. v. United States*, 435 U.S. 561, 577-78 (1978), and *Newman v. Commissioner*, 902 F.2d 159, 163 (2d Cir. 1990) to argue that financial accounting benefits arising from tax savings constitutes a good business purpose.

[203] If the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this provision.

[204] See, e.g., Treas. Reg. sec. 1.269-2, stating that characteristic of circumstances in which a deduction otherwise allowed will be disallowed are those in which the effect of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate.

to aggregate, disaggregate or otherwise recharacterize a transaction when applying the doctrine.[205] The proposal provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects.

Conjunctive analysis

The proposal clarifies that the economic substance doctrine involves a conjunctive analysis – there must be an objective inquiry regarding the effects of the transaction on the taxpayer's economic position, as well as a subjective inquiry regarding the taxpayer's motives for engaging in the transaction. Under the proposal, a transaction must satisfy both tests – i.e., it must change in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and the taxpayer must have a substantial non-tax purpose for entering into such transaction (and the transaction is a reasonable means of accomplishing such purpose) – in order to satisfy the economic substance doctrine. This clarification eliminates the disparity that exists among the circuits regarding the application of the doctrine, and modifies its application in those circuits in which either a change in economic position or a non-tax business purpose (without having both) is sufficient to satisfy the economic substance doctrine.

Non-tax business purpose

The proposal provides that a taxpayer's non-tax purpose for entering into a transaction (the second prong in the analysis) must be "substantial," and that the transaction must be "a reasonable means" of accomplishing such purpose. Under this formulation, the non-tax purpose for the transaction must bear a reasonable relationship to the taxpayer's normal business operations or investment activities.[206]

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[205] See, e.g., *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938) ("A given result at the end of a straight path is not made a different result because reached by following a devious path.").

[206] See, e.g., Treas. Reg. sec. 1.269-2(b) (stating that a distortion of tax liability indicating the principal purpose of tax evasion or avoidance might be evidenced by the fact that "the transaction was not undertaken for reasons germane to the conduct of the business of the taxpayer"). Similarly, in *ACM Partnership v. Commissioner*, 73 T.C.M. (CCH) 2189 (1997), the court stated:

> Key to [the determination of whether a transaction has economic substance] is that the transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry. A rational relationship between purpose and means ordinarily will not be found unless there was a reasonable expectation that the nontax benefits would be at least commensurate with the transaction costs. [citations omitted]

See also Martin McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters*, 94 Tax Notes 1017, 1023 (Feb. 25, 2002) (advocates "confining the most rigorous application of business purpose, economic substance, and purposive activity tests to transactions outside the ordinary course of the taxpayer's business – those transactions that do not appear to contribute to any business

In determining whether a taxpayer has a substantial non-tax business purpose, an objective of achieving a favorable accounting treatment for financial reporting purposes will not be treated as having a substantial non-tax purpose.[207] Furthermore, a transaction that is expected to increase financial accounting income as a result of generating tax deductions or losses without a corresponding financial accounting charge (i.e., a permanent book-tax difference)[208] should not be considered to have a substantial non-tax purpose unless a substantial non-tax purpose exists apart from the financial accounting benefits.[209]

By requiring that a transaction be a "reasonable means" of accomplishing its non-tax purpose, the proposal reiterates the present-law ability of the courts to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[210]

Profit potential

Under the proposal, a taxpayer may rely on factors other than profit potential to demonstrate that a transaction results in a meaningful change in the taxpayer's economic position; the proposal merely sets forth a minimum threshold of profit potential if that test is relied on to demonstrate a meaningful change in economic position. If a taxpayer relies on a profit potential, however, the present value of the reasonably expected pre-tax profit must be

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activity or objective that the taxpayer may have had apart from tax planning but are merely loss generators."); Mark P. Gergen, *The Common Knowledge of Tax Abuse,* 54 SMU L. Rev. 131, 140 (Winter 2001) ("The message is that you can pick up tax gold if you find it in the street while going about your business, but you cannot go hunting for it.").

[207] However, if the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, such tax benefits should not be disallowed solely because the transaction results in a favorable accounting treatment. An example is the repealed foreign sales corporation rules.

[208] This includes tax deductions or losses that are anticipated to be recognized in a period subsequent to the period the financial accounting benefit is recognized. For example, FAS 109 in some cases permits the recognition of financial accounting benefits prior to the period in which the tax benefits are recognized for income tax purposes.

[209] Claiming that a financial accounting benefit constitutes a substantial non-tax purpose fails to consider the origin of the accounting benefit (i.e., reduction of taxes) and significantly diminishes the purpose for having a substantial non-tax purpose requirement. See, *e.g., American Electric Power, Inc. v. U.S.*, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio, 2001), *aff'd* 326 F.3d.737 (6th Cir. 2003) ("AEP's intended use of the cash flows generated by the [corporate-owned life insurance] plan is irrelevant to the subjective prong of the economic substance analysis. If a legitimate business purpose for the use of the tax savings 'were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, [then] every sham tax-shelter device might succeed,'") (citing *Winn-Dixie v. Commissioner*, 113 T.C. 254, 287 (1999)).

[210] See, e.g., *ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48.

substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.[211] Moreover, the profit potential must exceed a risk-free rate of return. In addition, in determining pre-tax profit, fees and other transaction expenses and foreign taxes are treated as expenses.

In applying the profit potential test to a lessor of tangible property, depreciation, applicable tax credits (such as the rehabilitation tax credit and the low income housing tax credit), and any other deduction as provided in guidance by the Secretary are not taken into account in measuring tax benefits.

Transactions with tax-indifferent parties

The proposal also provides special rules for transactions with tax-indifferent parties. For this purpose, a tax-indifferent party means any person or entity not subject to Federal income tax, or any person to whom an item would have no substantial impact on its income tax liability. Under these rules, the form of a financing transaction will not be respected if the present value of the tax deductions to be claimed is substantially in excess of the present value of the anticipated economic returns to the lender. Also, the form of a transaction with a tax-indifferent party will not be respected if it results in an allocation of income or gain to the tax-indifferent party in excess of the tax-indifferent party's economic gain or income or if the transaction results in the shifting of basis on account of overstating the income or gain of the tax-indifferent party.

Other rules

The Secretary may prescribe regulations which provide (1) exemptions from the application of the proposal, and (2) other rules as may be necessary or appropriate to carry out the purposes of the proposal.

No inference is intended as to the proper application of the economic substance doctrine under present law. In addition, except with respect to the economic substance doctrine, the bill shall not be construed as altering or supplanting any other common law doctrine (including the sham transaction doctrine), and the Senate amendment shall be construed as being additive to any such other doctrine.

Effective Date

The proposal applies to transactions entered into after the date of enactment.

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[211] Thus, a "reasonable possibility of profit" will not be sufficient to establish that a transaction has economic substance.

2. Penalty for understatements attributable to transactions lacking economic substance, etc.

Present Law

General accuracy-related penalty

An accuracy-related penalty under section 6662 applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 (or, in the case of corporations, by the lesser of (a) 10 percent of the correct tax (or $10,000 if greater) or (b) $10 million), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[212] Except in the case of tax shelters,[213] the amount of any understatement is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment. The Treasury Secretary may prescribe a list of positions which the Secretary believes do not meet the requirements for substantial authority under this provision.

The section 6662 penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[214] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[215]

Listed transactions and reportable avoidance transactions

In general

A separate accuracy-related penalty under section 6662A applies to "listed transactions" and to other "reportable transactions" with a significant tax avoidance purpose (hereinafter

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[212] Sec. 6662.

[213] A tax shelter is defined for this purpose as a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement if a significant purpose of such partnership, other entity, plan, or arrangement is the avoidance or evasion of Federal income tax. Sec. 6662(d)(2)(C).

[214] Sec. 6664(c).

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

referred to as a "reportable avoidance transaction"). The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

Both listed transactions and reportable transactions are allowed to be described by the Treasury department under section 6707A(c), which imposes a penalty for failure adequately to report such transactions under section 6011. A reportable transaction is defined as one that the Treasury Secretary determines is required to be disclosed because it is determined to have a potential for tax avoidance or evasion.[216] A listed transaction is defined as a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of the reporting disclosure requirements.[217]

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction.[218] The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty generally applies), and the taxpayer is subject to an increased penalty equal to 30 percent of the understatement.[219] However, a taxpayer will be treated as having adequately disclosed a transaction for this purpose if the IRS Commissioner has separately rescinded the separate penalty under section 6707A for failure to disclose a reportable transaction.[220] The IRS Commissioner is authorized to do this only if the failure does not relate to a listed transaction and only if rescinding the penalty would promote compliance and effective tax administration.[221]

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[216] Sec. 6707A(c)(1).

[217] Sec. 6707A(c)(2).

[218] Sec. 6662A(a).

[219] Sec. 6662A(c).

[220] Sec. 6664(d).

[221] Sec. 6707A(d).

A public entity that is required to pay a penalty for an undisclosed listed or reportable transaction must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear; and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).[222]

Determination of the understatement amount

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of: (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return);[223] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.[224]

Strengthened reasonable cause exception

A penalty is not imposed under the provision with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires: (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011;[225] (2) that there is or was substantial authority for such treatment; and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such

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[222] Sec. 6707A(e).

[223] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Sec. 6662A(b).

[224] Sec. 6662A(e)(3).

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

belief: (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed; and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised. [226]

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor" or (2) is a "disqualified opinion."

Disqualified tax advisor

A disqualified tax advisor is any advisor who: (1) is a material advisor[227] and who participates in the organization, management, promotion or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates; (2) is compensated directly or indirectly[228] by a material advisor with respect to the transaction; (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained; or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents: (1) establishing a structure used in connection with the transaction (such as a partnership agreement); (2) describing the transaction (such as an offering memorandum or other statement describing the transaction); or (3) relating to the registration of the transaction with any federal, state or local government body.[229] Participation in the

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[226] Sec. 6664(d).

[227] The term "material advisor" means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case). Sec. 6111(b)(1).

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

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

"management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

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

Coordination with other penalties

To the extent a penalty on an understatement is imposed under section 6662A, that same amount of understatement is not also subject to the accuracy-related penalty under section 6662(a) or to the valuation misstatement penalties under section 6662(e) or 6662(h). However, such amount of understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1) and for purposes of identifying an underpayment under the section 6663 fraud penalty.

The penalty imposed under section 6662A does not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Description of Proposal

The proposal imposes a penalty for an understatement attributable to any transaction that lacks economic substance (referred to in the statute as a "non-economic substance transaction understatement").[230] The penalty rate is 40 percent (reduced to 20 percent if the taxpayer adequately discloses the relevant facts in accordance with regulations prescribed under section 6011). No exceptions (including the reasonable cause or rescission rules) to the penalty are available (i.e., the penalty is a strict-liability penalty).

A "non-economic substance transaction" means any transaction if (1) the transaction lacks economic substance (as defined in the earlier proposal regarding the economic substance doctrine),[231] (2) the transaction was not respected under the rules relating to transactions with

[230] Thus, unlike the present-law accuracy-related penalty under section 6662A (which applies only to listed and reportable avoidance transactions), the new penalty under the proposal applies to any transaction that lacks economic substance.

[231] The proposal generally provides that in any case in which a court determines that the economic substance doctrine is relevant, a transaction has economic substance only if: (1) the transaction

tax-indifferent parties (as described in the immediately preceding proposal regarding the economic substance doctrine),[232] or (3) any similar rule of law. For this purpose, a similar rule of law would include, for example, an understatement attributable to a transaction that is determined to be a sham transaction.

For purposes of the proposal, the calculation of an "understatement" is made in the same manner as in the present law provision relating to accuracy-related penalties for listed and reportable avoidance transactions (sec. 6662A). Thus, the amount of the understatement under the proposal would be determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return),[233] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item. In essence, the penalty will apply to the amount of any understatement attributable solely to a non-economic substance transaction.

As in the case of the understatement penalty for reportable and listed transactions under present law section 6662A(e)(3), except as provided in regulations, the taxpayer's treatment of an item will not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted regarding an examination of such return or such other date as specified by the Secretary.

As in the case of the understatement penalty for undisclosed reportable transactions under present law section 6707A, a public entity that is required to pay a penalty under the provision (but in this case, regardless of whether the transaction was disclosed) must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

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changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (2) the taxpayer has a substantial non-tax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose. Specific other rules also apply. See "Description of Proposal" for the immediately preceding provision, "Clarification of the economic substance doctrine."

[232] The proposal provides that the form of a transaction that involves a tax-indifferent party will not be respected in certain circumstances.

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

Regardless of whether the transaction was disclosed, once a penalty under the proposal has been included in the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally. Furthermore, the IRS is required to keep records summarizing the application of this penalty and providing a description of each penalty compromised under the proposal and the reasons for the compromise.

Any understatement on which a penalty is imposed under the provision will not be subject to the accuracy-related penalty under section 6662 or under 6662A (accuracy-related penalties for listed and reportable avoidance transactions). However, an understatement under the Senate amendment is taken into account for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under the proposal will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The proposal applies to transactions entered into after the date of enactment.

B. Tax Treatment of Certain Inverted Corporate Entities

Present Law

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the parent corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. Other corporations (i.e., those incorporated under the laws of foreign countries) generally are treated as foreign.

U.S. taxation of domestic corporations

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred, and U.S. tax is imposed on such income when repatriated. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F (secs. 951-964) and the passive foreign investment company rules (secs. 1291-1298). A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether such income is repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income that is "effectively connected" with the conduct of a trade or business in the United States. Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions prior to the American Jobs Creation Act of 2004

Prior to the American Jobs Creation Act of 2004 ("AJCA"), a U.S. corporation could reincorporate in a foreign jurisdiction and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions were commonly referred to as inversion transactions. Inversion transactions could take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions were stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S. corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion could be used to reach a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction could be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation could transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from U.S. taxing jurisdiction, the corporate group could seek to derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various earnings stripping or other transactions. This could include earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure could enable the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations (e.g., secs. 163(j) and 482).

Inversion transactions could give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognized gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation's share value had declined, and/or it had many foreign or tax-exempt shareholders, the impact of this section 367(a) "toll charge" was reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also could give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under secs. 1001, 311(b), 304, 367, 1248 or other provisions). The tax on any income recognized as a result of these restructurings could be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognized gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally did not recognize gain or loss, assuming the transaction met the requirements of a reorganization under section 368.

U.S. tax treatment of inversion transactions under AJCA

In general

AJCA added new section 7874 to the Code, which defines two different types of corporate inversion transactions and establishes a different set of consequences for each type. Certain partnership transactions also are covered.

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan[234] or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion ("80-percent inversion") by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.[235]

In determining whether a transaction meets the definition of an inversion under the provision, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called "hook" stock), the stock would not be considered in determining whether the transaction meets the definition. Similarly, if a U.S. parent corporation converts an existing wholly owned U.S. subsidiary into a new wholly owned controlled foreign corporation, the stock of the new foreign corporation would be disregarded, with the result that the transaction would not meet the definition of an inversion under the provision. Stock sold in a public offering related to the transaction also is disregarded for these purposes.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the provision are disregarded. In addition, the Treasury Secretary is to provide regulations to carry out the provision, including regulations to prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed

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[234] Acquisitions with respect to a domestic corporation or partnership are deemed to be "pursuant to a plan" if they occur within the four-year period beginning on the date which is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

[235] Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level "toll charge" of sec. 367(a) does not apply to these inversion transactions.

to qualify or disqualify a person as a related person or a member of an expanded affiliated group. Similarly, the Treasury Secretary has the authority to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.

Transactions involving at least 60 percent but less than 80 percent identity of stock ownership

The second type of inversion is a transaction that would meet the definition of an inversion transaction described above, except that the 80-percent ownership threshold is not met. In such a case, if at least a 60-percent ownership threshold is met, then a second set of rules applies to the inversion. Under these rules, the inversion transaction is respected (i.e., the foreign corporation is treated as foreign), but any applicable corporate-level "toll charges" for establishing the inverted structure are not offset by tax attributes such as net operating losses or foreign tax credits. Specifically, any applicable corporate-level income or gain required to be recognized under sections 304, 311(b), 367, 1001, 1248, or any other provision with respect to the transfer of controlled foreign corporation stock or the transfer or license of other assets by a U.S. corporation as part of the inversion transaction or after such transaction to a related foreign person is taxable, without offset by any tax attributes (e.g., net operating losses or foreign tax credits). This rule does not apply to certain transfers of inventory and similar property. These measures generally apply for a 10-year period following the inversion transaction.

Other rules

Under section 7874, inversion transactions include certain partnership transactions. Specifically, the provision applies to transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, if after the acquisition at least 60 percent (or 80 percent, as the case may be) of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), provided that the other terms of the basic definition are met. For purposes of applying this test, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified "toll charge" rules apply at the partner level.

A transaction otherwise meeting the definition of an inversion transaction is not treated as an inversion transaction if, on or before March 4, 2003, the foreign-incorporated entity had acquired directly or indirectly more than half of the properties held directly or indirectly by the domestic corporation, or more than half of the properties constituting the partnership trade or business, as the case may be.

Description of Proposal

The proposal extends the 80-percent inversion regime of section 7874 to certain other 80-percent inversions. The proposal applies the rules of section 7874(b), relating to 80-percent inversions, to transactions completed after March 20, 2002 (as opposed to March 4, 2003 under present law), in the manner described below. A transaction otherwise meeting the definition of an inversion transaction under the proposal is not treated as an inversion transaction if, on or before March 20, 2002 (as opposed to March 4, 2003 under present law), the foreign-

incorporated entity had acquired directly or indirectly more than half the properties held directly or indirectly by the domestic corporation, or more than half the properties constituting the partnership trade or business, as the case may be.

