PRESENT LAW AND BACKGROUND RELATING TO TAX ISSUES ASSOCIATED WITH IMMIGRATION REFORM

Scheduled for a Public Hearing
Before the
HOUSE COMMITTEE ON WAYS AND MEANS
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Prepared by the Staff
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INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing for July 26, 2006, on the tax impact of current and proposed border security and immigration policies. This document,[1] prepared by the staff of the Joint Committee on Taxation, presents a description of the tax provisions contained in S. 2611, the "Comprehensive Immigration Reform Act of 2006" as passed by the Senate on May 25, 2006, as well as the present law and select issues associated with those provisions. The Senate bill has four tax provisions: (1) provisions relating to payment of income tax by aliens, (2) limitations on refunds and refundable credits for aliens for taxable years prior to 2006, (3) an employer protection provision that absolves an employer of civil and criminal tax liability arising out of the employment of an alien applying for an adjustment of status, and (4) amendments to section 6103 of the Internal Revenue Code (the "Code") to permit the disclosure of return information to the Department of Homeland Security relating to the electronic employee verification system created by the bill and mismatched social security numbers contained in Forms W-2 filed by employers. The bill also has indirect effects on tax compliance and Federal tax revenues.

The tax provisions of the Senate bill raise many issues, including the ability to administer the payment of income tax provisions and refund limitations by the Internal Revenue Service, the necessity of absolving noncompliant employers of employment taxes, and whether the potential benefits to Department of Homeland Security workplace enforcement outweigh the adverse effects on taxpayer compliance and privacy that would result from the disclosures of return information.

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background Relating to Tax Issues Associated with Immigration Reform* (JCX-32-06), July 25, 2006.

I. PRESENT LAW

A. Income Tax Filing Requirements for U.S. Citizens, Residents, and Nonresidents

In general

The Code requires an individual to file a U.S. income tax return if the individual has gross income subject to U.S. tax that equals or exceeds certain amounts (generally, the sum of the standard deduction and the personal exemptions).[2] Any person required to submit a return, statement, or other document is required to include a valid taxpayer identification number ("TIN") on such return, statement, or other document for purposes of securing proper identification of such person.[3] For taxpayers eligible to obtain a Social Security Number ("SSN") assigned by the Social Security Administration, the SSN is to be used as an individual's TIN for tax purposes. The Internal Revenue Service ("IRS") also assigns individual taxpayer identification numbers ("ITIN") to an alien individual ineligible to obtain a SSN.[4]

Taxation of resident and nonresident aliens

Alien individuals generally are divided into two classes for purposes of U.S. income tax: resident aliens and nonresident aliens. An alien who resides in the United States generally is taxed in the same manner as a U.S. citizen if the individual meets the definition of a "resident."[5] An alien is considered a resident of the United States if the individual: (1) is a lawful permanent U.S. resident (the "green card test") at any time during the relevant year; (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time − during a three-year period, 183 or more days weighted toward the present year (the "substantial presence test"); or (3) makes a "first-year election" to be treated as a resident of the United States (a numerical formula under which an alien may pass the substantial presence test one year earlier than under normal rules).[6]

An alien who does not meet the definition of resident alien is considered to be a nonresident alien for U.S. tax purposes.[7] A nonresident alien is subject to U.S. tax on income from U.S. sources or income that is effectively connected with the conduct of a trade or business within the United States.[8] Generally, income is from U.S. sources if it is paid by domestic

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[2] Sec. 6012(a).

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

[4] Treas. Reg. sec. 301.6109-1(a).

[5] Treas. Reg. sec. 1.1-1(b).

[6] Sec. 7701(b)(1)(A).

[7] Sec. 7701(b)(1)(B).

[8] Sec. 871(b)(1).

corporations, U.S. citizens or resident aliens, or entities formed under the laws of the United States or a state. Income is also from U.S. sources if the property that produces the income is located in the United States or the services for which the income is paid were performed in the United States. Income taxes on U.S.-source income that is not effectively connected with the conduct of a trade or business within the United States is, in general, collected by withholding.[9] Foreign-source income earned by a nonresident alien generally is not subject to U.S. tax.[10] Bilateral income tax treaties may modify the U.S. taxation of a nonresident alien.

In general, the Code does not contain special rules regarding the treatment of illegal aliens. For Federal tax purposes, non-citizens are treated as either resident or non-resident aliens. For nonresident aliens, all U.S.-source wages are taxable; there is no requirement that the wages be derived from legal employment.[11]

Social Security Numbers

In general

The Social Security Act of 1935 authorized the Social Security Administration (the "SSA") to establish a recordkeeping system with respect to the Social Security benefit program. The SSN was created in 1936 as a means to track workers' earnings and eligibility for Social Security benefits. SSNs are issued by the SSA upon application by a citizen, a qualified alien (an alien individual legally admitted to the United States for permanent residency), by a parent on behalf of a qualified child, or by persons in other immigration categories that authorize U.S. employment. The application for a SSN is made on Form SS-5, the Application for Social Security Account Number (or Replacement of Lost Card). Applicants who apply for a SSN are required to submit documentary evidence to establish their identity, age, and citizenship or lawful alien status.