Under the proposal, the inverted foreign-incorporated entity that engaged in the transaction described above is deemed to have transferred all its assets and liabilities to a domestic corporation in a transaction that is generally treated as a nontaxable inbound reorganization ("repatriation"). The repatriation is deemed to occur at the end of the last day of the foreign-incorporated entity's taxable year that began in 2005. The basis of the assets of the foreign-incorporated entity generally remains the same in the hands of the domestic corporation, subject to any special adjustments for importing built-in losses (e.g., sec. 362(e)). Shareholders of the domestic corporation inherit the respective bases of their shares of the foreign-incorporated entity.

On the day of the repatriation, the earnings and profits of the inverted foreign-incorporated entity transfer over to the domestic corporation. The transfer of such earnings and profits is not a deemed dividend and does not result in a tax upon the domestic corporation or its shareholders. However, shareholders may be subject to tax on distributions of such earnings and profits.

Beginning on the day after the repatriation, the inverted foreign-incorporated entity is treated for all tax purposes as a domestic corporation. Thus, any income earned by the inverted foreign-incorporated entity after the date of repatriation is deemed to be earned by a domestic corporation, and therefore, is fully taxable at U.S. corporate income tax rates. As a further consequence of the repatriation of the inverted foreign-incorporated entity, foreign subsidiaries become controlled foreign corporations, subject to the rules of subpart F.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2005.

UNITED STATES SENATE
COMMITTEE ON FINANCE

Charles E. Grassley, Chairman

Wednesday June 28, 2006

215 Dirksen Senate Office Building

Agenda for Business Meeting

1. To Consider the Nomination of Henry M. Paulson, Jr., to be Secretary of the Treasury

2. S. 1321, the Telephone Excise Tax Repeal Act of 2005, and an amendment that incorporates S. 832, the Taxpayer Protection and Assistance Act of 2005

3. S. 3569, the United States - Oman Free Trade Agreement Implementation Act

109TH CONGRESS
2D SESSION

S. 3569

To implement the United States-Oman Free Trade Agreement.

IN THE SENATE OF THE UNITED STATES

Mr. Grassley (for himself and Mr. Baucus) (both by request) introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To implement the United States-Oman Free Trade Agreement.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "United States-Oman Free Trade Agreement Implementation Act".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

TITLE I—APPROVAL OF, AND GENERAL PROVISIONS RELATING TO, THE AGREEMENT

TITLE II—CUSTOMS PROVISIONS

TITLE III—RELIEF FROM IMPORTS

Subtitle A—Relief From Imports Benefiting From the Agreement

Subtitle B—Textile and Apparel Safeguard Measures

TITLE IV—PROCUREMENT

SEC. 2. PURPOSES.

The purposes of this Act are—

(1) to approve and implement the Free Trade Agreement between the United States and Oman en-

tered into under the authority of section 2103(b) of the Bipartisan Trade Promotion Authority Act of 2002 (19 U.S.C. 3803(b));

(2) to strengthen and develop economic relations between the United States and Oman for their mutual benefit;

(3) to establish free trade between the 2 nations through the reduction and elimination of barriers to trade in goods and services and to investment; and

(4) to lay the foundation for further cooperation to expand and enhance the benefits of such Agreement.

SEC. 3. DEFINITIONS.

In this Act:

(1) AGREEMENT.—The term "Agreement" means the United States-Oman Free Trade Agreement approved by Congress under section 101(a)(1).

(2) HTS.—The term "HTS" means the Harmonized Tariff Schedule of the United States.

(3) TEXTILE OR APPAREL GOOD.—The term "textile or apparel good" means a good listed in the Annex to the Agreement on Textiles and Clothing referred to in section 101(d)(4) of the Uruguay Round Agreements Act (19 U.S.C. 3511(d)(4)).

TITLE I—APPROVAL OF, AND GENERAL PROVISIONS RELATING TO, THE AGREEMENT

SEC. 101. APPROVAL AND ENTRY INTO FORCE OF THE AGREEMENT.

(a) APPROVAL OF AGREEMENT AND STATEMENT OF ADMINISTRATIVE ACTION.—Pursuant to section 2105 of the Bipartisan Trade Promotion Authority Act of 2002 (19 U.S.C. 3805) and section 151 of the Trade Act of 1974 (19 U.S.C. 2191), Congress approves—

(1) the United States-Oman Free Trade Agreement entered into on January 19, 2006, with Oman and submitted to Congress on [June 26, 2006]; and

(2) the statement of administrative action proposed to implement the Agreement that was submitted to Congress on [June 26, 2006].

(b) CONDITIONS FOR ENTRY INTO FORCE OF THE AGREEMENT.—At such time as the President determines that Oman has taken measures necessary to bring it into compliance with those provisions of the Agreement that are to take effect on the date on which the Agreement enters into force, the President is authorized to exchange notes with the Government of Oman providing for the

entry into force, on or after January 1, 2007, of the Agreement with respect to the United States.

SEC. 102. RELATIONSHIP OF THE AGREEMENT TO UNITED STATES AND STATE LAW.

(a) RELATIONSHIP OF AGREEMENT TO UNITED STATES LAW.—

(1) UNITED STATES LAW TO PREVAIL IN CONFLICT.—No provision of the Agreement, nor the application of any such provision to any person or circumstance, which is inconsistent with any law of the United States shall have effect.

(2) CONSTRUCTION.—Nothing in this Act shall be construed—

(A) to amend or modify any law of the United States, or

(B) to limit any authority conferred under any law of the United States,

unless specifically provided for in this Act.

(b) RELATIONSHIP OF AGREEMENT TO STATE LAW.—

(1) LEGAL CHALLENGE.—No State law, or the application thereof, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with the Agreement, except in an action brought by the

United States for the purpose of declaring such law or application invalid.

(2) DEFINITION OF STATE LAW.—For purposes of this subsection, the term "State law" includes—

(A) any law of a political subdivision of a State; and

(B) any State law regulating or taxing the business of insurance.

(c) EFFECT OF AGREEMENT WITH RESPECT TO PRIVATE REMEDIES.—No person other than the United States—

(1) shall have any cause of action or defense under the Agreement or by virtue of congressional approval thereof; or

(2) may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State, on the ground that such action or inaction is inconsistent with the Agreement.

SEC. 103. IMPLEMENTING ACTIONS IN ANTICIPATION OF ENTRY INTO FORCE AND INITIAL REGULATIONS.

(a) IMPLEMENTING ACTIONS.—

(1) PROCLAMATION AUTHORITY.—After the date of the enactment of this Act—

(A) the President may proclaim such actions, and

(B) other appropriate officers of the United States Government may issue such regulations,

as may be necessary to ensure that any provision of this Act, or amendment made by this Act, that takes effect on the date on which the Agreement enters into force is appropriately implemented on such date, but no such proclamation or regulation may have an effective date earlier than the date on which the Agreement enters into force.

(2) EFFECTIVE DATE OF CERTAIN PROCLAIMED ACTIONS.—Any action proclaimed by the President under the authority of this Act that is not subject to the consultation and layover provisions under section 104 may not take effect before the 15th day after the date on which the text of the proclamation is published in the Federal Register.

(3) WAIVER OF 15-DAY RESTRICTION.—The 15-day restriction in paragraph (2) on the taking effect of proclaimed actions is waived to the extent that the application of such restriction would prevent the

taking effect on the date on which the Agreement enters into force of any action proclaimed under this section.

(b) INITIAL REGULATIONS.—Initial regulations necessary or appropriate to carry out the actions required by or authorized under this Act or proposed in the statement of administrative action submitted under section 101(a)(2) to implement the Agreement shall, to the maximum extent feasible, be issued within 1 year after the date on which the Agreement enters into force. In the case of any implementing action that takes effect on a date after the date on which the Agreement enters into force, initial regulations to carry out that action shall, to the maximum extent feasible, be issued within 1 year after such effective date.

SEC. 104. CONSULTATION AND LAYOVER PROVISIONS FOR, AND EFFECTIVE DATE OF, PROCLAIMED ACTIONS.

If a provision of this Act provides that the implementation of an action by the President by proclamation is subject to the consultation and layover requirements of this section, such action may be proclaimed only if—

(1) the President has obtained advice regarding the proposed action from—

(A) the appropriate advisory committees established under section 135 of the Trade Act of 1974 (19 U.S.C. 2155); and

(B) the United States International Trade Commission;

(2) the President has submitted to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives a report that sets forth—

(A) the action proposed to be proclaimed and the reasons therefor; and

(B) the advice obtained under paragraph (1);

(3) a period of 60 calendar days, beginning on the first day on which the requirements set forth in paragraphs (1) and (2) have been met has expired; and

(4) the President has consulted with the Committees referred to in paragraph (2) regarding the proposed action during the period referred to in paragraph (3).

SEC. 105. ADMINISTRATION OF DISPUTE SETTLEMENT PROCEEDINGS.

(a) ESTABLISHMENT OR DESIGNATION OF OFFICE.—The President is authorized to establish or designate with-

in the Department of Commerce an office that shall be responsible for providing administrative assistance to panels established under chapter 20 of the Agreement. The office may not be considered to be an agency for purposes of section 552 of title 5, United States Code.

(b) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated for each fiscal year after fiscal year 2006 to the Department of Commerce such sums as may be necessary for the establishment and operations of the office established or designated under subsection (a) and for the payment of the United States share of the expenses of panels established under chapter 20 of the Agreement.

SEC. 106. ARBITRATION OF CLAIMS.

The United States is authorized to resolve any claim against the United States covered by article 10.15.1(a)(i)(C) or article 10.15.1(b)(i)(C) of the Agreement, pursuant to the Investor-State Dispute Settlement procedures set forth in section B of chapter 10 of the Agreement.

SEC. 107. EFFECTIVE DATES; EFFECT OF TERMINATION.

(a) EFFECTIVE DATES.—Except as provided in subsection (b), the provisions of this Act and the amendments made by this Act take effect on the date on which the Agreement enters into force.

(b) EXCEPTIONS.—Sections 1 through 3 and this title take effect on the date of the enactment of this Act.

(c) TERMINATION OF THE AGREEMENT.—On the date on which the Agreement terminates, the provisions of this Act (other than this subsection) and the amendments made by this Act shall cease to be effective.

TITLE II—CUSTOMS PROVISIONS

SEC. 201. TARIFF MODIFICATIONS.

(a) TARIFF MODIFICATIONS PROVIDED FOR IN THE AGREEMENT.—

(1) PROCLAMATION AUTHORITY.—The President may proclaim—

(A) such modifications or continuation of any duty,

(B) such continuation of duty-free or excise treatment, or

(C) such additional duties,

as the President determines to be necessary or appropriate to carry out or apply articles 2.3, 2.5, 2.6, 3.2.8, and 3.2.9, and Annex 2–B of the Agreement.

(2) EFFECT ON OMANI GSP STATUS.—Notwithstanding section 502(a)(1) of the Trade Act of 1974 (19 U.S.C. 2462(a)(1)), the President shall, on the date on which the Agreement enters into force, terminate the designation of Oman as a beneficiary de-

veloping country for purposes of title V of the Trade Act of 1974 (19 U.S.C. 2461 et seq.).

(b) OTHER TARIFF MODIFICATIONS.—Subject to the consultation and layover provisions of section 104, the President may proclaim—

(1) such modifications or continuation of any duty,

(2) such modifications as the United States may agree to with Oman regarding the staging of any duty treatment set forth in Annex 2–B of the Agreement,

(3) such continuation of duty-free or excise treatment, or

(4) such additional duties,

as the President determines to be necessary or appropriate to maintain the general level of reciprocal and mutually advantageous concessions with respect to Oman provided for by the Agreement.

(c) CONVERSION TO AD VALOREM RATES.—For purposes of subsections (a) and (b), with respect to any good for which the base rate in the Tariff Schedule of the United States to Annex 2–B of the Agreement is a specific or compound rate of duty, the President may substitute for the base rate an ad valorem rate that the President determines to be equivalent to the base rate.

SEC. 202. RULES OF ORIGIN.

(a) APPLICATION AND INTERPRETATION.—In this section:

(1) TARIFF CLASSIFICATION.—The basis for any tariff classification is the HTS.

(2) REFERENCE TO HTS.—Whenever in this section there is a reference to a heading or subheading, such reference shall be a reference to a heading or subheading of the HTS.

(b) ORIGINATING GOODS.—

(1) IN GENERAL.—For purposes of this Act and for purposes of implementing the preferential tariff treatment provided for under the Agreement, a good is an originating good if—

(A) the good is imported directly—

(i) from the territory of Oman into the territory of the United States; or

(ii) from the territory of the United States into the territory of Oman; and

(B)(i) the good is a good wholly the growth, product, or manufacture of Oman or the United States, or both;

(ii) the good (other than a good to which clause (iii) applies) is a new or different article of commerce that has been grown, produced, or manufactured in Oman or the United States, or

both, and meets the requirements of paragraph (2); or

(iii)(I) the good is a good covered by Annex 3–A or 4–A of the Agreement;

(II)(aa) each of the nonoriginating materials used in the production of the good undergoes an applicable change in tariff classification specified in such Annex as a result of production occurring entirely in the territory of Oman or the United States, or both; or

(bb) the good otherwise satisfies the requirements specified in such Annex; and

(III) the good satisfies all other applicable requirements of this section.

(2) REQUIREMENTS.—A good described in paragraph (1)(B)(ii) is an originating good only if the sum of—

(A) the value of each material produced in the territory of Oman or the United States, or both, and

(B) the direct costs of processing operations performed in the territory of Oman or the United States, or both,

is not less than 35 percent of the appraised value of the good at the time the good is entered into the territory of the United States.

(c) CUMULATION.—

(1) ORIGINATING GOOD OR MATERIAL INCORPORATED INTO GOODS OF OTHER COUNTRY.—An originating good, or a material produced in the territory of Oman or the United States, or both, that is incorporated into a good in the territory of the other country shall be considered to originate in the territory of the other country.

(2) MULTIPLE PRODUCERS.—A good that is grown, produced, or manufactured in the territory of Oman or the United States, or both, by 1 or more producers, is an originating good if the good satisfies the requirements of subsection (b) and all other applicable requirements of this section.

(d) VALUE OF MATERIALS.—

(1) IN GENERAL.—Except as provided in paragraph (2), the value of a material produced in the territory of Oman or the United States, or both, includes the following:

(A) The price actually paid or payable for the material by the producer of the good.

(B) The freight, insurance, packing, and all other costs incurred in transporting the material to the producer's plant, if such costs are not included in the price referred to in subparagraph (A).

(C) The cost of waste or spoilage resulting from the use of the material in the growth, production, or manufacture of the good, less the value of recoverable scrap.

(D) Taxes or customs duties imposed on the material by Oman or the United States, or both, if the taxes or customs duties are not remitted upon exportation from the territory of Oman or the United States, as the case may be.

(2) EXCEPTION.—If the relationship between the producer of a good and the seller of a material influenced the price actually paid or payable for the material, or if there is no price actually paid or payable by the producer for the material, the value of the material produced in the territory of Oman or the United States, or both, includes the following:

(A) All expenses incurred in the growth, production, or manufacture of the material, including general expenses.

(B) A reasonable amount for profit.

(C) Freight, insurance, packing, and all other costs incurred in transporting the material to the producer's plant.

(e) PACKAGING AND PACKING MATERIALS AND CONTAINERS FOR RETAIL SALE AND FOR SHIPMENT.—Packaging and packing materials and containers for retail sale and shipment shall be disregarded in determining whether a good qualifies as an originating good, except to the extent that the value of such packaging and packing materials and containers has been included in meeting the requirements set forth in subsection (b)(2).

(f) INDIRECT MATERIALS.—Indirect materials shall be disregarded in determining whether a good qualifies as an originating good, except that the cost of such indirect materials may be included in meeting the requirements set forth in subsection (b)(2).

(g) TRANSIT AND TRANSSHIPMENT.—A good shall not be considered to meet the requirement of subsection (b)(1)(A) if, after exportation from the territory of Oman or the United States, the good undergoes production, manufacturing, or any other operation outside the territory of Oman or the United States, other than unloading, reloading, or any other operation necessary to preserve the good in good condition or to transport the good to the territory of Oman or the United States.

(h) TEXTILE AND APPAREL GOODS.—

(1) DE MINIMIS AMOUNTS OF NONORIGINATING MATERIALS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), a textile or apparel good that is not an originating good because certain fibers or yarns used in the production of the component of the good that determines the tariff classification of the good do not undergo an applicable change in tariff classification set out in Annex 3–A of the Agreement shall be considered to be an originating good if the total weight of all such fibers or yarns in that component is not more than 7 percent of the total weight of that component.

(B) CERTAIN TEXTILE OR APPAREL GOODS.—A textile or apparel good containing elastomeric yarns in the component of the good that determines the tariff classification of the good shall be considered to be an originating good only if such yarns are wholly formed in the territory of Oman or the United States.

(C) YARN, FABRIC, OR GROUP OF FIBERS.—For purposes of this paragraph, in the case of a textile or apparel good that is a yarn,

fabric, or group of fibers, the term "component of the good that determines the tariff classification of the good" means all of the fibers in the yarn, fabric, or group of fibers.

(2) GOODS PUT UP IN SETS FOR RETAIL SALE.—Notwithstanding the rules set forth in Annex 3–A of the Agreement, textile or apparel goods classifiable as goods put up in sets for retail sale as provided for in General Rule of Interpretation 3 of the HTS shall not be considered to be originating goods unless each of the goods in the set is an originating good or the total value of the nonoriginating goods in the set does not exceed 10 percent of the value of the set determined for purposes of assessing customs duties.

(i) DEFINITIONS.—In this section:

(1) DIRECT COSTS OF PROCESSING OPERATIONS.—

(A) IN GENERAL.—The term "direct costs of processing operations", with respect to a good, includes, to the extent they are includable in the appraised value of the good when imported into Oman or the United States, as the case may be, the following:

(i) All actual labor costs involved in the growth, production, or manufacture of the good, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel.

(ii) Tools, dies, molds, and other indirect materials, and depreciation on machinery and equipment that are allocable to the good.

(iii) Research, development, design, engineering, and blueprint costs, to the extent that they are allocable to the good.

(iv) Costs of inspecting and testing the good.

(v) Costs of packaging the good for export to the territory of the other country.

(B) EXCEPTIONS.—The term "direct costs of processing operations" does not include costs that are not directly attributable to a good or are not costs of growth, production, or manufacture of the good, such as—

(i) profit; and

(ii) general expenses of doing business that are either not allocable to the good or

are not related to the growth, production, or manufacture of the good, such as administrative salaries, casualty and liability insurance, advertising, and sales staff salaries, commissions, or expenses.

(2) GOOD.—The term "good" means any merchandise, product, article, or material.

(3) GOOD WHOLLY THE GROWTH, PRODUCT, OR MANUFACTURE OF OMAN OR THE UNITED STATES, OR BOTH.—The term "good wholly the growth, product, or manufacture of Oman or the United States, or both" means—

(A) a mineral good extracted in the territory of Oman or the United States, or both;

(B) a vegetable good, as such a good is provided for in the HTS, harvested in the territory of Oman or the United States, or both;

(C) a live animal born and raised in the territory of Oman or the United States, or both;

(D) a good obtained from live animals raised in the territory of Oman or the United States, or both;

(E) a good obtained from hunting, trapping, or fishing in the territory of Oman or the United States, or both;

(F) a good (fish, shellfish, and other marine life) taken from the sea by vessels registered or recorded with Oman or the United States and flying the flag of that country;

(G) a good produced from goods referred to in subparagraph (F) on board factory ships registered or recorded with Oman or the United States and flying the flag of that country;

(H) a good taken by Oman or the United States or a person of Oman or the United States from the seabed or beneath the seabed outside territorial waters, if Oman or the United States, as the case may be, has rights to exploit such seabed;

(I) a good taken from outer space, if such good is obtained by Oman or the United States or a person of Oman or the United States and not processed in the territory of a country other than Oman or the United States;

(J) waste and scrap derived from—

(i) production or manufacture in the territory of Oman or the United States, or both; or

(ii) used goods collected in the territory of Oman or the United States, or both, if such goods are fit only for the recovery of raw materials;

(K) a recovered good derived in the territory of Oman or the United States from used goods and utilized in the territory of that country in the production of remanufactured goods; and

(L) a good produced in the territory of Oman or the United States, or both, exclusively—

(i) from goods referred to in subparagraphs (A) through (J), or

(ii) from the derivatives of goods referred to in clause (i),

at any stage of production.

(4) INDIRECT MATERIAL.—The term "indirect material" means a good used in the growth, production, manufacture, testing, or inspection of a good but not physically incorporated into the good, or a good used in the maintenance of buildings or the op-

eration of equipment associated with the growth, production, or manufacture of a good, including—

(A) fuel and energy;

(B) tools, dies, and molds;

(C) spare parts and materials used in the maintenance of equipment and buildings;

(D) lubricants, greases, compounding materials, and other materials used in the growth, production, or manufacture of a good or used to operate equipment and buildings;

(E) gloves, glasses, footwear, clothing, safety equipment, and supplies;

(F) equipment, devices, and supplies used for testing or inspecting the good;

(G) catalysts and solvents; and

(H) any other goods that are not incorporated into the good but the use of which in the growth, production, or manufacture of the good can reasonably be demonstrated to be a part of that growth, production, or manufacture.

(5) MATERIAL.—The term "material" means a good, including a part or ingredient, that is used in the growth, production, or manufacture of another good that is a new or different article of commerce

that has been grown, produced, or manufactured in Oman or the United States, or both.

(6) MATERIAL PRODUCED IN THE TERRITORY OF OMAN OR THE UNITED STATES, OR BOTH.—The term "material produced in the territory of Oman or the United States, or both" means a good that is either wholly the growth, product, or manufacture of Oman or the United States, or both, or a new or different article of commerce that has been grown, produced, or manufactured in the territory of Oman or the United States, or both.

(7) NEW OR DIFFERENT ARTICLE OF COMMERCE.—

(A) IN GENERAL.—The term "new or different article of commerce" means, except as provided in subparagraph (B), a good that—

(i) has been substantially transformed from a good or material that is not wholly the growth, product, or manufacture of Oman or the United States, or both; and

(ii) has a new name, character, or use distinct from the good or material from which it was transformed.

(B) EXCEPTION.—A good shall not be considered a new or different article of commerce

by virtue of having undergone simple combining or packaging operations, or mere dilution with water or another substance that does not materially alter the characteristics of the good.

(8) RECOVERED GOODS.—The term "recovered goods" means materials in the form of individual parts that result from—

(A) the disassembly of used goods into individual parts; and

(B) the cleaning, inspecting, testing, or other processing of those parts as necessary for improvement to sound working condition.

(9) REMANUFACTURED GOOD.—The term "remanufactured good" means an industrial good that is assembled in the territory of Oman or the United States and that—

(A) is entirely or partially comprised of recovered goods;

(B) has a similar life expectancy to a like good that is new; and

(C) enjoys a factory warranty similar to that of a like good that is new.

(10) SIMPLE COMBINING OR PACKAGING OPERATIONS.—The term "simple combining or packaging operations" means operations such as adding bat-

teries to devices, fitting together a small number of components by bolting, gluing, or soldering, and repacking or packaging components together.

(11) SUBSTANTIALLY TRANSFORMED.—The term "substantially transformed" means, with respect to a good or material, changed as the result of a manufacturing or processing operation so that—

(A)(i) the good or material is converted from a good that has multiple uses into a good or material that has limited uses;

(ii) the physical properties of the good or material are changed to a significant extent; or

(iii) the operation undergone by the good or material is complex by reason of the number of different processes and materials involved and the time and level of skill required to perform those processes; and

(B) the good or material loses its separate identity in the manufacturing or processing operation.

(j) PRESIDENTIAL PROCLAMATION AUTHORITY.—

(1) IN GENERAL.—The President is authorized to proclaim, as part of the HTS—

(A) the provisions set forth in Annex 3–A and Annex 4–A of the Agreement; and

(B) any additional subordinate category that is necessary to carry out this title, consistent with the Agreement.

(2) MODIFICATIONS.—

(A) IN GENERAL.—Subject to the consultation and layover provisions of section 104, the President may proclaim modifications to the provisions proclaimed under the authority of paragraph (1)(A), other than provisions of chapters 50 through 63 of the HTS (as included in Annex 3–A of the Agreement).

(B) ADDITIONAL PROCLAMATIONS.—Notwithstanding subparagraph (A), and subject to the consultation and layover provisions of section 104, the President may proclaim—

(i) modifications to the provisions proclaimed under the authority of paragraph (1)(A) as are necessary to implement an agreement with Oman pursuant to article 3.2.5 of the Agreement; and

(ii) before the end of the 1-year period beginning on the date of the enactment of this Act, modifications to correct any typo-

graphical, clerical, or other nonsubstantive technical error regarding the provisions of chapters 50 through 63 of the HTS (as included in Annex 3–A of the Agreement).

SEC. 203. CUSTOMS USER FEES.

Section 13031(b) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(b)) is amended by adding after paragraph (16) the following:

"(17) No fee may be charged under subsection (a) (9) or (10) with respect to goods that qualify as originating goods under section 202 of the United States-Oman Free Trade Agreement Implementation Act. Any service for which an exemption from such fee is provided by reason of this paragraph may not be funded with money contained in the Customs User Fee Account.".

SEC. 204. ENFORCEMENT RELATING TO TRADE IN TEXTILE AND APPAREL GOODS.

(a) ACTION DURING VERIFICATION.—

(1) IN GENERAL.—If the Secretary of the Treasury requests the Government of Oman to conduct a verification pursuant to article 3.3 of the Agreement for purposes of making a determination under paragraph (2), the President may direct the Secretary to take appropriate action described in

subsection (b) while the verification is being conducted.

(2) DETERMINATION.—A determination under this paragraph is a determination—

(A) that an exporter or producer in Oman is complying with applicable customs laws, regulations, procedures, requirements, or practices affecting trade in textile or apparel goods; or

(B) that a claim that a textile or apparel good exported or produced by such exporter or producer—

(i) qualifies as an originating good under section 202, or

(ii) is a good of Oman,

is accurate.

(b) APPROPRIATE ACTION DESCRIBED.—Appropriate action under subsection (a)(1) includes—

(1) suspension of liquidation of the entry of any textile or apparel good exported or produced by the person that is the subject of a verification referred to in subsection (a)(1) regarding compliance described in subsection (a)(2)(A), in a case in which the request for verification was based on a reasonable suspicion of unlawful activity related to such good; and

(2) suspension of liquidation of the entry of a textile or apparel good for which a claim has been made that is the subject of a verification referred to in subsection (a)(1) regarding a claim described in subsection (a)(2)(B).

(c) ACTION WHEN INFORMATION IS INSUFFICIENT.—If the Secretary of the Treasury determines that the information obtained within 12 months after making a request for a verification under subsection (a)(1) is insufficient to make a determination under subsection (a)(2), the President may direct the Secretary to take appropriate action described in subsection (d) until such time as the Secretary receives information sufficient to make a determination under subsection (a)(2) or until such earlier date as the President may direct.

(d) APPROPRIATE ACTION DESCRIBED.—Appropriate action referred to in subsection (c) includes—

(1) publication of the name and address of the person that is the subject of the verification;

(2) denial of preferential tariff treatment under the Agreement to—

(A) any textile or apparel good exported or produced by the person that is the subject of a verification referred to in subsection (a)(1) re-

garding compliance described in subsection (a)(2)(A); or

(B) a textile or apparel good for which a claim has been made that is the subject of a verification referred to in subsection (a)(1) regarding a claim described in subsection (a)(2)(B); and

(3) denial of entry into the United States of—

(A) any textile or apparel good exported or produced by the person that is the subject of a verification referred to in subsection (a)(1) regarding compliance described in subsection (a)(2)(A); or

(B) a textile or apparel good for which a claim has been made that is the subject of a verification referred to in subsection (a)(1) regarding a claim described in subsection (a)(2)(B).

SEC. 205. RELIQUIDATION OF ENTRIES.

Subsection (d) of section 520 of the Tariff Act of 1930 (19 U.S.C. 1520(d)) is amended—

(1) in the matter preceding paragraph (1)—

(A) by striking "or"; and

(B) by striking "for which" and inserting ", or section 202 of the United States-Oman

Free Trade Agreement Implementation Act for which"; and

(2) in paragraph (3), by inserting "and information" after "documentation".

SEC. 206. REGULATIONS.

The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out—

(1) subsections (a) through (i) of section 202;

(2) the amendment made by section 203; and

(3) proclamations issued under section 202(j).

TITLE III—RELIEF FROM IMPORTS

SEC. 301. DEFINITIONS.

In this title:

(1) OMANI ARTICLE.—The term "Omani article" means an article that—

(A) qualifies as an originating good under section 202(b); or

(B) receives preferential tariff treatment under paragraphs 8 through 11 of article 3.2 of the Agreement.

(2) OMANI TEXTILE OR APPAREL ARTICLE.—The term "Omani textile or apparel article" means an article that—

(A) is listed in the Annex to the Agreement on Textiles and Clothing referred to in section 101(d)(4) of the Uruguay Round Agreements Act (19 U.S.C. 3511(d)(4)); and

(B) is an Omani article.

(3) COMMISSION.—The term "Commission" means the United States International Trade Commission.

Subtitle A—Relief From Imports Benefiting From the Agreement

SEC. 311. COMMENCING OF ACTION FOR RELIEF.

(a) FILING OF PETITION.—A petition requesting action under this subtitle for the purpose of adjusting to the obligations of the United States under the Agreement may be filed with the Commission by an entity, including a trade association, firm, certified or recognized union, or group of workers, that is representative of an industry. The Commission shall transmit a copy of any petition filed under this subsection to the United States Trade Representative.

(b) INVESTIGATION AND DETERMINATION.—Upon the filing of a petition under subsection (a), the Commission, unless subsection (d) applies, shall promptly initiate an investigation to determine whether, as a result of the reduction or elimination of a duty provided for under the

Agreement, an Omani article is being imported into the United States in such increased quantities, in absolute terms or relative to domestic production, and under such conditions that imports of the Omani article constitute a substantial cause of serious injury or threat thereof to the domestic industry producing an article that is like, or directly competitive with, the imported article.

(c) APPLICABLE PROVISIONS.—The following provisions of section 202 of the Trade Act of 1974 (19 U.S.C. 2252) apply with respect to any investigation initiated under subsection (b):

(1) Paragraphs (1)(B) and (3) of subsection (b).

(2) Subsection (c).

(3) Subsection (i).

(d) ARTICLES EXEMPT FROM INVESTIGATION.—No investigation may be initiated under this section with respect to any Omani article if, after the date on which the Agreement enters into force with respect to the United States, import relief has been provided with respect to that Omani article under this subtitle.

SEC. 312. COMMISSION ACTION ON PETITION.

(a) DETERMINATION.—Not later than 120 days after the date on which an investigation is initiated under sec-

tion 311(b) with respect to a petition, the Commission shall make the determination required under that section.

(b) APPLICABLE PROVISIONS.—For purposes of this subtitle, the provisions of paragraphs (1), (2), and (3) of section 330(d) of the Tariff Act of 1930 (19 U.S.C. 1330(d) (1), (2), and (3)) shall be applied with respect to determinations and findings made under this section as if such determinations and findings were made under section 202 of the Trade Act of 1974 (19 U.S.C. 2252).

(c) ADDITIONAL FINDING AND RECOMMENDATION IF DETERMINATION AFFIRMATIVE.—

(1) IN GENERAL.—If the determination made by the Commission under subsection (a) with respect to imports of an article is affirmative, or if the President may consider a determination of the Commission to be an affirmative determination as provided for under paragraph (1) of section 330(d) of the Tariff Act of 1930 (19 U.S.C. 1330(d)), the Commission shall find, and recommend to the President in the report required under subsection (d), the amount of import relief that is necessary to remedy or prevent the injury found by the Commission in the determination and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition.

(2) LIMITATION ON RELIEF.—The import relief recommended by the Commission under this subsection shall be limited to that described in section 313(c).

(3) VOTING; SEPARATE VIEWS.—Only those members of the Commission who voted in the affirmative under subsection (a) are eligible to vote on the proposed action to remedy or prevent the injury found by the Commission. Members of the Commission who did not vote in the affirmative may submit, in the report required under subsection (d), separate views regarding what action, if any, should be taken to remedy or prevent the injury.

(d) REPORT TO PRESIDENT.—Not later than the date that is 30 days after the date on which a determination is made under subsection (a) with respect to an investigation, the Commission shall submit to the President a report that includes—

(1) the determination made under subsection (a) and an explanation of the basis for the determination;

(2) if the determination under subsection (a) is affirmative, any findings and recommendations for import relief made under subsection (c) and an explanation of the basis for each recommendation; and

(3) any dissenting or separate views by members of the Commission regarding the determination and recommendation referred to in paragraphs (1) and (2).

(e) PUBLIC NOTICE.—Upon submitting a report to the President under subsection (d), the Commission shall promptly make public such report (with the exception of information which the Commission determines to be confidential) and shall cause a summary thereof to be published in the Federal Register.

SEC. 313. PROVISION OF RELIEF.

(a) IN GENERAL.—Not later than the date that is 30 days after the date on which the President receives the report of the Commission in which the Commission's determination under section 312(a) is affirmative, or which contains a determination under section 312(a) that the President considers to be affirmative under paragraph (1) of section 330(d) of the Tariff Act of 1930 (19 U.S.C. 1330(d)(1)), the President, subject to subsection (b), shall provide relief from imports of the article that is the subject of such determination to the extent that the President determines necessary to remedy or prevent the injury found by the Commission and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition.

(b) EXCEPTION.—The President is not required to provide import relief under this section if the President determines that the provision of the import relief will not provide greater economic and social benefits than costs.

(c) NATURE OF RELIEF.—

(1) IN GENERAL.—The import relief that the President is authorized to provide under this section with respect to imports of an article is as follows:

(A) The suspension of any further reduction provided for under Annex 2–B of the Agreement in the duty imposed on such article.

(B) An increase in the rate of duty imposed on such article to a level that does not exceed the lesser of—

(i) the column 1 general rate of duty imposed under the HTS on like articles at the time the import relief is provided; or

(ii) the column 1 general rate of duty imposed under the HTS on like articles on the day before the date on which the Agreement enters into force.

(2) PROGRESSIVE LIBERALIZATION.—If the period for which import relief is provided under this section is greater than 1 year, the President shall provide for the progressive liberalization of such re-

lief at regular intervals during the period in which the relief is in effect.