The issuance of a SSN results in the creation of: (1) a record at the SSA of the applicant's earnings for purposes of determining the old-age, survivors, and disability insurance and other benefits to which a person may be entitled, and (2) a numerical identifier unique to the applicant that is used by a variety of governmental and private entities. Each year, the SSA receives copies of Forms W-2 issued by employers to their employees. The SSA matches the name and SSN provided on Form W-2 against its database of all SSNs issued. When a match occurs, the earnings reported on each particular Form W-2 are recorded in the relevant individual's lifetime earnings history contained in the SSA record.

Types of Social Security cards

The SSA issues three types of Social Security cards depending on an individual's citizen or alien status and whether or not an alien is authorized by the Department of Homeland Security

[9] Sec. 1441.

[10] Sec. 864(c)(4).

[11] Rev. Rul. 60-77, 1960-1 C.B. 386.

to work in the United States (a "for-work SSN" card). The first type of Social Security card shows the individual's name and SSN only. The card shows that the holder can work in the United States without restriction. Persons eligible to receive this type of card include U.S. citizens or aliens who are lawfully admitted to the United States for permanent residence therein, or who have permission from the Department of Homeland Security to work permanently in the United States.

The second type of Social Security card bears, in addition to the individual's name and SSN, the legend, "NOT VALID FOR EMPLOYMENT." This card is issued to aliens who do not obtain permission to work permanently in the United States from the Department of Homeland Security. The SSA currently issues SSNs to aliens who are not otherwise eligible for SSNs if a Federal or State law requires that the alien provide his or her SSN to obtain a particular benefit or service. Under these circumstances, the application for a SSN must be accompanied by documentation from the appropriate government entity explaining the need for the SSN. The Department of Homeland Security then verifies the documentation before the SSA is allowed to issue the SSN.

The third type of Social Security card bears, in addition to the individual's name and SSN, the legend "VALID FOR WORK ONLY WITH DHS AUTHORIZATION." The SSA issues this type of card to individuals who have been granted a temporary visa and who have permission from the Department of Homeland Security to work temporarily in the United States.

Individual taxpayer identification numbers

The IRS issues ITINs to individuals who are required to have a taxpayer identification number, but who do not have and are not eligible to obtain a SSN from the SSA. ITINs are issued regardless of immigration status because both resident and nonresident aliens may have tax return and payment responsibilities under the Code. Generally, individuals must have a filing requirement and file a valid Federal income tax return to receive an ITIN, unless they meet an exception. ITINs are for Federal tax reporting only and are not valid identification outside the tax system. Thus, an ITIN does not authorize an individual to work in the United States or provide eligibility for Social Security benefits.

Use of TINs on tax returns

Each person listed as a taxpayer on a return must have either a SSN or an ITIN. In addition, taxpayers are required to list on their return the SSN of every dependent claimed, regardless of age.[12] If a return requesting a refund is filed without a SSN or ITIN for the primary filer and spouse, the refund will be delayed until a valid identification number is obtained. Also, if a dependent's or qualifying child's SSN or ITIN has been omitted, the dependency exemption, and child credit will be denied and tax liabilities will be adjusted accordingly.

To claim the Earned Income Credit ("EIC"), an individual and his or her spouse (if filing a joint return) must have a qualifying SSN issued by the Social Security Administration.[13] If a

[12] Sec. 151(e).

[13] Secs. 32(c)(1)(F) and (m).

taxpayer is claiming the EIC with respect to a qualifying child, the qualifying child also is required to have a qualifying SSN.[14] A Social Security card that bears the legend "VALID FOR WORK ONLY WITH DHS AUTHORIZATION" is considered a valid SSN for EIC purposes.[15] However, a Social Security card that bears the legend "NOT VALID FOR EMPLOYMENT" is not a valid SSN for EIC purposes. In addition, an individual who has applied for and been granted an ITIN is not eligible for the EIC.

Statute of limitations

Assessment and collection

The statute of limitations within which the IRS may assess additional taxes is generally three years from the date a return is filed.[16] If no return is filed, there is no limitation on the period within which tax may be assessed. The statute of limitations within which a tax may be collected after assessment is generally 10 years from the date of assessment. In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment at any time.[17]

Claims for credit or refund

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.

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[14] Secs. 32(c)(3)(D) and (m).

[15] IRS Publication 596, Earned Income Credit ("EIC").

[16] Sec. 6501.

[17] Sec. 6501(c).

B. Employment Taxes

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").[18]

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").[19] 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, employees must pay a tax of 6.2 percent of wages up to the FUTA wage base of $7,000.

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. Special withholding rules apply to certain types of payments.

Wages paid to employees, FICA, RRTA, and income taxes withheld from employees' wages, are required to be reported on employment tax returns and on Forms W-2.[20]

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[18] Secs. 3101-3128 (FICA), 3201-3241 (RRTA), 3301-3311 (FUTA), and 3401-3404 (income tax withholding).

[19] A similar tax is imposed on self-employment income under the Self-Employment Contributions Act ("SECA"). Under the OASDI component, the rate of tax is the combined employer and employee rates under the OASDI portion of FICA, i.e., 12.40 percent. Under the HI component, the rate is the combined employer and employee rate under the HI portion of FICA, i.e., 2.90 percent. The amount of self-employment tax under the OASDI is subject to the same limit as under FICA, i.e., this component is capped at $90,000 of self-employment income (for 2005). The amount of self-employment income subject to HI taxes is not capped.

[20] 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, including services performed by nonresident aliens pursuant to certain visas.[21] For example, temporary agricultural workers lawfully admitted to the United States with an H-2 visa are not covered under Social Security and do not pay FICA taxes.[22] Other examples of excluded work include services performed by academic students (F-1 visas), exchange visitors (J-1 visas), vocational or non-academic students (M-1 visas), and international cultural exchange visitors (Q-1 visas).[23] The work of certain individuals, such as temporary visitors for business (B-1 visas), involving personal servants or airline crew members and family members of foreign government officials (A-1 and A-2 visas) may have their work covered under Social Security if they have been issued an "Employment Authorization Document" by the Department of Homeland Security.[24]

There is no exception from Federal employment taxes for services performed by an illegal alien. The IRS has ruled that the exception from FICA taxes for temporary agricultural workers does not apply to aliens who enter the country illegally.[25]

Penalties on employers for SSN mismatches

Each year, employers send Forms W-2 and W-3 to the SSA by February 28 (or March 31 if filed electronically). SSA processes the forms and attempts to reconcile any mismatches. After processing, SSA transmits the information to the IRS. To help correct SSN mismatches, SSA sends letters to both employers and employees in an attempt to match names with SSNs. The letters are sent to employers who submit a wage report containing more than 10 Forms W-2 that SSA cannot process.[26]

Section 6041 requires employers to provide true and accurate information returns, including correct SSN or TIN on Forms W-2 reporting wages or salaries paid to employees. An employer may be subject to a penalty of $50 per Form W-2 or 1099 that omits or includes an

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[21] See, e.g., secs. 3121(b)(19), 3231(e), and 3306(c)(19). These exceptions apply only to services performed to carry out the purposes of the visa.

[22] Treas. Reg. sec. 31.3121(b)(1)-1(c).

[23] Treas. Reg. sec. 31.3121(b)(19)-1.

[24] See, Martin H. Gerry, Deputy Commissioner, Disability and Income Security Programs, Social Security Administration, *Testimony Before the Subcommittee on Social Security of the House Committee on Ways and Means* (March 2, 2006).

[25] Revenue Ruling 77-140, 1970-1 C.B. 301.

[26] For further discussion of the SSN mismatch program and the assertion of penalties, see, Mark W. Everson, Commissioner, Internal Revenue Service, *Testimony Before the Subcommittee on Oversight of the House Committee on Ways and Means* (February 16, 2006).

inaccurate SSN or TIN.[27] The maximum penalty for any calendar year is $250,000. An employer can avoid the penalty if it is shown that the failure to provide correct information was due to reasonable cause and not willful neglect.[28]

[27] Sec. 6721.

[28] Sec. 6724.

C. Confidentiality and Disclosure of Returns and Return Information

In general

Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Code.[29] A "return" is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the Code, that is filed with the Secretary by, on behalf of, or with respect to any person.[30] "Return" also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed. A Form W-2 is an information return and therefore, a return for purposes of section 6103. The Form W-2 is considered the return of both the employer and the employee to whom it relates.

The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the Code.[31] "Taxpayer return information" is a subset of return information. Taxpayer return information is return information filed with or furnished to the IRS by, or on behalf of, the taxpayer to whom

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[29] Sec. 6103(a).

[30] Sec. 6103(b)(1).

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

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

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

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

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

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

the information relates. For example, information submitted to the IRS by a taxpayer's accountant on behalf of the taxpayer is "taxpayer return information."

Section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.[32] For example, section 6103(l) (relating to disclosures for purposes other than tax administration) contains more than 20 separate provisions permitting disclosures of specific items of return information to agencies such as the SSA, the Department of Labor, the Pension Benefit Guaranty Corporation, Federal, State and local child support agencies, and the Department of Education, among others, to administer specifically identified programs.

Disclosures to the Social Security Administration

For purposes of administering the Social Security Act, the Code authorizes disclosure to the SSA, upon written request, of returns and return information relating to self-employment taxes (Chapter 2 of the Code); Federal Insurance Contributions Act ("FICA") taxes (Chapter 21 of the Code); and taxes withheld at the source on wages (Chapter 24 of the Code).[33]

Documents which may be disclosed under this provision include but are not limited to:

- Schedule C, Form 1040, Profit (or Loss) from Business or Profession,
- Schedule E, Form 1040, Supplemental Income Schedule-Part III, Income or Loss from Partnerships,
- Schedule F, Form 1040, Farm Income and Expenses,
- Schedule SE, Form 1040, Computation of Social Security Self-Employment Tax,
- Form 1065, U.S. Partnership Return of Income,
- Form 941, Employer's Quarterly Federal Tax Return,
- Form 942, Employer's Quarterly Tax Return for Household Employees or portions Schedule H, Form 1040,
- Form 943, Employer's Annual Tax Return for Agricultural Employees,
- Form W-2, Wage and Tax Statement (limited to those portions of the W-2 relating to Chapters 21 and 24),

[32] Sec. 6103(c) - (o). Such exceptions include disclosures by consent of the taxpayer, disclosures to State tax officials, disclosures to the taxpayer and persons having a material interest, disclosures to Committees of Congress, disclosures to the President, disclosures to Federal employees for tax administration purposes, disclosures to Federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures of taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

[33] Sec. 6103(l)(1)(A).