(d) PERIOD OF RELIEF.—

(1) IN GENERAL.—Subject to paragraph (2), any import relief that the President provides under this section may not, in the aggregate, be in effect for more than 3 years.

(2) EXTENSION.—

(A) IN GENERAL.—If the initial period for any import relief provided under this section is less than 3 years, the President, after receiving a determination from the Commission under subparagraph (B) that is affirmative, or which the President considers to be affirmative under paragraph (1) of section 330(d) of the Tariff Act of 1930 (19 U.S.C. 1330(d)(1)), may extend the effective period of any import relief provided under this section, subject to the limitation under paragraph (1), if the President determines that—

(i) the import relief continues to be necessary to remedy or prevent serious injury and to facilitate adjustment by the domestic industry to import competition; and

(ii) there is evidence that the industry is making a positive adjustment to import competition.

(B) ACTION BY COMMISSION.—

(i) INVESTIGATION.—Upon a petition on behalf of the industry concerned that is filed with the Commission not earlier than the date which is 9 months, and not later than the date which is 6 months, before the date any action taken under subsection (a) is to terminate, the Commission shall conduct an investigation to determine whether action under this section continues to be necessary to remedy or prevent serious injury and to facilitate adjustment by the domestic industry to import competition and whether there is evidence that the industry is making a positive adjustment to import competition.

(ii) NOTICE AND HEARING.—The Commission shall publish notice of the commencement of any proceeding under this subparagraph in the Federal Register and shall, within a reasonable time thereafter, hold a public hearing at which the

Commission shall afford interested parties and consumers an opportunity to be present, to present evidence, and to respond to the presentations of other parties and consumers, and otherwise to be heard.

(iii) REPORT.—The Commission shall transmit to the President a report on its investigation and determination under this subparagraph not later than 60 days before the action under subsection (a) is to terminate, unless the President specifies a different date.

(e) RATE AFTER TERMINATION OF IMPORT RELIEF.—When import relief under this section is terminated with respect to an article, the rate of duty on that article shall be the rate that would have been in effect, but for the provision of such relief, on the date on which the relief terminates.

(f) ARTICLES EXEMPT FROM RELIEF.—No import relief may be provided under this section on any article that has been subject to import relief under this subtitle after the date on which the Agreement enters into force.

SEC. 314. TERMINATION OF RELIEF AUTHORITY.

(a) GENERAL RULE.—Subject to subsection (b), no import relief may be provided under this subtitle after the

date that is 10 years after the date on which the Agreement enters into force.

(b) PRESIDENTIAL DETERMINATION.—Import relief may be provided under this subtitle in the case of an Omani article after the date on which such relief would, but for this subsection, terminate under subsection (a), if the President determines that Oman has consented to such relief.

SEC. 315. COMPENSATION AUTHORITY.

For purposes of section 123 of the Trade Act of 1974 (19 U.S.C. 2133), any import relief provided by the President under section 313 shall be treated as action taken under chapter 1 of title II of such Act (19 U.S.C. 2251 et seq.).

SEC. 316. CONFIDENTIAL BUSINESS INFORMATION.

Section 202(a)(8) of the Trade Act of 1974 (19 U.S.C. 2252(a)(8)) is amended in the first sentence—

(1) by striking "and"; and

(2) by inserting before the period at the end ", and title III of the United States-Oman Free Trade Agreement Implementation Act".

Subtitle B—Textile and Apparel Safeguard Measures

SEC. 321. COMMENCEMENT OF ACTION FOR RELIEF.

(a) IN GENERAL.—A request under this subtitle for the purpose of adjusting to the obligations of the United States under the Agreement may be filed with the President by an interested party. Upon the filing of a request, the President shall review the request to determine, from information presented in the request, whether to commence consideration of the request.

(b) PUBLICATION OF REQUEST.—If the President determines that the request under subsection (a) provides the information necessary for the request to be considered, the President shall cause to be published in the Federal Register a notice of commencement of consideration of the request, and notice seeking public comments regarding the request. The notice shall include a summary of the request and the dates by which comments and rebuttals must be received.

SEC. 322. DETERMINATION AND PROVISION OF RELIEF.

(a) DETERMINATION.—

(1) IN GENERAL.—If a positive determination is made under section 321(b), the President shall determine whether, as a result of the reduction or elimination of a duty under the Agreement, an

Omani textile or apparel article is being imported into the United States in such increased quantities, in absolute terms or relative to the domestic market for that article, and under such conditions as to cause serious damage, or actual threat thereof, to a domestic industry producing an article that is like, or directly competitive with, the imported article.

(2) SERIOUS DAMAGE.—In making a determination under paragraph (1), the President—

(A) shall examine the effect of increased imports on the domestic industry, as reflected in changes in such relevant economic factors as output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits, and investment, none of which is necessarily decisive; and

(B) shall not consider changes in technology or consumer preference as factors supporting a determination of serious damage or actual threat thereof.

(b) PROVISION OF RELIEF.—

(1) IN GENERAL.—If a determination under subsection (a) is affirmative, the President may provide relief from imports of the article that is the subject of such determination, as described in para-

graph (2), to the extent that the President determines necessary to remedy or prevent the serious damage and to facilitate adjustment by the domestic industry to import competition.

(2) NATURE OF RELIEF.—The relief that the President is authorized to provide under this subsection with respect to imports of an article is an increase in the rate of duty imposed on the article to a level that does not exceed the lesser of—

(A) the column 1 general rate of duty imposed under the HTS on like articles at the time the import relief is provided; or

(B) the column 1 general rate of duty imposed under the HTS on like articles on the day before the date on which the Agreement enters into force.

SEC. 323. PERIOD OF RELIEF.

(a) IN GENERAL.—Subject to subsection (b), any import relief that the President provides under subsection (b) of section 322 may not, in the aggregate, be in effect for more than 3 years.

(b) EXTENSION.—If the initial period for any import relief provided under section 322 is less than 3 years, the President may extend the effective period of any import relief provided under that section, subject to the limitation

set forth in subsection (a), if the President determines that—

(1) the import relief continues to be necessary to remedy or prevent serious damage and to facilitate adjustment by the domestic industry to import competition; and

(2) there is evidence that the industry is making a positive adjustment to import competition.

SEC. 324. ARTICLES EXEMPT FROM RELIEF.

The President may not provide import relief under this subtitle with respect to any article if—

(1) the article has been subject to import relief under this subtitle after the date on which the Agreement enters into force; or

(2) the article is subject to import relief under chapter 1 of title II of the Trade Act of 1974 (19 U.S.C. 2251 et seq.).

SEC. 325. RATE AFTER TERMINATION OF IMPORT RELIEF.

When import relief under this subtitle is terminated with respect to an article, the rate of duty on that article shall be the rate that would have been in effect, but for the provision of such relief, on the date on which the relief terminates.

SEC. 326. TERMINATION OF RELIEF AUTHORITY.

No import relief may be provided under this subtitle with respect to any article after the date that is 10 years after the date on which duties on the article are eliminated pursuant to the Agreement.

SEC. 327. COMPENSATION AUTHORITY.

For purposes of section 123 of the Trade Act of 1974 (19 U.S.C. 2133), any import relief provided by the President under this subtitle shall be treated as action taken under chapter 1 of title II of such Act.

SEC. 328. CONFIDENTIAL BUSINESS INFORMATION.

The President may not release information that is submitted in a proceeding under this subtitle and that the President considers to be confidential business information unless the party submitting the confidential business information had notice, at the time of submission, that such information would be released, or such party subsequently consents to the release of the information. To the extent a party submits confidential business information to the President in a proceeding under this subtitle, the party shall also submit a nonconfidential version of the information, in which the confidential business information is summarized or, if necessary, deleted.

TITLE IV—PROCUREMENT

SEC. 401. ELIGIBLE PRODUCTS.

Section 308(4)(A) of the Trade Agreements Act of 1979 (19 U.S.C. 2518(4)(A)) is amended—

(1) by striking "or" at the end of clause (iv);

(2) by striking the period at the end of clause (v) and inserting "; or"; and

(3) by adding at the end the following new clause:

"(vi) a party to the United States-Oman Free Trade Agreement, a product or service of that country or instrumentality which is covered under that Agreement for procurement by the United States.".

THE UNITED STATES-OMAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

STATEMENT OF ADMINISTRATIVE ACTION

This Statement of Administrative Action ("Statement") is submitted to the Congress consistent with section 2105(a)(1)(C)(ii) of the Bipartisan Trade Promotion Authority Act of 2002 ("TPA Act") and accompanies the implementing bill for the United States-Oman Free Trade Agreement ("Agreement"). The bill approves and makes statutory changes necessary or appropriate to implement the Agreement, which the United States Trade Representative signed on January 19, 2006.

This Statement describes significant administrative actions proposed to implement U.S. obligations under the Agreement.

In addition, incorporated into this Statement are two other statements required under section 2105(a) of the TPA Act: (1) an explanation of how the implementing bill and proposed administrative action will change or affect existing law; and (2) a statement setting forth the reasons why the implementing bill and proposed administrative action are necessary or appropriate to carry out the Agreement. The Agreement does not change the provisions of any agreement the United States has previously negotiated with Oman.

For ease of reference, this Statement generally follows the organization of the Agreement, with the exception of grouping the general provisions of the Agreement (Chapters One and Eighteen through Twenty-Two) at the beginning of the discussion.

For each chapter of the Agreement, the Statement describes the pertinent provisions of the implementing bill, explaining how the bill changes or affects existing law, and stating why those provisions are necessary or appropriate to implement the Agreement. The Statement then describes the administrative action proposed to implement the particular chapter of the Agreement, explaining how the proposed action changes existing administrative practice or authorizes further action and stating why such actions are necessary or appropriate to implement the Agreement.

It should be noted that this Statement does not, for the most part, discuss those many instances in which U.S. law or administrative practice will remain unchanged under the Agreement. In many cases, U.S. laws and regulations are already in conformity with the obligations assumed under the Agreement.

Finally, references in this Statement to particular sections of U.S. statutes are based on those statutes in effect as of the date this Statement was submitted to the Congress.

Chapters:
One (Initial Provisions and Definitions)
Eighteen (Transparency)
Nineteen (Administration of the Agreement)
Twenty (Dispute Settlement)
Twenty-One (Exceptions)
Twenty-Two (Final Provisions)

1. Implementing Bill

a. Congressional Approval

Section 101(a) of the implementing bill provides Congressional approval for the Agreement and this Statement, as required by sections 2103(b)(3) and 2105(a)(1) of the TPA Act.

b. Entry into Force

Article 22.5 of the Agreement requires the United States and Oman to exchange written notifications that their respective internal requirements for the entry into force of the Agreement have been fulfilled. The exchange of notifications is a necessary condition for the Agreement's entry into force. Section 101(b) of the implementing bill authorizes the President to exchange notes with Oman to provide for entry into force of the Agreement with respect to the United States on or after January 1, 2007. The exchange of notes is conditioned on a determination by the President that Oman has taken measures necessary to comply with those of its obligations that are to take effect at the time the Agreement enters into force.

Certain provisions of the Agreement become effective after the Agreement enters into force. For example, certain provisions relating to customs administration become effective with respect to Oman no later than two years after the Agreement enters into force. Likewise, certain provisions regarding financial services become effective with respect to Oman no later than three years after the Agreement enters into force. Finally, the transparency provisions of Chapter Seven (Technical Barriers to Trade) become effective with respect to both countries no later than five years after the Agreement enters into force.

c. Relationship to Federal Law

Section 102(a) of the bill establishes the relationship between the Agreement and U.S. law. The implementing bill, including the authority granted to federal agencies to promulgate implementing regulations, is intended to bring U.S. law fully into compliance with U.S. obligations under the Agreement. The bill accomplishes that objective with respect to federal legislation by amending existing federal statutes that would otherwise be inconsistent with the Agreement and, in certain instances, by creating entirely new provisions of law.

Section 102(a) clarifies that no provision of the Agreement will be given effect under domestic law if it is inconsistent with federal law, including provisions of federal law enacted or amended by the bill. Section 102(a) will not prevent implementation of federal statutes consistent with the Agreement, where permissible under the terms of such statutes. Rather, the section reflects the Congressional view that necessary changes in federal statutes should be specifically enacted rather than provided for in a blanket preemption of federal statutes by the Agreement.

The Administration has made every effort to include all laws in the implementing bill and to identify all administrative actions in this Statement that must be changed in order to conform with the new U.S. rights and obligations arising from the Agreement. Those include both regulations resulting from statutory changes in the bill itself and changes in laws, regulations, rules, and orders that can be implemented without a change in the underlying U.S. statute.

Accordingly, at this time it is the expectation of the Administration that no changes in existing federal law, rules, regulations, or orders other than those specifically indicated in the implementing bill and this Statement will be required to implement the new international obligations that the United States will assume under the Agreement. This is without prejudice to the President's continuing responsibility and authority to carry out U.S. law and agreements. As experience under the Agreement is gained over time, other or different administrative actions may be taken in accordance with applicable law to implement the Agreement. If additional action is called for, the Administration will seek legislation from Congress or, if a change in regulation is required, follow normal agency procedures for amending regulations.

d. Relationship to State Law

The Agreement's rules generally cover state and local laws and regulations, as well as those at the federal level. There are a number of exceptions to, or limitations on, this general rule, however, particularly in the areas of government procurement, labor and environment, investment, and cross-border trade in services and financial services.

The Agreement does not automatically "preempt" or invalidate state laws that do not conform to the Agreement's rules, even if a dispute settlement panel were to find a state measure inconsistent with the Agreement. The United States is free under the Agreement to determine how it will conform with the Agreement's rules at the federal and non-federal levels. The Administration is committed to carrying out U.S. obligations under the Agreement, as they apply to the states, through the greatest possible degree of state-federal consultation and cooperation.

Section 102(b)(1) of the bill makes clear that only the United States is entitled to bring an action in court in the event that there is an unresolved conflict between a state law, or the application of a state law, and the Agreement. The authority conferred on the United States under this paragraph is intended to be used only as a last resort, in the unlikely event that efforts to achieve consistency through consultations do not succeed.

The reference in section 102(b)(2) of the bill to the business of insurance is required by virtue of section 2 of the McCarran-Ferguson Act (15 U.S.C. 1012). That section states that no federal statute shall be construed to supersede any state law regulating or taxing the business of insurance unless the federal statute "specifically relates to the business of insurance." Certain provisions of the Agreement (for example, Chapter Twelve, relating to financial services) do apply to state measures regulating the insurance business, although "grandfathering" provisions in Chapter Twelve exempt existing inconsistent (*i.e.*, "non-conforming") measures.

Given the provision of the McCarran-Ferguson Act, the implementing bill must make specific reference to the business of insurance in order for the Agreement's provisions covering the insurance business to be given effect with respect to state insurance law. Insurance is otherwise treated in the same manner under the Agreement and the implementing bill as other financial services under the Agreement.

e. Private Lawsuits

Section 102(c) of the implementing bill precludes any private right of action or remedy against a federal, state, or local government, or against a private party, based on the provisions of the Agreement. A private party thus could not sue (or defend a suit against) the United States, a state, or a private party on grounds of consistency (or inconsistency) with the Agreement. The provision also precludes a private right of action attempting to require, preclude, or modify federal or state action on grounds such as an allegation that the government is required to exercise discretionary authority or general "public interest" authority under other provisions of law in conformity with the Agreement.

With respect to the states, section 102(c) represents a determination by the Congress and the Administration that private lawsuits are not an appropriate means for ensuring state compliance with the Agreement. Suits of this nature might interfere with the Administration's conduct of trade and foreign relations and with suitable resolution of disagreements or disputes under the Agreement.

Section 102(c) does not preclude a private party from submitting a claim against the United States to arbitration under Chapter Ten (Investment) of the Agreement or seeking to enforce an award against the United States issued pursuant to such arbitration. The provision also would not preclude any agency of government from considering, or entertaining argument on, whether its action or proposed action is consistent with the Agreement, although any change in agency action would have to be consistent with domestic law.

f. Implementing Regulations

Section 103(a) of the bill provides the authority for new or amended regulations to be issued, and for the President to proclaim actions implementing the provisions of the Agreement, as of the date the Agreement enters into force. Section 103(b) of the bill requires that, whenever possible, all federal regulations required or authorized under the bill and those proposed in this Statement as necessary or appropriate to implement immediately applicable U.S. obligations

the Agreement are to be developed and promulgated within one year of the Agreement's y into force. In practice, the Administration intends, wherever possible, to amend or issue other regulations required to implement U.S. obligations under the Agreement at the time the greement enters into force. The process for issuing regulations pursuant to this authority will comply with the requirements of the Administrative Procedures Act, including requirements to provide notice and an opportunity for public comment on such regulations. If issuance of any regulation will occur more than one year after the date provided in section 103(b), the officer responsible for issuing such regulation will notify the relevant committees of both Houses of the delay, the reasons for such delay, and the expected date for issuance of the regulation. Such notice will be provided at least 30 days prior to the end of the one-year period.

g. Dispute Settlement

Section 105(a) of the bill authorizes the President to establish within the Department of Commerce an office responsible for providing administrative assistance to dispute settlement panels established under Chapter Twenty of the Agreement. This provision enables the United States to implement its obligations under Article 20.3 of the Agreement. This office will not be an "agency" within the meaning of 5 U.S.C. 552, consistent with treatment provided under the United States-Bahrain Free Trade Agreement, the United States-CAFTA-DR Free Trade Agreement, the United States-Morocco Free Trade Agreement, the United States-Australia Free Trade Agreement, the United States-Chile Free Trade Agreement, the United States-Singapore Free Trade Agreement, the North American Free Trade Agreement ("NAFTA"), and the United States-Canada Free Trade Agreement. Thus, for example, the office will not be subject to the Freedom of Information Act or the Government in the Sunshine Act. Because they are international bodies, panels established under Chapter Twenty are not subject to those acts.

Section 105(b) of the bill authorizes the appropriation of funds to support the office established pursuant to section 105(a).

h. Effective Dates

Section 107(b) of the bill provides that the first three sections of the bill as well as Title I of the bill go into effect when the bill is enacted into law.

Section 107(a) provides that the other provisions of the bill and the amendments to other statutes made by the bill take effect on the date on which the Agreement enters into force. Section 107(c) provides that the provisions of the bill and the amendments to other statutes made by the bill will cease to be effective on the date on which the Agreement terminates.

2. Administrative Action

No administrative changes will be necessary to implement Chapters One, Eighteen, Twenty, Twenty-One, and Twenty-Two.

Article 19.1.1 of the Agreement requires each government to designate a contact point to

include denying preferential tariff treatment to a textile or apparel good for which a claim has been made that is the subject of the verification and denying entry of such a good into the United States. Such further appropriate action may remain in effect until the Secretary receives information sufficient to make a determination under section 204(a) or until such earlier date as the President may direct.

b. Textile and Apparel Safeguard

Article 3.1 of the Agreement establishes a special procedure and makes remedies available to domestic textile and apparel industries that have sustained or are threatened by serious damage from imports of textile or apparel goods that receive preferential tariff treatment under the Agreement. The Administration does not anticipate that the Agreement will result in damaging increases in textile or apparel imports from Oman. Nevertheless, the Agreement's textile and apparel safeguard procedure will ensure that relief is available, if needed.

The safeguard mechanism applies when, as a result of the elimination of a customs duty under the Agreement, textile or apparel goods from Oman that receive preferential tariff treatment are being imported into the United States in such increased quantities, in absolute or relative terms, and under such conditions as to cause serious damage or actual threat thereof to a U.S. industry producing like or directly competitive goods. In these circumstances, Article 3.1 permits the United States to increase duties on the imported goods to a level that does not exceed the lesser of the prevailing U.S. normal trade relations (most-favored-nation) ("NTR (MFN)") duty rate for the good or the U.S. NTR (MFN) duty rate in effect on the day before the Agreement entered into force.

Section 301(2) of the bill defines the term "Omani textile or apparel article" as an article listed in the Annex to the WTO Agreement on Textiles and Clothing that is also a Omani article, as defined in section 301(1).

Subtitle B of Title III of the bill (sections 321 through 328) implements the Agreement's textile and apparel safeguard provisions.

Section 321(a) of the bill provides that an interested party may file with the President a request for a textile or apparel safeguard measure. The President is to review a request initially to determine whether to commence consideration of the request on its merits.

Under section 321(b), if the President determines that the request contains information necessary to warrant consideration on the merits, the President must provide notice in the *Federal Register* stating that the request will be considered and seeking public comments on the request. The notice will contain a summary of the request itself and the dates by which comments and rebuttals must be received. Subject to protection of confidential business information, if any, the full text of the request will be made available on the Department of Commerce, International Trade Administration's website.

If the President determines under section 321 that a request contains the information necessary for it to be considered, then section 322 sets out the procedures to be followed in considering the request. Section 322(a)(1) of the bill provides for the President to determine whether, as a result of the elimination of a duty provided for under the Agreement, an Omani textile or apparel article is being imported into the United States in such increased quantities, in absolute terms or relative to the domestic market for that article, and under such conditions that imports of the article are causing serious damage, or actual threat thereof, to a domestic industry producing an article that is like, or directly competitive with, the imported article. This determination corresponds to the determination required under Article 3.1.1 of the Agreement. Section 322(a)(2) of the bill includes criteria for determining serious damage or actual threat thereof, consistent with Article 3.1.2 of the Agreement.

Section 322(b) of the bill identifies the relief that the President may provide to a U.S. industry that the President determines is facing serious damage or actual threat thereof. Such relief may consist of an increase in duties to the lower of: (1) the NTR (MFN) duty rate in place for the textile or apparel article at the time the relief is granted; or (2) the NTR (MFN) duty rate for that article on the day before the Agreement enters into force.

Section 323 of the bill provides that the maximum period of relief under the textile and apparel safeguard is three years. However, if the initial period of import relief is less than three years, the President may extend the relief (to a maximum aggregate period of three years) if the President determines that continuation is necessary to remedy or prevent serious damage and to facilitate adjustment, and that the domestic industry is, in fact, adjusting to import competition.

Section 324 of the bill provides that relief may not be granted to an article under the textile and apparel safeguard if: (1) relief previously has been granted to that article under the textile and apparel safeguard; or (2) the article is subject, or becomes subject, to a safeguard measure under chapter 1 of title II of the Trade Act of 1974.

Section 325 of the bill provides that on the date of termination of import relief, imports of the textile or apparel article that was subject to the safeguard action will be subject to the rate of duty that would have been in effect on that date in the absence of the relief.

Section 326 of the bill provides that authority to provide relief under the textile and apparel safeguard with respect to any Omani article will expire 10 years after duties on the article are eliminated.

Under Article 3.1.6 of the Agreement, if the United States provides relief to a domestic industry under the textile and apparel safeguard, it must provide Oman "mutually agreed trade liberalizing compensation in the form of concessions having substantially equivalent trade effects or equivalent to the value of the additional duties expected to result from the emergency action." If the United States and Oman are unable to agree on trade liberalizing compensation, Oman may increase customs duties equivalently on U.S. goods. The obligation to provide compensation terminates upon termination of the safeguard relief.

Section 123 of the Trade Act of 1974 (19 U.S.C. 2133), as amended, authorizes the President to provide trade compensation for global safeguard measures taken pursuant to chapter 1 of title II of the Trade Act of 1974. Section 327 of the implementing bill extends that authority to measures taken pursuant to the Agreement's textile and apparel safeguard provisions.

Finally, section 328 of the bill provides that confidential business information submitted in the course of consideration of a request for a textile or apparel safeguard may not be released absent the consent of the party providing the information. It also provides that a party submitting confidential business information in a textile or apparel safeguard proceeding must submit a non-confidential version of the information or a summary of the information.

2. Administrative Action

a. Enforcement of Textile and Apparel Rules of Origin

Section 204 of the bill governs situations in which U.S. customs officials request that Oman initiate verifications regarding enforcement of textile and apparel rules of origin. Following a U.S. request for a verification, the Committee for the Implementation of Textile Agreements ("CITA"), an interagency entity created by Executive Order 11651 that carries out certain textile trade policies for the United States by delegation of authority from the President, may direct U.S. officials to take appropriate action described in section 204(b) of the bill while the verification is being conducted. U.S. customs officials will determine whether the exporter or producer that is subject to the verification is complying with applicable customs rules, and whether statements regarding the origin of textile or apparel goods exported or produced by that firm are accurate. If U.S. customs officials determine that an exporter or producer is not complying with applicable customs rules or that it is making false statements regarding the origin of textile or apparel goods, they will report their findings to CITA. Similarly, if U.S. customs officials are unable to make the necessary determination (*e.g.*, due to lack of cooperation by the exporter or producer), they will report that fact to CITA. CITA may direct U.S. officials to take appropriate action described in section 204(d) in the case of an adverse determination or a report that customs officials are unable to make the necessary determination. If the appropriate action includes denial of preferential tariff treatment or denial of entry, CITA will issue an appropriate directive.

Section 204 of the bill provides the exclusive basis in U.S. law for CITA to direct appropriate action implementing Article 3.3 of the Agreement.

b. Textile and Apparel Safeguard

The function of receiving requests for textile and apparel safeguard measures under section 321 of the bill, making determinations of serious damage or actual threat thereof under section 322(a), and providing relief under section 322(b) will be performed by CITA, pursuant to a delegation of the President's authority under the bill. CITA will issue procedures for requesting such safeguard measures, for making its determinations under section 322(a), and for providing relief under section 322(b).

Chapter Four (Rules of Origin)

1. Implementing Bill

a. General

Section 202 of the implementing bill codifies the general rules of origin set forth in Chapter Four of the Agreement. These rules apply only for the purposes of this bill and for the purposes of implementing the customs duty treatment provided under the Agreement. An originating good of Oman for the purposes of this bill would not necessarily be a good of, or import from, Oman for the purposes of other U.S. laws or regulations.

For a good entering the United States to qualify as an originating good, it must be imported directly from Oman. Additionally, it must be covered by one of three specified categories. First, a good is an originating good if it is "wholly the growth, product, or manufacture of Oman or the United States, or both." The term "good wholly the growth, product, or manufacture of Oman or the United States, or both" is defined in section 202(i)(3) of the bill and includes, for example, minerals extracted in either country, animals born and raised in either country, and waste and scrap derived from production of goods that takes place in the territory of either or both countries.

The term "good wholly the growth, product, or manufacture of Oman or the United States, or both" includes "recovered goods." These are parts resulting from the disassembly of used goods, which are brought into good working condition, in order to be combined with other recovered goods and other materials to form a "remanufactured good." The term "remanufactured good" is separately defined in section 202(i)(9) to mean an industrial good assembled in the territory of Oman or the United States that: (1) is entirely or partially comprised of recovered goods; (2) has a similar life expectancy to a like good that is new; and (3) enjoys a factory warranty similar to that of a like good that is new.

Second, a good is an "originating good" if it is a "new or different article of commerce" that has been grown, produced, or manufactured in Oman or the United States, or both. Under this category, the sum of: (1) the value of the materials produced in Oman or the United States, or both; and (2) the "direct costs of processing operations" performed in Oman or the United States, or both, must be at least 35 percent of the appraised value of the good at the time it is entered into the territory of either country. This category does not apply to goods specified in Annex 3-A or Annex 4-A of the Agreement.

This second category incorporates two defined terms. The term "new or different article of commerce" is defined under section 202(i)(7) of the bill as "a good [ ] that has been substantially transformed from a good or material that is not wholly the growth, product, or manufacture of Oman or the United States, or both; and [that] has a new name, character, or use distinct from the good or material from which it was transformed." The term "direct costs of

processing operations," defined in section 202(i)(1) of the bill, refers to costs directly incurred in, or that can be reasonably allocated to, the growth, production, or manufacture of a good. It includes a variety of types of costs, such as labor costs, depreciation on machinery or equipment, research and development, inspection costs, and packaging costs, among others.

Third, a good is an "originating good" if it meets the product-specific rules set out in Annex 3-A or Annex 4-A of the Agreement and satisfies all other applicable requirements of section 202. In general, Annex 3-A and Annex 4-A of the Agreement require that non-originating materials used in the production of a good undergo a change in tariff classification, as specified in each Annex, as a result of production occurring entirely in the territory of Oman or the United States, or both.

The remainder of section 202 of the implementing bill sets forth specific rules that supplement the rules for qualifying under the second and third categories just described. For example, section 202(e) provides that "[p]ackaging and packing materials and containers for retail sale and shipment shall be disregarded in determining whether a good qualifies as an originating good, except to the extent that the value of such packaging and packing materials and containers has been included in meeting the requirements set forth in subsection (b)(2)." Other provisions in section 202 address valuation of materials and rules regarding indirect materials, transit and transshipment, and a variety of other matters.

b. Proclamation Authority

Section 202(j)(1) of the bill authorizes the President to proclaim the specific rules of origin in Annex 3-A and Annex 4-A of the Agreement, as well as any additional subordinate rules necessary to carry out the customs duty provisions of the bill consistent with the Agreement. In addition, section 202(j)(2) gives authority to the President to modify certain of the Agreement's specific origin rules by proclamation, subject to the consultation and layover provisions of section 104 of the bill. (*See* discussion under item 1.a of Chapter Two, above.)

Various provisions of the Agreement expressly contemplate modifications to the rules of origin. For example, Article 3.2.3 calls for the United States and Oman to consult at either country's request to consider whether rules of origin for particular textile or apparel goods should be revised in light of the availability of fibers, yarns, or fabrics in their respective territories. In addition, Article 4.13 provides that, within six months of the date of entry into force of the Agreement, the United States and Oman will endeavor to develop to the extent practicable a regional cumulation regime covering the United States and Middle Eastern countries that have free trade agreements with the United States.

Section 202(j)(2) of the bill expressly limits the President's authority to modify by proclamation specific rules of origin pertaining to textile or apparel goods (listed in Chapters 50 through 63 of the HTS and identified in Annex 3-A of the Agreement). Those rules of origin may be modified by proclamation in only two circumstances: (1) to implement an agreement with Oman pursuant to Article 3.2.5 of the Agreement to address the commercial availability of particular fibers, yarns, or fabrics; and (2) to correct typographical, clerical, or other non-

substantive technical errors within one year of enactment of the implementing bill.

c. Claims for Preferential Tariff Treatment

Article 4.11.4 of the Agreement provides that an importer may claim preferential tariff treatment for an originating good within one year of importation, even if no such claim was made at the time of importation. In seeking a refund for excess duties paid, the importer must provide to the customs authorities information substantiating that the good was in fact an originating good at the time of importation.

Section 205 of the bill implements U.S. obligations under Article 4.11.4 of the Agreement by amending section 520(d) of the Tariff Act of 1930 (19 U.S.C. 1520(d)) to allow an importer to claim preferential tariff treatment for originating goods within one year of their importation.

2. Administrative Action

The rules of origin in Chapter Four of the Agreement are intended to direct the benefits of customs duty elimination under the Agreement principally to firms producing or manufacturing goods in Oman and the United States. For this reason, the rules ensure that, in general, a good is eligible for benefits under the Agreement only if it: (1) is wholly grown, produced, or manufactured in one or both countries; (2) has been substantially transformed from a good or material that is not wholly grown, produced, or manufactured in one or both countries; or (3) meets specific "tariff shift" rules identified for particular products.

a. Claims for Preferential Tariff Treatment

Section 206 of the bill authorizes the Secretary of the Treasury to prescribe regulations necessary to carry out the tariff-related provisions of the bill, including the rule of origin provisions. The Department of the Treasury will use this authority in part to promulgate any regulations necessary to implement the Agreement's provisions governing claims for preferential tariff treatment. Under Article 4.10(a) of the Agreement, an importer claiming preferential tariff treatment is deemed to have certified that the good qualifies for such treatment. Under Article 4.10(b), an importer may be requested to explain in a detailed declaration the basis for such a claim. Article 4.11.1 requires that a claim for preferential tariff treatment be granted unless customs officials have information indicating that the importer's claim fails to comply with the Agreement's rules of origin. Article 4.11.3 requires a Party to provide a written determination, with factual and legal findings, if it denies a claim.

b. Verification

Under Article 4.11.2, a Party may verify claims that goods imported from Oman satisfy the Agreement's rules of origin. Article 3.3 sets out special procedures for verifying claims that textile or apparel goods imported from Oman meet the Agreement's origin rules. U.S. officials will carry out verifications under Articles 4.11.2 and 3.3 of the Agreement pursuant to authorities

under current law. For example, section 509 of the Tariff Act of 1930 (19 U.S.C. 1509) provides authority to examine records and issue summonses to determine liability for duty and ensure compliance with U.S. customs laws.

Chapter Five (Customs Administration)

1. Implementing Bill

No statutory changes will be required to implement Chapter Five.

2. Administrative Action

a. Inquiry Point

Article 5.1.2 of the Agreement requires each country to designate an inquiry point for inquiries from interested persons on customs matters. The U.S. Bureau of Customs and Border Protection ("BCBP") will serve as the U.S. inquiry point for this purpose. Consistent with Article 5.1.2, the BCBP will post information on the Internet at "www.cbp.gov" concerning how interested persons can make customs-related inquiries.

b. Advance Rulings

Treasury regulations for advance rulings under Article 5.10 of the Agreement (on classification, valuation, duty drawback, qualification as an "originating good," and duty-free treatment of goods returned to the United States after repair or alteration in Oman) will parallel in most respects existing regulations in Part 177 of the Customs Regulations for obtaining advance rulings. Consistent with Article 5.10.2 of the Agreement, advance rulings will be required to be issued within 150 days of receipt by customs officials of all information reasonably required to process the application for the ruling.

Chapter Six (Sanitary and Phytosanitary Measures)

No statutory or administrative changes will be required to implement Chapter Six.

Chapter Seven (Technical Barriers to Trade)

1. Implementing Bill

No statutory changes will be required to implement Chapter Seven.

2. Administrative Action

Article 7.7 of the Agreement calls for each government to designate an official to coordinate with interested parties in its territory on bilateral issues and initiatives regarding technical barriers to trade ("TBT"), and to communicate with the other government on such matters. A USTR official responsible for TBT matters or trade relations with Oman will serve as the U.S. TBT Chapter Coordinator.

Chapter Eight (Safeguards)

1. Implementing Bill

Subtitle A of Title III of the bill implements in U.S. law the bilateral safeguard provisions set out in Chapter Eight of the Agreement. (As discussed under Chapter Three (Textiles and Apparel), above, Subtitle B of Title III of the bill implements the textile and apparel safeguard provisions of the Agreement.)