- Return information related to the bullets above. [34]

For administering section 1131 of the Social Security Act, section 6103(l)(1)(B) authorizes disclosure to the SSA of return information described in section 6057(d) pertaining to pension, profit-sharing, stock bonus plans, etc. to which part I of subchapter D of Chapter 1 of the Code applies. [35]

Section 6103(l)(5) authorizes disclosure of information returns to the SSA for: (1) carrying out an effective returns processing program; (2) the Combined Annual Wage Reporting ("CAWR") Program; and (3) certain disclosures for epidemiological and similar research. The information returns which may be disclosed under section 6103(l)(5) are those filed under Part III, Subchapter A, Chapter 61 of the Internal Revenue Code. These include primarily Form W-2; Form W-3 (Transmittal of Wage and Tax Statements); and Form 1099-R (Distributions from Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc).[36]

Section 432 of the Social Security Act specifies that notwithstanding section 6103(a), such documents as necessary for CAWR processing will be made available to SSA. This allows any type of tax information to be disclosed where such disclosures are necessary for CAWR.

Section 6103 and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996

Section 6103(a) provides "Returns and return information shall be confidential [and shall not be disclosed] except as authorized by the title." Consistent with tenets of statutory construction, it has been a long-standing interpretation of the IRS that, unless a provision of law outside the Code explicitly overrides section 6103 by specifically identifying it, a statute of general application (i.e. "notwithstanding any other law") does not override the restrictions of section 6103 on the disclosure of returns and return information.[37] The Illegal Immigration Reform and Immigration Responsibility Act of 1996 requires the Commissioner of Social Security to report to the Attorney General the names and addresses of aliens who are not eligible

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[34] Internal Revenue Service, Internal Revenue Manual, *Disclosure of Official Information: Administration of the Social Security Act - Social Security Administration*, Ch. 11.3, sec. 11.3.29.3 (05-27-2005).

[35] Section 6057(d) covers statements, notifications, reports and other information received by the IRS pursuant to the annual plan registration requirements of section 6057. Section 1131 of the Social Security Act relates to notification of Social Security claimant with respect to deferred vested benefits.

[36] Internal Revenue Service, Internal Revenue Manual, *Disclosure of Official Information: Disclosure of Information Returns to Social Security Administration*, Ch. 11.3, sec. 11.3.29.3.2 (05-27-2005).

[37] See, Office of Tax Policy, Department of the Treasury, *Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions, Volume I: Study of General Provisions* (October 2000) at 37.

for employment but who had Social Security earnings.[38] The provision does not specifically override section 6103. If this information is derived from return information furnished to the Social Security Administration, such as form W-2, the information is protected by section 6103, which does not provide a specific exception covering this type of disclosure.

The Illegal Immigration Reform and Immigrant Responsibility Act of 1996 also provides that information concerning illegal alien status should be provided to the Immigration and Naturalization Service notwithstanding any other law.[39] The Treasury Inspector General for Tax Administration has noted that the IRS is not providing information about a taxpayer's illegal alien status that the IRS may have obtained as a result of an application of ITIN or otherwise because the provisions does not specifically override section 6103.[40]

Safeguards to prevent, and penalties applicable to, the unauthorized disclosure or inspection of return information

Criminal penalties for unauthorized disclosure

The willful unauthorized disclosure of tax information is a felony punishable by a $5,000 fine, up to five years imprisonment, or both.[41] Willful unauthorized inspection of tax information is a misdemeanor punishable by a $1,000 fine, up to one-year imprisonment or both.[42] Federal employees and officers are required to be discharged from employment upon conviction of willful unauthorized disclosure or inspection.

Civil penalties for unauthorized disclosure or inspection

An action for damages against the United States is permitted when any Federal officer or employee knowingly or by reason of negligence inspects or discloses tax information in violation

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[38] 8 U.S.C. sec. 1360(c)(2). That section provides:

> (2) If earnings are reported on or after January 1, 1997, to the Social Security Administration on a social security account number issued to an alien not authorized to work in the United States, the Commissioner of Social Security shall provide the Attorney General with information regarding the name and address of the alien, the name and address of the person reporting the earnings, and the amount of the earnings. The information shall be provided in an electronic form agreed upon by the Commissioner and the Attorney General.

[39] 8 U.S.C. secs. 1360(b) and 1730.

[40] Treasury Inspector General for Tax Administration, *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (September 1999).

[41] Sec. 7213(a)(1).

[42] Sec. 7213A(a)(2)(b).

of any provision of section 6103.[43] A plaintiff is entitled to: (1) actual damages sustained as a result of unauthorized disclosure (including punitive damages for willful or grossly negligent disclosures), or (2) liquidated damages of $1,000 per disclosure, whichever is greater, as well as costs of the action and in certain cases, attorney fees. No liability arises from a good faith but erroneous interpretation of section 6103 or a disclosure made at the request of the taxpayer.

Safeguards

Section 6103 requires as a condition for receiving tax information, that recipient agencies establish, to the satisfaction of the IRS, physical, administrative and technical safeguards to the protect the confidentiality of the information received.[44] Such safeguards include a standardized system of records with respect to requests for disclosure of tax information and the reason for such disclosure, secure storage for the tax information, restrictions which limit access to the tax information to persons whose duties and responsibilities require access, and other safeguards as the IRS deems appropriate. The IRS is to review the safeguards established by such agencies.

[43] Sec. 7431.

[44] Sec. 6103(p)(4). See also Internal Revenue Service, Publication 1075, *Tax Information Security Guidelines for Federal, State and Local Agencies: Safeguards for Protecting Federal Tax Returns and Return Information* (Rev. 6/2000).

II. DESCRIPTION OF THE TAX PROVISIONS IN THE COMPREHENSIVE IMMIGRATION REFORM ACT OF 2006

A. Tax Liability of Alien Employees

Section 601 of the bill sets forth requirements for individuals to obtain an adjustment of alien status. One such requirement is that the alien be employed in the United States, in the aggregate, at least three years during the five-year period ending on April 5, 2006 and at least six years after the date of enactment of the bill (the "employment period"). In addition, the alien must establish by a date no later than the date on which status is adjusted, that he or she has paid any Federal tax liabilities, including penalties and interest, for any year during the employment period for which the statutory period for assessment has not expired.

Under the provision, the alien may establish that he or she has paid any Federal tax liability for the employment period by establishing that: (1) no such tax liability exists; (2) all outstanding liabilities have been paid; or (3) the alien has entered into an agreement for payment of all outstanding liabilities with the IRS. The Secretary is required to establish rules and procedures under which the IRS shall provide documentation to assist aliens in establishing that they have satisfied outstanding Federal tax liabilities.

Under the provision, aliens who are required to establish that they have paid any Federal tax liability are prohibited from receiving a refund of an overpayment of tax for any taxable year prior to 2006. In addition, such aliens are prohibited from filing a claim for the EIC or any other credit otherwise allowable under the Code for any taxable year prior to 2006.

B. Employer Absolution from Civil and Criminal Tax Liabilities

Section 601 of the bill enables employers who may have hired workers illegally to be absolved of all civil and criminal tax liabilities relating directly to the employment of an alien who is applying for an adjustment of status. The tax provision states in its entirety:

> Immigration Status of alien.−Employers of aliens applying for adjustment of status under this section shall not be subject to civil and criminal tax liability relating directly to the employment of such alien.

As drafted, the provision exempts the employer from all civil and criminal tax liability (tax, penalties, and interest) arising from the employment of such an alien, without clearly providing a statutory limit on the tax periods to which the exemption applies. The provision does not require as a condition of exemption, that the employer take any specific action to assist the employee in connection with the adjustment of status.[45]

[45] By contrast, in order to avoid civil and criminal liability under section 8 U.S.C. 274A for employing unauthorized aliens, the employer is required to provide such unauthorized aliens "with copies of employment records or other evidence of employment pursuant to an application for adjustment of status under this section or any other application or petition pursuant to other provisions of the immigration laws."

C. Section 6103 Provisions

Overview

The bill amends section 6103 to require SSA, upon written request of the Secretary of Homeland Security, to disclose certain return information to Department of Homeland Security ("DHS"), and its contractors. The provision requires the disclosure of taxpayer identity with respect to employers required to participate in the Electronic Employee Verification System and their employees, including all new hires. The provision also permits the disclosure of taxpayer identity with respect to employers receiving no-match notices and submitting information returns with duplicate TINs. The provision also requires the disclosure of the identity of employers filing Forms W-2 with respect to the same employee when SSA has reason to believe those forms contain evidence of identity fraud.

The use of the disclosed information is restricted to establishing and enforcing employer participation in the Electronic Employee Verification System proposed by the bill, carrying out non-criminal law aspects of certain provisions of the Immigration and Nationality Act, and the civil operation of the Alien Terrorist Removal Court. The provision sunsets three years after the date of enactment.

Section 6103 amendment to facilitate implementation of the Electronic Employee Verification System

The bill contains amendments to section 6103 to facilitate the implementation of the bill's Electronic Employee Verification System ("EEVS").[46] Under the bill, DHS and SSA are to implement the system to determine whether the information provided by employees to employers – name, social security number, date of birth, place of birth, employer identification number and alien registration number, if applicable − is consistent with the information the agencies maintain, and whether or not the employee is eligible to work in the United States. Every employer must submit employee data for new hires to the system beginning 18 months after the DHS receives the funds necessary to implement the system. The Secretary of Homeland Security can allow employers to participate on a voluntary basis before that date and the Secretary of Homeland Security can require employers critical to homeland security to participate before full implementation. The Secretary of Homeland Security can also require individual employers to participate prior to full implementation if the Secretary of Homeland Security has reasonable cause to believe they have violated immigration laws.