Sections 311 through 316 of the bill authorize the President to suspend duty reductions or impose duties temporarily at NTR (MFN) rates on an "Omani article" when, after an investigation, the ITC determines that as a result of the reduction or elimination of a duty under the Agreement, the article is being imported into the United States in such increased quantities and under such conditions as to be a substantial cause of serious injury or threat of serious injury to a domestic industry that produces a like or directly competitive good. The standards and procedures set out in these provisions closely parallel the procedures set out in sections 201 through 204 of the Trade Act of 1974.

Section 301(1) defines the term "Omani article" for purposes of the safeguard provisions to mean a good qualifying as an "originating good" under section 202(b) of the bill or a textile or apparel good containing non-originating fabric or yarn that receives preferential tariff treatment under Articles 3.2.8 and 3.2.9 of the Agreement.

Section 311 provides for the filing of petitions with the ITC and for the ITC to conduct bilateral safeguard investigations. Section 311(a) provides that a petition requesting a bilateral safeguard action may be filed by an entity that is "representative of an industry." As under section 202(a)(1) of the Trade Act of 1974, the term "entity" includes a trade association, firm, certified or recognized union, or a group of workers.

Section 311(b) sets out the standard to be used by the ITC in undertaking an investigation and making a determination in bilateral safeguard proceedings.

Section 311(c) makes applicable by reference several provisions of the Trade Act of 1974. These are the definition of "substantial cause" in section 202(b)(1)(B), the factors listed in section 202(c) applied in making determinations, the hearing requirement of section 202(b)(3), and the provisions of section 202(i) permitting confidential business information to be made available under protective order to authorized representatives of parties to a safeguard investigation.

Section 311(d) exempts from investigation under this section an Omani article that has been subject to a safeguard measure under Subtitle A of Title III of the bill after the Agreement's entry into force. In other words, a safeguard measure under Subtitle A of Title III of the bill may be applied only once for a particular good.

Section 312(a) establishes deadlines for ITC determinations following an investigation under section 311(b). The ITC must make its injury determination within 120 days of the date on which it initiates an investigation.

Section 312(b) makes applicable the provisions of section 330(d) of the Tariff Act of 1930, which will apply when the ITC Commissioners are equally divided on the question of injury or remedy.

Under section 312(c), if the ITC makes an affirmative injury determination, or a determination that the President may consider to be an affirmative determination under section 312(b), it must find and recommend to the President the amount of import relief that is necessary to remedy or prevent the serious injury and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition. The relief that may be recommended by the ITC is limited to that authorized in section 313(c). Similar to procedures under the global safeguards provisions in current law, section 312(c) of the bill provides that only those members of the ITC who agreed to the affirmative determination under section 312(a) may vote on the recommendation of relief under section 312(c).

Under section 312(d), the ITC is required to transmit a report to the President not later than 30 days after making its injury determination. The ITC's report must include: (1) the ITC's determination under section 312(a) and the reasons supporting it; (2) if the determination under section 312(a) is affirmative or may be considered to be affirmative by the President, any findings and recommendations for import relief and an explanation of the basis for each recommendation; and (3) any dissenting or separate views of ITC Commissioners. Section 312(e) requires the ITC to publish its report promptly and to publish a summary of the report in the *Federal Register.*

Under section 313(a) of the bill, the President is directed, subject to section 313(b), to take action not later than 30 days after receiving a report from the ITC containing an affirmative determination or a determination that the President may consider to be an affirmative determination. The President must provide import relief to the extent that the President determines is necessary to remedy or prevent the injury found by the ITC and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition. Under section 313(b), the President is not required to provide import relief if the President determines that the relief will not provide greater economic and social benefits than costs.

Section 313(c)(1) sets forth the nature of the relief that the President may provide. In general, the President may take action in the form of:

- a suspension of further reductions in the rate of duty to be applied to the articles in question; or

- an increase in the rate of duty on the articles in question to a level that does not exceed the lesser of the existing NTR (MFN) rate or the NTR (MFN) rate of duty imposed on the day before the Agreement entered into force.

Under section 313(c)(2), if the relief the President provides has a duration greater than one year, the relief must be subject to progressive liberalization at regular intervals over the course of its application.

Section 313(d) of the bill provides that the maximum period of import relief under the bilateral safeguard is three years. However, if the initial period of import relief is less than three years, the President may extend the relief (to a maximum aggregate period of three years) if the President determines that continuation of relief is necessary to remedy or prevent serious injury and to facilitate adjustment to import competition, and that there is evidence that the industry is making a positive adjustment to import competition. That determination must follow an affirmative determination by the ITC to the same effect, or a determination that the President may consider to be an affirmative determination.

Section 313(e) specifies the duty rate to be applied to Omani articles after termination of a bilateral safeguard action. On the termination of relief, the rate of duty on that article is the rate that would have been in effect, but for the provision of such relief, on the date the relief terminates.

Section 313(f) exempts from relief an Omani article that already has been subject to a safeguard measure under Subtitle A of Title III of the bill. In other words, a safeguard measure under Subtitle A may be applied only once for a particular good.

Section 314 provides that the President's authority to take action under the bilateral safeguard provision expires 10 years after the date on which the Agreement enters into force. The President may take action under the bilateral safeguard provision after that period, but only if the President determines that the Government of Oman consents.

Section 315 allows the President to provide trade compensation to Oman, as required under Article 8.3 of the Agreement, when the United States imposes relief through a bilateral safeguard action. Section 315 provides that for purposes of section 123 of the Trade Act of 1974, which allows the President to provide compensation for global safeguards, any relief provided under section 313 will be treated as an action taken under the global safeguard provisions of U.S. law (sections 201 through 204 of the Trade Act of 1974).

Section 316 amends section 202(a) of the Trade Act of 1974 to provide that the procedures in section 332(g) of the Tariff Act of 1930 with respect to the release of confidential business information are to apply to bilateral safeguard investigations.

The Administration has not provided classified information to the ITC in past safeguard proceedings and does not expect to provide such information in future proceedings. In the unlikely event that the Administration provides classified information to the ITC in such proceedings, that information would be protected from publication in accordance with Executive Order 12958, as amended.

2. Administrative Action

No administrative changes will be required to implement Chapter Eight.

Chapter Nine (Government Procurement)

1. Implementing Bill

In order to comply with its obligations under Chapter Nine, the United States must waive the application of certain laws, regulations, procedures, and practices that ordinarily treat foreign goods and services and suppliers of such goods and services less favorably than U.S. goods, services, and suppliers. Section 301(a) of the Trade Agreements Act of 1979 (19 U.S.C. 2511(a)) authorizes the President to waive the application of such laws, regulations, procedures, and practices with respect to "eligible products" of a foreign country designated under section 301(b) of that Act. The President has delegated this authority to the United States Trade Representative. Section 401 of the implementing bill amends the definition of "eligible product" in section 308(4)(A) of the Trade Agreements Act. As amended, section 308(4)(A) will provide that, for a party to the United States-Oman Free Trade Agreement, an "eligible product" means "a product or service of that country or instrumentality which is covered under the free trade agreement for procurement by the United States." This amended definition, coupled with the President's exercise of authority under section 301(a) of the Trade Agreements Act as delegated to the United States Trade Representative, will allow for non-discriminatory procurement of products and services of Oman.

2. Administrative Action

Annex 9-A of the Agreement establishes dollar thresholds for procurements above which U.S. government procuring entities must allow Omani suppliers to bid in accordance with the rules set forth in Chapter Nine. USTR will notify the Federal Acquisition Regulatory ("FAR") Council of the thresholds that pertain to Oman under the Agreement. The FAR Council will then incorporate those thresholds into the Federal Acquisition Regulations.

Chapter Ten (Investment)

1. Implementing Bill

Section 106 of the bill authorizes the United States to use binding arbitration to resolve

claims by Omani investors or by their covered investments in the United States under Article 10.15.1(a)(i)(C) or Article 10.15.1(b)(i)(C) of the Agreement. Those articles concern disputes over certain types of government contracts, and section 106 of the bill clarifies that the United States consents to the arbitration of such disputes. No statutory authorization is required for the United States to engage in binding arbitration for other claims covered by Article 10.15. Provisions allowing arbitration of contract claims have regularly been included in U.S. bilateral investment treaties over recent decades, and were included in the free trade agreements with Morocco, Chile, and Singapore.

2. **Administrative Action**

No administrative changes will be required to implement Chapter Ten.

Chapter Eleven (Cross-Border Trade in Services)

No statutory or administrative changes will be required to implement Chapter Eleven.

Chapter Twelve (Financial Services)

No statutory or administrative changes will be required to implement Chapter Twelve.

Chapter Thirteen (Telecommunications)

No statutory or administrative changes will be required to implement Chapter Thirteen.

Chapter Fourteen (Electronic Commerce)

No statutory or administrative changes will be required to implement Chapter Fourteen.

Chapter Fifteen (Intellectual Property Rights)

No statutory or administrative changes will be required to implement Chapter Fifteen.

Chapter Sixteen (Labor)

1. **Implementing Bill**

No statutory changes will be required to implement Chapter Sixteen.

2. Administrative Action

Article 16.4.2 of the Agreement calls for each country to designate an office to serve as the contact point for implementing the Agreement's labor provisions. The Department of Labor's Bureau of International Labor Affairs will serve as the U.S. contact point for this purpose.

The Administration welcomes the commitments provided by the Minister of Commerce & Industry of Oman, in a letter to Ambassador Portman dated May 8, 2006, describing the actions that Oman will take to improve and enforce its labor laws. In light of strong Congressional interest in this matter, the Administration intends to update the Congress periodically on the progress that Oman achieves in realizing all commitments made to labor law reform.

Chapter Seventeen (Environment)

1. Implementing Bill

No statutory changes will be required to implement Chapter Seventeen.

2. Administrative Action

Article 17.8.1 of the Agreement provides that either Party may request consultations with the other concerning any matter arising under the Chapter and contemplates that each Party will designate a contact point to receive such requests. USTR's Office of Environment and Natural Resources will serve as the U.S. contact point for this purpose.

SENATE FINANCE COMMITTEE
STATEMENT OF INFORMATION REQUESTED OF NOMINEE

The Committee requests the nominee provide the following information in a single written statement by typing each question in full followed by the nominee's response. Please provide three copies of your typed statement to Carla Martin, Chief Clerk, 219 Dirksen Senate Office Building, Washington, D.C. 20510.

A. BIOGRAPHICAL INFORMATION

1. Name: (Include any former names used.)

   Henry Merritt Paulson, Jr.
   (Hank)

2. Position to which nominated:

   Secretary of Treasury

3. Date of nomination:

   June 19, 2006.

4. Address: (List current residence, office, and mailing addresses.)

   Home (also mailing): [redacted]

   Office (also mailing): [redacted]

5. Date and place of birth:

   [redacted]

6. Marital status: (Include maiden name of wife or husband's name.)

[redacted]

7. Names and ages of children:

[redacted]

8. Education: (List secondary and higher education institutions, dates attended, degree received, and date degree granted.)

Barrington High School
1960 - 1964 High School Diploma June 1964

Dartmouth College
1964 – 1968 B.A. June 1968

Harvard Business School
1968-1970 M.B.A. June 1970

9. Employment record: (List all jobs held since college, including the title or description of job, name of employer, location of work, and dates of employment.)

1970 - 1972	Comptroller, Analysis Group	U.S. Department of Defense	Washington, DC
1972 - 1974	Staff Assistant	White House	Washington, DC
1974 - 1977	Associate		Chicago, IL
1977 - 1982	Vice President		Chicago, IL
1982 - 1999	Partner		Chicago, IL/New York, NY
1983 - 1988	Head of Investment Banking Services for Midwest Region	Goldman Sachs	Chicago, IL
1988 - 1990	Managing Partner for Chicago Office		Chicago, IL
1990 - 1994	Co-Head of Investment Banking		Chicago, IL/New York, NY

1994 - 1997	Vice Chairman & Chief Operating Officer		New York, NY
1997 - 1998	President & Chief Operating Officer		New York, NY
1998 - 1999	Co-Senior Partner		New York, NY
1999 - present	Chairman & Chief Executive Officer		New York, NY

10. Government experience: (List any advisory, consultative, honorary, or other part-time service or positions with Federal, State or local governments, other than those listed above.)

President's Export Council.

11. Business relationships: (List all positions held as an officer, director, trustee, partner, proprietor, agent, representative, or consultant of any corporation, company, firm, partnership, other business enterprise, or educational or other institution.)

The Goldman Sachs Group, Inc.: Chairman & Chief Executive Officer
Harvard Business School: Dean's Advisory Board Member
Indian School of Business: Governing Board Member
Tsinghua University School of Economics and Management: Advisory Board Member
The Bobolink Foundation: Co-Trustee
Henry M. Paulson, Jr. Family Trust: Trustee
Catalyst, Inc.: Director
Financial Services Forum: Chairman
The Nature Conservancy: Chairman
Asia Pacific Council of the Nature Conservancy: Co-Chairman

12. Memberships: (List all memberships and offices held in professional, fraternal, scholarly, civic, business, charitable, and other organizations.)

Member Only:

Alfalfa Club, Membership
Business Council: Corporate Member
Business Roundtable: Corporate Member
Catalyst: Corporate Board Member
Chicago Club: Non-resident Member

Commercial Club of Chicago: Non-resident Member
Committee to Encourage Corporate Philanthropy: Corporate Member
Economic Club of Chicago: Non-resident Member
First Church of Christ, Scientist: Member

13. Political affiliations and activities:

a. List all public offices for which you have been a candidate.

N/A

b. List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Chair of a New York reception honoring President Bush (2003).

Chair of a New York fundraiser for the NRCC (2003).

Served as State Finance Committee member for Bush/Cheney '04 (2003).

Served on a fundraising committee for Senatorial candidate Jack Ryan (2004).

Vice Chairman, New York City Host Committee, Republican National Convention (2004).

c. Itemize all political contributions to any individual, campaign organization, political party, political action committee, or similar entity of $50 or more for the past 10 years.

Date	Recipient	Amount
4/26/06	Goldman Sachs Group, Inc. PAC	$5,000.00
1/31/06	VOLPAC	$5,000.00
12/30/05	Enzi for US Senate	$2,100.00
12/16/05	Friends of Roy Blunt	$2,100.00
12/14/05	Sue Kelly for Congress	$2,100.00
12/13/05	Stevens for Senate	$2,100.00
12/13/05	Crapo for U.S. Senate	$2,100.00
8/29/05	Baker for Congress (campaign did not realize limits had been increased)	-$100.00
8/19/05	Baker for Congress (campaign did not realize limits had been increased)	-$100.00
7/21/05	Team Sununu	$2,100.00
7/21/05	Friends of John Boehner	$2,100.00

7/21/05	Baker for Congress	$2,100.00
7/21/05	Baker for Congress	$2,100.00
7/21/05	NRCC	$15,000.00
7/21/05	Cantor for Congress	$2,100.00
7/21/05	McCrery for Congress Committee	$2,100.00
7/21/05	TOMPAC	$5,000.00
7/21/05	Chambliss for Congress	$2,100.00
5/19/05	Goldman Sachs Group, Inc. PAC	$5,000.00
5/3/05	NRSC	$25,000.00
10/15/04	Citizens for Arlen Specter	$2,000.00
10/6/04	Martinez for Senate	$2,000.00
10/6/04	Reynolds for Congress	$2,000.00
9/15/04	DeMint for Senate Committee, Inc.	$2,000.00
9/15/04	Richard Burr Committee	$2,000.00
9/15/04	Baker for Congress	$2,000.00
9/15/04	Defend America PAC	$5,000.00
9/15/04	Grassley Committee Incorporates	$2,000.00
5/20/04	Citizens for Gillmor	$2,000.00
5/17/04	Shelley Moore Capito for Congress	$2,000.00
5/17/04	TOMPAC	$500.00
5/17/04	Shelby for US Senate	$2,000.00
5/17/04	Richard Burr Committee	$2,000.00
2/4/04	Goldman Sachs Group, Inc. PAC	$5,000.00
12/8/03	VOLPAC	$5,000.00
12/5/03	Portman for Congress Committee	$2,000.00
12/5/03	Cantor for Congress	$2,000.00
12/5/03	Missourians for Kit Bond	$1,000.00
12/5/03	Crapo for U.S. Senate	$1,000.00
12/5/03	Citizens for Arlen Specter	$1,000.00
12/1/03	NRSC	$10,000.00
9/18/03	Jack Ryan for US Senate	$2,000.00
6/25/03	Bush-Cheney '04	$2,000.00
6/25/03	NRCC	$15,000.00
6/19/03	League of Conservation Voters PAC	$5,000.00
3/10/03	TOMPAC	$2,500.00
2/12/03	Goldman Sachs Group, Inc. PAC	$5,000.00
1/9/03	Shelby for US Senate	$2,000.00
9/23/02	NRSC, Non-Federal	$50,000.00
6/20/02	NRCC	$5,000.00
6/14/02	Team Sununu	$1,000.00
5/16/02	NRSC	$10,000.00
4/1/02	League of Conservation Voters PAC	$5,000.00
3/26/02	Goldman Sachs Group, Inc. PAC	$2,000.00
4/18/01	Goldman Sachs Group, Inc. PAC	$2,000.00
7/28/00	RNC, Republican Nat'l State Elections	$40,000.00

	Committee	
5/30/00	RNC, Presidential Trust, Non-Federal	$10,000.00
3/14/00	Goldman Sachs Group, Inc. PAC	$5,000.00
2/18/00	McCain 2000, Inc.	$1,000.00
2/11/00	Friends of Phil Gramm	$1,000.00
9/27/99	League of Conservation Voters PAC	$5,000.00
6/21/99	Committee to Re-Elect Marge Roukema	$1,000.00
3/26/99	Bill Bradley for President Committee	$1,000.00
1/18/99	Goldman Sachs Group, Inc. PAC	$1,250.00
11/2/98	Mark Udall for Congress	$500.00
10/26/98	Mike Ferguson for Congress	$1,000.00
9/14/98	Freedom Project	$2,500.00
9/14/98	NRCC	$2,500.00
8/19/98	League of Conservation Voters PAC	$5,000.00
7/20/98	Hagel for Senate	$1,000.00
4/23/98	Lazio for Congress	$1,000.00
4/2/98	McCain for Senate '98	$1,000.00
1/30/98	Goldman Group, Inc. PAC	$2,000.00
11/04/97	NRSC	$10,000.00
9/2/97	NRCC	$10,000.00
8/13/97	Emily's List	$500.00
5/20/97	Evan Bayh Committee	$1,000.00
3/14/97	Citizens for Arlen Specter	$1,000.00
1/30/97	Goldman Sachs Group, Inc. PAC	$3,000.00
10/28/96	NRSC, Non-Federal	$25,000.00
4/25/96	NRSC	$10,000.00
3/15/96	Friends of Schumer	$1,000.00
2/23/96	Goldman Sachs Group, Inc. PAC	$2,500.00
2/2/96	Zimmer for Senate	$1,000.00
2/2/96	Zimmer for Senate	$1,000.00
1/3/96	Idaho 2000 (Idaho Democratic Party in connection with Minick Senate race)	$5,000.00

14. Honors and Awards: (List all scholarships, fellowships, honorary degrees, honorary society memberships, military medals, and any other special recognitions for outstanding service or achievement.)

N/A

15. Published writings: (List the titles, publishers, and dates of all books, articles, reports, or other published materials you have written.)

- *Cafta is the American Way*, Wall Street Journal, July 14, 2005;
- *Under the Same Sky*, Finance Manager Magazine, February, 2005;

- *Trustworthy Observer*, Financial Times, May 2, 2003;
- *Good for All Americans*, Wall Street Journal, March 19, 2003;
- *China's Entry into WTO*, China Securities News, January, 2002;
- *Restoring Investor Confidence: An Agenda for Change*, Financial Services Advisor, November-December 2002;
- Book Review: *Comments & Analysis – A Washington Power Broker Regrets*, Financial Times, September 30, 2002;
- *Congress Should Put Trade on the Fast Track*, Wall Street Journal, November 20, 2001;
- *Global Free Market is Good for All*, Irish Times, November 16, 2001;
- *The Gospel of Globalisation: Business Leaders Must Promote the Social and Economic Benefits of Liberalisation*, Financial Times, November 13, 2001;
- *Cut Taxes Broadly, Boldly, Now* (also listed as *Bush Tax Plan: Just What the Economic Needs*), Wall Street Journal, February 15, 2001;
- *Integrating Technology into Every Business Process*, Investment Dealers' Digest, May 22, 2000;
- *More Than the Boom of One I.P.O.*, New York Times, April 15, 2000

16. Speeches: (List all **formal** speeches you have delivered during the past five years which are on **topics relevant to the position** for which you have been nominated. Provide the Committee with two copies of each formal speech.)

- Introductory Remarks, GS 2006 Chief Investment Officer Conference, May 11, 2006;
- Introductory Remarks, GS Alternative Energy Conference, May 2, 2006;
- Remarks, HBS Leadership & Ethics Forum, March 28, 2006;
- Remarks, WCS Annual Meeting, March 1, 2006;
- Introductory Remarks, The Executives' Club of Chicago, February 23, 2006;
- Remarks, Dinner by Mathias Dopfner, February 7, 2006;
- Remarks, Site 26 Groundbreaking, November 29, 2005;
- Remarks, Financial Services Forum, October 18, 2005;
- Welcoming Remarks, GS IMF Reception, September 25, 2005;
- Handelsblatt Conference, Frankfurt, Germany, September 7, 2005;
- Remarks, China Institute in America Gala, June 15, 2005;
- Speech, Swiss-American Chamber of Commerce Speech, Zurich, April 22, 2005;
- Remarks, GS 2005 Chief Investment Officer Conference, Paris, April 21, 2005;
- Opening Remarks, Howard University, March 30, 2005;
- Remarks, London School of Economics, March 17, 2005;
- Remarks, Arthur Burns Dinner, February 16, 2005;
- Remarks, Wharton School, January 12, 2005;

- Remarks, TiE Tri–State Organization, Remarks, November 20, 2004;
- Remarks, Wildlife Conservation Society Gala, October 13, 2004;
- Remarks, Stanford Law Directors College, June 21, 2004;
- Remarks, U.S. - China Executive Summit, June 17, 2004;
- Remarks, Carlyle Group, May 4, 2004;
- Remarks, Association of German Business Correspondents, April 27, 2004;
- Remarks, The GS Group, Inc. Annual Shareholders Meeting, March 30, 2004;
- Remarks, Yale School of Management Dinner, March 18, 2004;
- Remarks, Parlour Club, London, March 10, 2004;
- Remarks, The Goldman Sachs Group, Inc., 2004;
- Remarks, The Goldman Sachs Group, Inc., 2004;
- Welcoming Remarks, NRCC Luncheon, June 16, 2003;
- Principia College Commencement Address, June 8, 2003;
- Remarks, Harvard Business School Statesman Award, May 29, 2003;
- Remarks, MOMA Acceptance of David Rockefeller Award, March 11, 2003;
- Remarks, Promoting and Protecting Shareholders Interests, February 14, 2003;
- Remarks, Yale Dinner Honoring Mayor Bloomberg, February 10, 2003;
- Remarks, Ivy Football Association Dinner, January 22, 2003;
- CNBC/WSJ CEO Summit, 2003;
- Remarks, Wharton Global Business Forum, Philadelphia, Pennsylvania November 15, 2002;
- Remarks, Welcome to Communicopia Dinner, 2002;
- Introductory Remarks, GS Board Dinner, Munich, September 2002;
- CNBC Script, Business Center, July 9, 2002;
- Tribute to John Whitehead, Spirit of America Dinner, June 20, 2002;
- Welcoming Remarks, Consumer Products Dinner, May 8, 2002;
- Remarks, Women's Leadership Conference, May 3, 2002;
- Concluding Remarks, American Bankers Association Dinner Honoring Chinese Vice President Ahu Jintro, New York, April 29, 2002;
- Introduction of Mayor Bloomberg - Annual Meeting of New York City Partnership/New York City Investment Fund, April 10, 2002;
- Remarks, Fire Engine Truck Dedication, April 5, 2002;
- Remarks, CEO Round Table, Chicago, February 25, 2002;
- Remarks for Citizens' Committee for NYC Dinner, February 11, 2002;
- Remarks, The Goldman Sachs Group, Inc. Annual Shareholders Meeting, 2002;
- Talking Points for Holiday Party with Engine 4, December 2001;
- Translation of Capital Piece, November 23, 2001;

- Financial Times Conference, November 12, 2001;
- Welcome to Communicopia Dinner, October 2, 2001;
- Remarks, Interfaith Service, October 1, 2001;
- Speech, Capital Investor Relations Awards Dinner, Frankfurt, September 4, 2001;
- Remarks, British Museum Dinner, London, June 25, 2001;
- Speech, Microsoft Conference, May 22-23, 2001;
- Talking Points, US Economic Outlook, May 9, 2001;
- Opening Statement, Fortune Conference, May 9, 2001;
- Forum Opening Remarks, April 28, 2001;
- Remarks at Tsinghua University Boa, Effectively Leading a Modern Enterprise, April 28, 2001;
- Remarks, Big Brothers/Big Sisters of New York City 21st Annual "Sidewalks of New York" Awards Dinner, April 23, 2001;
- Remarks, Introduction of Richard Wagoner, Battle Royale, April 4, 2001;
- Remarks, Dinner With Technology Leaders, February 1, 2001;
- Points for Davos, January 29, 2001;
- The Goldman Sachs Group, Inc., Annual Meeting of Shareholders, 2001

17. Qualifications: (State what, in your opinion, qualifies you to serve in the position to which you have been nominated.)

During most of my 32-year professional career at Goldman Sachs, I have worked in management and leadership positions. In this capacity, as well as in positions at the White House and at the Department of Defense, I have dealt with a range of issues faced by the Treasury, both at home and abroad. As a banker and business executive in the private sector, I have acquired extensive knowledge of the market place as well as international finance and economics. I have considerable familiarity and experience with many of the areas for which the Treasury Department has primary responsibility and oversight. In addition, both in government and the private sector, I have had the opportunity to work with Treasury's key external counterparts: the Congress, the interagency process, the financial, business, and non-profit communities, and the international financial community. Lastly, having led a large, truly global, organization, I have had some exposure dealing with the budget and appropriations processes.

B. FUTURE EMPLOYMENT RELATIONSHIPS

1. Will you sever all connections with your present employers, business firms, associations, or organizations if you are confirmed by the Senate? If not, provide details.

Yes.

2. Do you have any plans, commitments, or agreements to pursue outside employment, with or without compensation, during your service with the government? If so, provide details.

No.

3. Has any person or entity made a commitment or agreement to employ your services in any capacity after you leave government service? If so, provide details.

No.

4. If you are confirmed by the Senate, do you expect to serve out your full term or until the next Presidential election, whichever is applicable? If not, explain.

Yes, if confirmed by the Senate, I expect to serve at the pleasure of the President.

C. POTENTIAL CONFLICTS OF INTEREST

1. Indicate any investments, obligations, liabilities, or other relationships which could involve potential conflicts of interest in the position to which you have been nominated.

Any potential conflicts of interest have been identified and resolved in accordance with the terms and conditions of my ethics agreement with the Department of Treasury, which is documented by letter to John Schorn, Deputy Assistant General Counsel (General Law and Ethics) and Designated Agency Ethics Official. Should any potential conflict of interest arise in the future, I will seek guidance from a Treasury ethics official.

2. Describe any business relationship, dealing or financial transaction which you have had during the last 10 years, whether for yourself, on behalf of a client, or acting as an agent, that could in any way constitute or result in a possible conflict of interest in the position to which you have been nominated.

Any potential conflicts of interest have been identified and resolved in accordance with the terms and conditions of my ethics agreement with the Department of Treasury, which is documented by letter to John Schorn, Deputy Assistant

General Counsel (General Law and Ethics) and Designated Agency Ethics Official. Should any potential conflict of interest arise in the future, I will seek guidance from a Treasury ethics official.

3. Describe any activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat, or modification of any legislation or affecting the administration and execution of law or public policy. Activities performed as an employee of the Federal government need not be listed.

From 1996 to 2006, as the Chairman and Chief Executive Officer of The Goldman Sachs Group, Inc., I helped represent or oversee representation of the company's interests before both the Congress and the Administration on a wide range of issues, including:

- Global competitiveness
- Market Structure
- Social security reform options
- General tax and trade
- Mutual fund legislation
- Financial modernization legislation
- China PNTR
- President's Export Council

On February 29, 2000, I testified on behalf of The Goldman Sachs Group, Inc. at a field hearing of the Senate Banking Committee regarding Marketplace of the Future.

4 Explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items. (Provide the Committee with two copies of any trust or other agreements.)

Any potential conflicts of interest will be identified and resolved in accordance with the terms and conditions of my ethics agreement with the Department of Treasury, which is documented by letter to John Schorn, Deputy Assistant General Counsel (General Law and Ethics) and Designated Agency Ethics Official. Should any potential conflict of interest arise in the future, I will seek guidance from a Treasury ethics official.

5. Two copies of written opinions should be provided directly to the Committee by the designated agency ethics officer of the agency to which you have been

nominated and by the Office of Government Ethics concerning potential conflicts of interest or any legal impediments to your serving in this position.

6. The following information is to be provided only by nominees to the positions of United States Trade Representative and Deputy United States Trade Representative:

Have you ever represented, advised, or otherwise aided a foreign government or a foreign political organization with respect to any international trade matter? If so, provide the name of the foreign entity, a description of the work performed (including any work you supervised), the time frame of the work (e.g., March to December 1995), and the number of hours spent on the representation.

N/A

D. LEGAL AND OTHER MATTERS

1. Have you ever been the subject of a complaint or been investigated, disciplined, or otherwise cited for a breach of ethics for unprofessional conduct before any court, administrative agency, professional association, disciplinary committee, or other professional group? If so, provide details.

No.

2. Have you ever been investigated, arrested, charged, or held by any Federal, State, or other law enforcement authority for a violation of any Federal, State, county or municipal law, regulation, or ordinance, other than a minor traffic offense? If so, provide details.

In mid-August 1969, I climbed the fence of a public swimming pool in West Lafayette, Indiana and swam in this pool after hours. I was arrested for trespassing and fingerprinted. Subsequently, all charges against me were dropped.

3. Have you ever been involved as a party in interest in any administrative agency proceeding or civil litigation? If so, provide details.

From time to time, I have been named as a defendant or respondent in litigation relating to the business of The Goldman Sachs Group, Inc. and its affiliates, and on several occasions I have given testimony as a witness in response to a deposition subpoena or regulatory request. To the best of my

recollection and information available to me, I have been a defendant or respondent in the following matters:

1. *Jean Mullin v. John Browne, et al.* (USDC/SDNY) (derivative action alleging breaches of fiduciary duty by The Goldman Sachs Group, Inc. Board of Directors in connection with the firm's research and IPO allocation practices);

2. *Lapin v. Goldman Sachs Group, Inc., et al.* (USDC/SDNY, USNV/DLV) (alleges violations of the federal securities laws in connection with Goldman Sachs' research activities);

3. *Christopher Carmona v. Henry M. Paulson, Jr., et al.* (USDC/SDNY) (derivative action alleging breaches of fiduciary duty by The Goldman Sachs Group, Inc. Board of Directors in connection with Goldman Sachs' role as an underwriter of Refco's IPO);

4. *Jeanne Masden v. Henry M. Paulson, Jr., et al.* (USDC/SDNY) (purported class action relating to fee practices of certain Goldman Sachs sponsored mutual funds);

5. *Osher v. Browne, et al.* (USDC/SDNY) (derivative action alleging violations of the federal securities laws, dismissed by stipulation of the parties in 2001);

6. *NYC Dept. of Finance v. Paulson* (NY Judgments and Liens) (no information is available in the public record regarding this lien except for a docket sheet; according to the docket sheet, this lien was vacated in 1997).

To the best of my recollection and information available to me, I have given testimony as a witness in the following matters:

1. *Spitzer v. Grasso* (NY State Supreme Court, NY County) (deposition testimony arising from services as a former director of the New York Stock Exchange) (2005);

2. Investigation by the Massachusetts securities regulator in connection with merger of Procter and Gamble and The Gillette Cos. (June 2005);

3. Field Hearing of Senate Banking Committee on the topic of Financial Marketplace of the Future (February 29, 2000).

4. Have you ever been convicted (including pleas of guilty or nolo contendere) of any criminal violation other than a minor traffic offense? If so, provide details.

No.

5. Please advise the Committee of any additional information, favorable or unfavorable, which you feel should be considered in connection with your nomination.

N/A

E. TESTIFYING BEFORE CONGRESS

1. If you are confirmed by the Senate, are you willing to appear and testify before any duly constituted committee of the Congress on such occasions as you may be reasonably requested to do so?

Yes.

2. If you are confirmed by the Senate, are you willing to provide such information as is requested by such committees?

Yes.

O

O'MELVENY & MYERS LLP

BEIJING
BRUSSELS
CENTURY CITY
HONG KONG
LONDON
LOS ANGELES

1625 Eye Street, NW
Washington, D.C. 20006-4001

TELEPHONE (202) 383-5300
FACSIMILE (202) 383-5414
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NEWPORT BEACH
NEW YORK
SAN FRANCISCO
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TOKYO

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June 22, 2006

WRITER'S DIRECT DIAL
(202) 383-5322

BY HAND DELIVERY

WRITER'S E-MAIL ADDRESS
rrizzi@omm.com

The Honorable Charles E. Grassley
Chairman, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Re: ***Henry M. Paulson, Jr. Nomination: Senate Committee on Finance Questionnaire***

Dear Mr. Chairman:

After Mr. Paulson submitted the Questionnaire to the Senate Committee on Finance yesterday, a few suggested revisions to the Questionnaire were brought to our attention:

1. In response to Section A, Question No. 11, business relationships should also include "Peregrine Fund: Chairman Emeritus."

2. In response to Section A, Question No. 12, memberships should also include "Kennedy Center: Corporate Board Member."

3. In response to Section A, Question No. 13(b), Mr. Paulson's political activities should also include the following:

(a) "Member of Business Leaders for Schumer (2004)."

(b) "Served as co-host for New York City event for Senator Tom Carper (2003)."

(c) "Signed solicitation letter in connection with New York City event for Senator Walter Minnick (1996)."

[redacted]

[redacted]

Please call or email if you have any questions.

Very truly yours,

Robert A. Rizzi, Esq.
of O'MELVENY & MYERS LLP

BAR:mah

DC1:671716.1

Statement for the Record of Senator Rick Santorum for
Senate Finance Committee Markup on
S. 1321, the Telephone Excise Tax Repeal Act of 2005
June 27, 2006

Thank you, Mr. Chairman. On June 28, 2005, I introduced the Telephone Excise Tax Repeal Act of 2005, and what a difference a year makes. I am very pleased that the Chairman has allowed us to consider this important legislation today.