The bill amends section 6103 to require, upon written request of the Secretary of Homeland Security, SSA to disclose certain return information to DHS, and its contractors. In particular, the bill permits SSA to disclose the taxpayer identity information of employers that SSA has reason to believe have failed to register and participate in EEVS. This belief is based on a comparison of information submitted to SSA by DHS and tax information in the possession of SSA (e.g., Form W-2). The bill also permits SSA to disclose the taxpayer identity information

[46] Sec. 301 of S. 2611 as passed by the Senate.

of all employees of the nonparticipating employer hired after the date the employer is required to participate in EEVS.

SSA is required to disclose the taxpayer identity information of all employees of employers designated by DHS as a "critical employer" based on an assessment of homeland security or national security needs or of employers required to participate in EEVS because DHS believes the employer has engaged in material violations involving the employment of illegal aliens. The bill also requires SSA to disclose the taxpayer identity information of employers participating in EEVS and of all new hires of such employer based on the date the employer begins participation in EEVS or since the date of the last DHS request for such information.

Disclosure of return information relating to no-match notices and use of duplicate TINs

Upon written request from the Secretary of Homeland Security, SSA is required to disclose taxpayer identity information of employers who have submitted tax information with more than 100 names and TINs that do not match SSA records, or who have submitted more than 10 forms W-2 with employees all sharing the same TIN. SSA also is required to disclose upon written request of the Secretary of Homeland Security, the taxpayer identity information of employers who have filed information returns SSA believes contains evidence of identity fraud due to the multiple use of the same TIN of an employee (multiple employers filing information returns with respect to the same employee).

DHS contractor compliance with confidentiality safeguards

The provision requires that DHS conduct on-site reviews every three years of all of its contractors or other agents receiving Federal tax 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 tax information. This review is intended to cover secure storage, restricting access, computer security, and other safeguards deemed appropriate by the Secretary. Under the provision, DHS 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 tax 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.

III. ISSUES RELATED TO THE TAX PROVISIONS IN THE COMPREHENSIVE IMMIGRATION REFORM ACT OF 2006

A. Federal Tax Liability of Aliens

The bill requires an alien applying for adjustment of status to establish that he or she has paid any outstanding Federal tax liabilities for any taxable year during the employment period for which the statutory period for assessment has not expired. Although the employment period for this purpose may be eight years or longer, the period for which the alien is required to establish payment for outstanding tax liabilities is shortened considerably by the rule referencing the general three-year statutory period for assessing a tax. Generally, the period for assessing an addition to tax is three years from the date a return is filed. Thus, under the bill, if an alien has filed tax returns for the years covered by the employment period, the alien will only be required to pay outstanding tax liabilities (if any) for the three-year period prior to the date the alien's status is adjusted to meet the requirements of the bill. On the other hand, if the alien has not filed a tax return for any year during the entire employment period, the statute of limitations remains open and the alien will be required to pay any outstanding liabilities for that year. In any event, the IRS's ability to collect assessed liabilities is unaffected. Generally the IRS has a 10-year statute of limitations on collection.

The bill also prohibits aliens who are required to establish that they have paid any Federal tax liability from receiving a refund of an overpayment or from filing a claim for any credit otherwise allowable under the Code for any taxable year prior to 2006. Under present law, however, a taxpayer may file a refund claim within three years of the filing of the tax return or within two years of the payment of tax, whichever is later. Thus, the provision in the bill would have the effect of denying refunds to some alien taxpayers who would not otherwise be time barred from obtaining a refund under the Code. Similarly, the provision prohibits alien taxpayers from claiming any credit otherwise allowable under the Code. This disallowance applies not only to the EIC, which is not available to aliens filing with ITINs under present law, but also to any credit that may reduce taxes, such as the child tax credit or the dependent care credit. To the extent illegal aliens are required to pay taxes notwithstanding their immigration status, some may question the fairness of prohibiting aliens from recovering an overpayment of taxes or reducing their tax liability by otherwise allowable credits.

In addition, the bill may result in disparate treatment of alien taxpayers based on when the application for adjustment of status is filed. By its terms, the provision only denies refunds and credits to alien taxpayers filing an application for adjustment of status. The bill, however, is not clear as to when an alien must file an application for adjustment of status. As one of the requirements for adjustment of status is that the alien be employed at least six years after the date of enactment, there may be instances in which the alien does not file an application for adjustment of status until after the general period for filing a claim for refund for the 2006 year would have expired, notwithstanding the limitations in the bill. In such cases, for example, the limitation on refunds in the bill may have no effect on alien taxpayers. In other cases, an alien taxpayer may apply for adjustment of status before the general period of limitations for obtaining a refund has expired. When attempting to establish that he or she is has paid any Federal tax liability for the employment period, the alien may learn he is entitled to a refund for a taxable year prior to 2006, but the bill would deny a refund in this case. Thus, aliens who are otherwise

similarly situated may receive different tax treatment based solely on when an application for adjustment of status is filed.

In addition, the provision creates potential administrative problems. As discussed, the provision only denies refunds and credits to alien taxpayers filing an application for adjustment of status. The IRS, however, may not be able to determine the identity or timing of aliens filing applications. Under present law, the IRS has the ability to identify aliens who do not have and are not eligible to receive SSNs, i.e., those taxpayers using ITINs. Under the bill, however, aliens satisfying certain eligibility requirements will receive SSNs allowing them to obtain employment. Without a system for identifying aliens filing applications for adjustment of status, the IRS will lose the ability to identify those taxpayers who are not eligible to receive refunds or credits. Moreover, it is unclear whether the restrictions on the ability of aliens to claim otherwise allowable credits apply to tax returns filed prior to the filing of an application of adjustment, nor is it clear how the IRS would administer such a rule if that were the case.

B. Employer Protection from Employment Taxes

The bill relieves an employer of all civil and criminal tax liability directly related to the employment of a person applying for an adjustment of status. Some would argue that such a provision is necessary because an alien has to prove employment as part of the application for adjustment of status, which would identify the employer of the illegal alien. An employer might deny that he employed such individual if such an admission could be used by the IRS to assess taxes and penalties against such employer.

However, the bill provides for the confidentiality of information furnished by the applicant: "Except as otherwise provided in this section, no Federal agency or bureau, nor any officer or employee of such agency or bureau, may (A) use the information furnished by the applicant pursuant to an application filed [relating to earned adjustment for principal aliens, their spouses and children] for any purpose other than to make a determination on the application; (B) make any publication through which the information furnished by any particular applicant can be identified; or (C) permit anyone other than the sworn officers and employees of such agency, bureau or approved entity, as approved by the Secretary of Homeland Security, to examine individual applications that have been filed." There is an exception to this general rule of confidentiality that allows DHS and the Department of State to respond to written requests for information from a duly recognized law enforcement entity in connection with a criminal investigation or prosecution, or a national security investigation or prosecution. It appears that the IRS would have to request information in connection with a criminal investigation to get access to the contents of the application, and it appears that the IRS would not have access to the application information for civil purposes, as DHS would be barred from affirmatively disclosing such information and a request from the IRS for civil purposes could not be honored.

In addition, it appears that the employer would be absolved of liability even if the IRS independently developed the case without having access to the application materials. Further, the employer receiving this protection from tax, penalties and interest is not required to do anything to affirmatively assist the applicant with the application. The employer is not required to furnish proof of employment or other documentation to the alien applying for an adjustment of status.

Some may argue an exemption from all tax liabilities, civil and criminal, for the employer, is inconsistent with the provisions requiring the alien to satisfy all of the alien's tax liabilities arising out of that same employment. The employer has likely enjoyed the benefit of deducting the alien employee's wages as a business expense and some would argue that such employers should also bear the burden of the taxes associated with the employment of such alien. Still others might argue that such an exemption is unfair to employers who were compliant with their employment tax obligations, notwithstanding the illegal status of the employee. Finally, some might argue that an exemption for all tax liabilities is overly broad and provides an incentive for employers to hire illegal aliens, for whom employers are not required to pay employment taxes under the bill, over U.S. citizens and resident aliens, for whom employers remain liable for all employment taxes.

C. Section 6103 Issues

In general

Section 6103 reflects the balance between the needs of Federal agencies for information and a citizen's right to privacy. While it may be easier for government agencies to obtain information from the IRS, it has been argued that tax returns are completed by taxpayers for use by the IRS, and the IRS should not be a lending library for government as a whole. Taxpayers have a legitimate expectation of privacy in their communications with the IRS. This expectation of privacy promotes tax compliance. On the other side are the needs of government agencies to obtain information necessary to perform their duties efficiently and effectively.

Provisions may result in the disclosure of taxpayer information unrelated to immigration violations

DHS has asserted that the volume of records in possession of SSA for which the name and SSN do not match is an indication of widespread evasion of the immigration laws.[47] DHS has noted that very few employers respond to SSA's letters regarding no matches. "[G]iven the fact that simple errors can be corrected easily by both the employer and the employee, the extremely low return rate signals that an overwhelming percentage of the 'no match' instances cannot be explained by legitimate discrepancies and . . . suggests an attempt to obtain unauthorized employment through means of fraudulent SSNs."[48] The identity of the employer taken from a Form W-2, and the fact the employer filed a Form W-2 with incorrect information is all "return information" within the meaning of section 6103.

The Senate bill requires SSA to provide to DHS the taxpayer identity of employers with more than 100 instances of no-match information. It is not clear that "no-match" information directly relates to the employment of an illegal alien. A name and social security number may not match because an individual has changed her name as a result of marriage or divorce. A no match may be the result of transcription errors, name similarities, or other factors unrelated to the person's immigration status. Some no matches result because instructions have been issued to employers who file their earning reports electronically to use all zeros in the SSN field when they do not have a number for their worker. For these reasons, some might argue that the information may not provide DHS with data that provides useful leads in discovering immigration violations.