Some of you may not be aware of the history of this tax, and may not even be aware that you are paying it. The telephone excise tax originated on long distance service under the *Spanish American War Act of 1898.* At that time, only the wealthy had telephones, the U.S. had no income tax, and the country relied on excise taxes to fund the war. However, you would not know the intent of this tax looking at it now. In fact, when you look closely at your phone bill, the charge on your phone bill doesn't say "luxury tax" or "war tax." So why does this tax still exist? Good question.

Although created to cover war expenses in 1898, the revenue from the telephone excise tax goes into the general receipts of the U.S. Treasury and is not earmarked for any particular government function or service. From its inception, the federal telephone excise tax was repeatedly imposed on a temporary basis. However since 1932, the tax has continuously been imposed. This tax has been scheduled to expire – partially or completely – at least 17 different times. In 1990, just before the tax was set to expire, Congress made the tax permanent at 3 percent of local and long distance services.

So the tax is now permanent, but the question is whether it is necessary. The Joint Committee on Taxation stated in its January 2005 report "there is no compelling policy argument for imposing taxes on communications services." The Congressional Budget Office took this a step further by stating in February 2005 that the tax "has harmful effects on economic policy."

And then there are the court cases. I have closely monitored the IRS's litigation over this archaic tax. The IRS has lost all of its Federal cases on the taxation of calling plans that are not based on both 'time and distance' as required by the law. Most recently, the IRS lost its appeal in my Circuit, the Third Circuit Court of Appeals. Therefore the governing precedent comes from the decisions from the Second, Third, Sixth, Eleventh and the District of Columbia Circuits – covering 13 states and the District of Columbia – determining that this tax should not be applied to most current calling plans. In addition, seven Federal district courts have also ruled against the IRS, with no appellate court upholding the IRS position.

On May 10, 2006, I sent a letter to Secretary Snow which I will submit for the record. I noted in that letter that back in February Secretary Snow had told Congress that the Treasury would likely have to concede defeat if the IRS continued to lose appeals cases. With the latest loss in the Third Circuit, I believed that the time had come for IRS to stop

applying this unfair – and apparently illegal – tax. I was very pleased when I joined Secretary Snow on May 25, 2006 to announce that the government would stop collecting the tax on long-distance telephone services, and that the Internal Revenue Service (IRS) would issue refunds of tax on long-distance service for the past three years. However, I noted than that while this was a victory, it left in place the tax imposed on local service only plans which are essential for the elderly and low-income constituents. As I have said in the past, this tax is regressive and burdens one of the essential services relied upon by millions of Americans every day, not only for basic communications but also for emergency services, and the modified tax only makes the tax more regressive and burdensome.

That brings us to today where we have the opportunity to hang up the telephone tax. Simple common sense dictates that repeal of the telephone excise tax is long overdue. In our modern world, communication is not a luxury. Rather, telecommunications have become part of the basic fabric of our social and economic life. The growth of the technologies on which communications rides and the widespread use of communications in general should be encouraged and not taxed. The telephone tax is a regressive, inequitable, inefficient and unnecessary tax that Congressional policy makers have found to serve no rational policy purpose. I strongly urge my colleagues to join me in supporting the full and final repeal of the telephone excise tax. Mr. Chairman, thank you for making time today to help us hang up the telephone tax.

RICK SANTORUM
PENNSYLVANIA

REPUBLICAN CONFERENCE
CHAIRMAN

WASHINGTON, DC
511 DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, DC 20510
(202) 224-6324

United States Senate

http://santorum.senate.gov

COMMITTEES:
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RULES AND ADMINISTRATION
SPECIAL COMMITTEE ON AGING

May 10, 2006

The Honorable John W. Snow
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Snow:

I have closely monitored the IRS's litigation over the archaic tax law that imposes a three percent excise tax on America's telephone consumers. The IRS has lost all of its Federal cases on the taxation of calling plans that are not based on both 'time and distance' as required by the law. Most recently, the IRS lost its appeal today in my Circuit, the Third Circuit Court of Appeals. Therefore the governing precedent comes from the decisions from the Second, Third, Sixth, Eleventh and the District of Columbia Circuits – covering 13 states and the District of Columbia – determining that this tax should not be applied to most current calling plans. In addition, seven Federal district courts have also ruled against the IRS, with no appellate court upholding the IRS position. Despite these facts, the IRS continues to collect the tax, which has led to continued litigation by taxpayers obligated to pay the tax.

Last year the IRS issued Notice 2005-79, informing telecommunications carriers to continue to collect the tax. You stated to Congress in February that the Treasury would likely have to concede defeat if the IRS continued to lose appeals cases. In addition, I understand that the IRS has not asked for certiorari in the two cases where the final appeal is available to the Supreme Court. Finally, as I am sure you are also aware, there are currently four class action lawsuits that have been filed against the IRS and telecommunications carriers, cases that will likely require significant expenditure of taxpayer dollars to defend. With this latest loss in the Third Circuit, the time has come for IRS to stop applying this unfair – and apparently illegal – tax. The protracted litigation by taxpayers to recover this tax will only escalate if you fail to act.

Based on my review, I feel strongly that the IRS should stop applying this tax to most modern communications services, including nationwide calling plans, voice over Internet protocol (VoIP) services, all wireless phone plans, and simplified bundled packages of services purchased by consumers for flat rates. This change should, in theory, leave only purely "local" telephone service subject to this unfair tax. It is important that the IRS revoke Notice 2005-79 and create a common sense, nationwide rule for all consumers. In addition, a workable and timely means of refunding to taxpayers the last three years of payments under this tax must be provided. I offer my support in helping you to find the appropriate solution.

☐ ALLENTOWN
3802 FEDERAL OFFICE BUILDING
504 WEST HAMILTON STREET
ALLENTOWN, PA 18105
(610) 770-0142

☐ ALTOONA
REGENCY SQUARE
SUITE 202
ROUTE 220 NORTH
ALTOONA, PA 16601
(814) 946-7023

☐ COUDERSPORT
81 MARVIN HILL ROAD
COUDERSPORT, PA 16915
(814) 454-7114

☐ ERIE
1705 WEST 26TH STREET
ERIE, PA 16508
(814) 454-7114

☐ HARRISBURG
555 WALNUT STREET
FIRST FLOOR
HARRISBURG, PA 17101
(717) 231-7540

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WIDENER BUILDING
ONE SOUTH PENN SQUARE
SUITE 960
PHILADELPHIA, PA 19107
(215) 864-6900

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PITTSBURGH, PA 15219
(412) 562-0533

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THE RITZ BUILDING
222 WYOMING AVENUE
SCRANTON, PA 18503
(570) 344-8799

As you may be aware, I introduced S. 1321 in June 2005 to repeal the telephone excise tax. It has quickly gathered 15 cosponsors in the Senate, while the companion bill in the House has gained over 180 cosponsors. This outdated and nonsensical tax is long overdue for repeal. It is regressive and burdens one of the essential services relied upon by millions of Americans every day, not only for basic communications but also for emergency services. It is the only significant Federal excise tax levied on a product or service that is neither dedicated to a trust fund nor considered a "sin." Finally, due to a lack of guidance the tax is not applied evenly on all similar services and as a result creates an unfair playing field among competitors.

I am confident that if your Department acts fairly and quickly, then Congress will act on my legislation and fully repeal the remaining remnants of this antiquated tax. I remain willing to provide any assistance in crafting the right solution to this untenable situation.

Sincerely,

Rick Santorum

Rick Santorum
United States Senate

For The Record

Opening Statement of Chairman Chuck Grassley
Senate Finance Committee Executive Session
Wednesday, June 28, 2006

The Committee will now convene in open executive session to consider favorably reporting S. 3569, a bill to implement the United States–Oman Free Trade Agreement.

Before addressing the merits of the bill, I want to discuss the process that's led to today's markup. The United States and Oman signed this Agreement on January 19th of this year.

The U.S. International Trade Commission completed its investigation and issued its report on the likely economic effects of this Agreement in February 2006.

The Subcommittee on International Trade of this Committee held a hearing on this Agreement on March 6, 2006.

The full Committee met on May 18, 2006, to informally consider proposed legislation implementing this Agreement.

During the Committee's informal consideration, I introduced a Chairman's modification to the proposed Statement of Administrative Action.

My modification called upon the Administration to monitor and report on the efforts of the Omani Government to prohibit compulsory or coerced labor.

The Administration took my modification and broadened it.

The Statement of Administration Action that accompanies the bill before the Committee today contains a commitment from the Administration to periodically update Congress on the progress that Oman achieves in realizing all commitments made to labor law reform.

I think that's an improvement on my modification. It's an example of how the Committee's process of informal consideration of trade agreements works.

The Committee also adopted an amendment offered by Senator Conrad to prevent goods made with slave labor from benefitting from the Agreement.

I supported the Conrad amendment because I shared some of his concerns. Those concerns motivated me to introduce my Chairman's modification.

But at the time the amendment was adopted, I also noted the Administration's assertion that current law already provides a greater impediment to forced labor than the Conrad amendment.

That's why I asked the Administration to respond to the Committee on that point in greater detail.

The General Counsel of the Office of the United States Trade Representative responded to my request by letter dated June 22, 2006.

I've shared that letter with the Members of this Committee in advance of today's markup.

If there are further questions of the Committee regarding the Administration's position, we have officials from the Office of the United States Trade Representative here with us today to respond.

I'd now like to turn to the merits of the U.S.-Oman Free Trade Agreement.

This is a strong agreement for U.S. farmers, manufacturers, and service providers.

The Agreement will immediately provide duty-free treatment for almost all U.S. industrial and consumer products once it enters into force.

Some 87 percent of U.S. agricultural exports to Oman will be given duty-free status upon implementation.

And the remaining tariffs will be eliminated in ten years.

This Agreement will also open new markets for U.S. service providers.

I realize that Oman is not a large market, but this agreement will indeed benefit people throughout the United States.

In addition, this agreement will be yet another important step in advancing the President's vision of building a Middle East Free Trade Area by 2013.

And, it will cement our ties with an important ally in that part of the world. I urge my colleagues to support this important Agreement. Senator Baucus.

Opening Statement
Senator Bunning
Committee on Finance - Business Meeting
28 June 2006

MR. CHAIRMAN,

I LOOK FORWARD TO TAKING UP THE BUSINESS BEFORE THE COMMITTEE TODAY.

AS AN ADVOCATE FOR THE REPEAL OF THE TELEPHONE EXCISE TAX FOR MANY YEARS, I WAS VERY PLEASED WHEN I HEARD LAST MONTH OF THE I.R.S. DECISION TO STOP COLLECTING THE TAX ON LONG DISTANCE SERVICE.

IT IS NOW TIME FOR THIS COMMITTEE TO REPEAL THE LAST PART OF THE TAX – THE TAX ON LOCAL TELEPHONE SERVICE.

I COMMEND SENATOR SANTORUM FOR TAKING THE LEAD ON THIS ISSUE.

AS MY COLLEAGUES KNOW, THIS TAX WAS PUT IN PLACE OVER 100 YEARS AGO AS A TEMPORARY LUXURY TAX.

HOME TELEPHONE SERVICE IS NO LONGER A LUXURY IN THIS COUNTRY - AS IT IS NOW AVAILABLE TO ALMOST EVERY AMERICAN.

THUS, THE TAX HAS CHANGED FROM A LUXURY TAX TO A REGRESSIVE TAX THAT ADVERSELY AFFECTS LOW INCOME HOUSEHOLDS.

THE ACTION WE TAKE TODAY IS IMPORTANT AND LONG OVERDUE. I AM PLEASED TO SUPPORT THIS BILL.

ALSO, I AM PLEASED THAT WE ARE USING THIS TIME TO ADDRESS A NUMBER OF I.R.S. ADMINISTRATIVE ISSUES.

THESE TYPES OF ISSUES AREN'T ALWAYS HIGH PROFILE AND HEADLINE-GRABBING, BUT THEY ARE IMPORTANT RESPONSIBILITIES OF THIS COMMITTEE.

THE COMMITTEE WILL ALSO TURN ITS ATTENTION TODAY TO OUR TRADE RESPONSIBILTIES AS WE HAVE THE OPPORTUNITY TO VOTE ON THE TRADE AGREEMENT WITH OMAN.

WHILE I PLAN TO SUPPORT THE AGREEMENT, I DO WANT TO HIGHLIGHT ONE PARTICULAR ISSUE OF IMPORTANCE TO MY STATE OF KENTUCKY.

I HAVE BEEN PLEASED TO SEE THAT MANY RECENT TRADE AGREEMENTS TREAT THE EXPORTATION OF TOBACCO PRODUCTS LIKE OTHER COMMODITIES.

HOWEVER, I WAS SORRY TO SEE THAT THIS TREND DOES NOT ALSO APPLY TO THE AGREEMENT BEFORE US TODAY.

I WANT TO EXPRESS MY CONCERN ABOUT THE TREATMENT OF TOBACCO PRODUCTS UNDER THIS TRADE AGREEMENT.

WAITING 10 YEARS TO RECEIVE DUTY-FREE TREATMENT IS TOO LONG.

I DO UNDERSTAND THE CULTURAL CONCERNS AT ISSUE HERE – WE FACED A SIMILAIR SITUATION WITH THE BAHRAIN AGREEMENT - BUT I WANT IT MADE CLEAR THAT I EXPECT THAT THIS AGREEMENT WILL NOT BE VIEWED AS A MODEL FOR OTHER AGREEMENTS WITH REGARD TO THE TREATMENT OF TOBACCO PRODUCTS.

I LOOK FORWARD TO A PRODUCTIVE MORNING AND I THANK THE CHAIR.

STATEMENT OF SENATOR ROCKEFELLER

JUNE 28, 2006

FINANCE COMMITTEE BUSINESS MEETING

This morning, both the Finance Committee and the Commerce Committee took steps to make the internet tax moratorium permanent. I am very disturbed by these efforts, and I want to caution my colleagues about the dangerous path we are going down if we make permanent a federal ban on state and local taxation of Internet access.

Let me first make clear that I have supported the ban on internet access taxes in the past. I appreciate that the internet has the power change the way that Americans connect to each other, much as telephones, radios and televisions did for previous generations. To promote increased access to this new technology I voted to extend the current moratorium through 2007. However, I raised concerns at that time about any effort to make the moratorium permanent. And none of those concerns has been satisfactorily addressed.

As a former governor, I have a keen appreciation for how difficult it is to balance a state budget. Unlike Congress and the president, most governors cannot just resort to deficit spending when their budgets do not balance. They must make difficult and painful cuts to spending to balance their budgets. Obviously, governors only impose taxes because states must collect sufficient revenues to pay police, firefighters, teachers, and their other bills.

We should make no mistake: making this moratorium permanent not only prevents states from imposing new taxes on internet access, it will certainly deprive states of current revenues collected on telephone and cable services. How easy for us to sit in Washington and take credit for protecting people from new internet taxes. But are we prepared to tell our constituents what other taxes the states will have to raise in order to make up the lost revenues from phone and cable services?

In my home state of West Virginia, the state and local governments collect approximately $25 million per year in traditional telecommunications and cable taxes. Those revenues fund emergency 911 services, and school, and roads, and other priorities. Traditional telephone and television services are migrating to the internet, and the current moratorium will prevent states from taxing those services when they are bundled together with internet access.

While a temporary moratorium on internet taxation was supportable while the technology was new, there is no need to make such a moratorium permanent. And I believe that out of due respect to our federal system, we should allow governors faced with difficult budget decisions the maximum flexibility to arrive at a fair and sustainable tax system.

Statement of Senator John Kerry
Senate Finance Subcommittee
on Long-term Growth and Debt Reduction Hearing:
"Small Business Pension Plans: How Can We Increase Worker Coverage?"
June 29, 2006

Mr. Chairman, thank you for holding this hearing today on this extremely important topic – small business pension coverage. Back in April, this Subcommittee held a hearing on our national savings rate. We heard compelling testimony from witnesses about our fiscal outlook and how we need to improve our public and private savings. An important component of this is personal savings.

Our personal savings rate is negative for the first time since the Great Depression. We need to ask ourselves if we are saving enough for retirement. Retirement savings consists of individual savings, Social Security, and pensions. Currently, Congress is working on legislation that would strengthen one aspect of our pension systems, defined benefit plans, but more must be done.

We have to ask ourselves if we are providing the right tax incentives that will help improve pension coverage. According to the Joint Committee on Taxation, we will spend over $700 billion over the next five years on tax expenditures for pension plans. From the testimony that we will hear today, we will learn that 71 million employees work for companies that do not offer pension plans. This statistic begs the question are we spending our resources appropriately. I am concerned that we might be providing too many tax benefits to those who do not need any incentives to save and that we are not doing enough for small businesses and low-income individuals.

Pension coverage needs to improve, particularly for small businesses. In 2004, only 26 percent of workers at firms with fewer than 25 employees participated in pension plans. We need to work together to improve this statistic. I look forward to learning from the witnesses ways that we can improve coverage. We need to know what works and what doesn't.

We will hear about a new proposal – automatic individual retirement accounts (IRAs). This proposal has merit because it provides a simple way for small employers to help their employees save. I look forward to learning more details about this proposal and how it will fit into our current system. If implemented properly, it could be a stepping stone for small employers to offer pension coverage. Hopefully, employers would start with an automatic IRA and then offer a plan with more benefits.

I look forward to working with Chairman Smith on legislation that will make it easier for small businesses to offer pension plans. I thank the Chairman for holding this hearing that should provide constructive information on how we should help the 36 million Americans employed by firms with less than 25 employees save for retirement.