On the other hand, a single employer with more than 100 instances of no-match information for its employees may be a significant indicator that the employer is hiring people who are ineligible to work in the United States and who are using stolen or fictitious TINs. One could argue that limiting the disclosure to employers that have more than 100 "no matches" targets the information to those employers for which further investigation might be most fruitful.

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[47] Stewart A. Baker, Assistant Secretary for Policy, U.S. Department of Homeland Security, *Testimony Before the Subcommittee on Oversight of the House Committee on Ways and Means* (February 16, 2006).

[48] Id.

However, the significance of 100 instances of no match information may depend on the size of the employer. For example, an employer with thousands of employees and multiple geographic locations, 100 instances of no match information may not be as significant as it would be for a smaller employer having incorrect SSNs for half of its workers. In addition, increased enforcement by DHS. In addition, it should be noted that increased enforcement by DHS may have an adverse effect on tax compliance as currently tax compliant employers stop filing Forms W-2 for their employees in order to avoid detection by DHS.

The Senate bill also requires the disclosure of the identity of multiple employers reporting wages for the same employee, if SSA has reason to believe identity fraud is involved based on a comparison with information submitted to SSA by DHS. This provision may be overly broad as many persons have more than one job in a single tax year and the fact that multiple employers have filed Forms W-2 with respect to an employee does not necessarily indicate a violation of the immigration laws.

Authorizing disclosure of return information for purposes of enforcing EEVS may be premature and affect the privacy of millions of workers

The section 6103 amendments of the Senate bill are intended to serve as a backstop for the EEVS system by relying on Forms W-2 and will result in the dissemination of taxpayer identity information (name, address, and TIN) of both authorized and unauthorized workers. The bill requires the disclosure to DHS of the taxpayer identity information of each new employee and the taxpayer identity of their employer. That could potentially result in the disclosure of information relating to millions of taxpayers. Taxpayer identity is sensitive information, the unauthorized release of which can result in identity fraud and other harm.

The provisions permit disclosures not only to officers and employees of DHS but to contractors of DHS as well. The more widespread the dissemination of return information, the more opportunities there are for unauthorized disclosures of such information to occur. Thus, some may be concerned that a data breach could jeopardize the privacy of a significant number of taxpayers, the majority of whom will not be illegal aliens. It also stretches the resources of the IRS to review the safeguards of an agency as large as DHS, as well as its contractors.

Some may argue that the EEVS system proposed by the Senate bill should be operational before the disclosure of return information is contemplated. In this manner, the extent of the need for return information could be evaluated based on how well the system has operated without such information. It should be noted that since the Form W-2 is filed after the close of the calendar year, such forms do not provide a current snapshot of an employer's employees. In fact, many employees may leave their employers during the calendar year and many more may leave before DHS may begin an investigation of the employer. Some employers may find it difficult to obtain information from former employees to prove their legal status. Thus, some may argue that information more current than Form W-2 should be relied upon for enforcement of the EEVS.

D. Indirect Effects on Revenues Resulting from Immigration Reform

Effects on tax compliance as a result of the EEVS

S. 2611 establishes the EEVS. It can be anticipated that that certain illegal aliens currently using IRS-issued ITINs for filing tax returns, and the withholding of income and employment taxes would stop using ITINs for these purposes. This decline in use may arise because an ITIN would be an indicator of ineligibility for employment under EEVS for illegal aliens. However, over time, some, but not all, of these individuals may gain legal employment status under various provisions in the underlying bill.

The decline in the use of ITINs may result in increased noncompliance with the tax laws; e.g. reduced filing of tax returns, and reduced withholding of income and employment taxes. For example, the bill could result in a reduction in the amount of Old Age, Survivors, and Disability Insurance ("OASDI") employment taxes withheld. On the other hand, while fewer income tax returns will be filed by illegal aliens, these returns have a negative average income tax rate due to refundable credits (i.e, the taxpayer is due a refund). As a result, income tax revenues (relative to the present-law baseline) would increase when these returns are no longer filed.

Other tax effects

The legalization provisions of this bill have a number of tax consequences. Overall, the bill could result in an increase in the number of alien workers employed in the United States for whom taxes are withheld both for individual income tax and employment tax purposes, notwithstanding the employer protection provisions discussed above. To the extent that a higher portion of current wages paid are reported by employers to the IRS, there would be an increase in the amount of deductions taken by employers with respect to those wages. The bill also would increase the number of workers who are eligible to claim refundable tax credits. For example, the EIC requires that taxpayers and their otherwise qualifying children have a SSN that is valid for employment. As a result of the bill, it is expected that there will be an increase in the number of workers and their children who will satisfy this requirement. It is expected that this will increase the amount of refundable tax credits claimed. Similarly, the guest worker provisions of the bill would increase the number of workers with withholdings for individual income and employment taxes and refundable tax credits.