



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

January 12, 2015

The Honorable Paul Ryan, Chairman  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20515

RE: [Tax Reform Act of 2014](#)

Dear Chairman Ryan:

As Congress considers tax reform, the American Institute of Certified Public Accountants (AICPA) offers the following comments on the tax reform legislative act, entitled the [Tax Reform Act of 2014](#).

We applaud the tremendous efforts devoted to hearings, research, and drafting that went into the creation of the Tax Reform Act of 2014. We recognize the challenges of creating a plan that both lowers tax rates and broadens the income tax base in a manner that is neutral in terms of both revenue and distribution.

We recognize that the Tax Reform Act of 2014 is bound by revenue neutrality constraints particularly in the individual income tax rate structure. However, we firmly support simplicity in the tax structure and elimination of all surtaxes and phase-outs. We suggest a simplified tax rate structure that is applied consistently across all taxpayers.

We offer comments on some of the most important issues to the AICPA and its members. However, silence on an issue does not necessarily mean that we support a particular provision, as we are only commenting on selected issues in this letter. We intend to submit detailed comments on additional issues in the near future.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. Our members advise clients on Federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

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We welcome the opportunity to discuss these comments on the Tax Reform Act of 2014 or to answer any questions that you may have. I can be reached at (801) 523-1051 or [tlewis@sisna.com](mailto:tlewis@sisna.com); or you may contact Jeff Porter, Chair of the Tax Reform Task Force, at (304) 522-2553 or [jporter@portercpa.com](mailto:jporter@portercpa.com); or Melissa Labant, AICPA Director of Tax Advocacy & Professional Standards, at (202) 434-9234, or [mlabant@aicpa.org](mailto:mlabant@aicpa.org).

Sincerely,

A handwritten signature in black ink, appearing to read "Troy K. Lewis". The signature is written in a cursive, flowing style.

Troy K. Lewis, CPA  
Chair, Tax Executive Committee

cc: The Honorable Sander M. Levin, Ranking Member, House Committee on Ways and Means  
The Honorable Orrin G. Hatch, Chairman of the Senate Committee on Finance  
The Honorable Ronald L. Wyden, Ranking Member of the Senate Committee on Finance  
The Honorable Mark Mazur, Assistant Secretary for Tax Policy, Department of the Treasury  
The Honorable William J. Wilkins, Chief Counsel, Internal Revenue Service

## American Institute of Certified Public Accountants (AICPA) Comments on House Committee on Ways and Means Chairman Camp's Tax Reform Act of 2014

Our attached comments relate to the U.S. House of Representatives, Committee on Ways and Means Chairman Camp's tax reform legislative text of the [Tax Reform Act of 2014](#)<sup>1</sup> (hereinafter referred to as "the Tax Reform Act" or "Proposal"). Unless section references are noted as being from the Internal Revenue Code (IRC or "Code"), the section references are to the proposed legislative text in the Tax Reform Act. The AICPA would be pleased to discuss with Members of Congress and their staff any of the various issues addressed in this letter.

### General Comments

Our tax system must be administrable, not hinder economic growth, have minimal compliance costs, and allow taxpayers to understand their tax obligations. These features of a tax system are achievable if principles of good tax policy are considered in the design of the system.

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy. As with our prior comments on tax proposals, we have considered the following ten principles in our specific comments.<sup>2</sup>

## Principles of Good Tax Policy

- 1. Equity and Fairness.**  
Similarly situated taxpayers should be taxed similarly.
- 2. Certainty.**  
The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
- 3. Convenience of Payment.**  
A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
- 4. Economy in Collection.**  
The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
- 5. Simplicity.**  
The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
- 6. Neutrality.**  
The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
- 7. Economic Growth and Efficiency.**  
The tax system should not impede or reduce the productive capacity of the economy.
- 8. Transparency and Visibility.**  
Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
- 9. Minimum Tax Gap.**  
A tax should be structured to minimize noncompliance.
- 10. Appropriate Government Revenues.**  
The tax system should enable the government to determine how much tax revenue will likely be collected and when.



<sup>1</sup> Committee on Ways and Means Chairman Camp's February 21, 2014, Tax Reform Act of 2014; [http://waysandmeans.house.gov/uploadedfiles/statutory\\_text\\_tax\\_reform\\_act\\_of\\_2014\\_discussion\\_draft\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft_022614.pdf).

<sup>2</sup>AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; <http://www.aicpa.org/taxreform>.

We strongly encourage Congress to consider using these principles to guide comprehensive tax reform. We particularly want to stress a few of these principles and their importance in shaping effective tax reform.

*Equity and Fairness:* The tax system should consider both vertical and horizontal equity. *Horizontal equity* provides that taxpayers with equal abilities to pay should pay the same amount of tax. *Vertical equity* means that a taxpayer with a greater ability to pay should pay more than a taxpayer with a lesser ability to pay. We suggest consideration of equity in reviewing tax preferences – which preferences are retained and which are modified. In addition, equity should consider the range of taxes imposed on individuals and businesses, including employment and excise taxes.

*Certainty:* Since 2001, several temporary tax provisions with short expiration time periods have been added to the Code. However, almost all of these provisions have been routinely extended. Often, taxpayers have been unable to rely upon the extension of expiring tax provisions because such extensions occurred either late in the tax year of expiration or in some cases even into the next tax year. Many of these tax provisions were intended to cause taxpayers to behave in certain desired economic positive ways. When the tax laws are not certain, taxpayers, by default, will generally not anticipate the extensions, and the objectives are, therefore, not achieved.

*Simplicity:* Our current tax system is heavily burdened by complexity. Multiple and duplicative tax calculations, definitions, and preferences lead to taxpayer confusion and, thus, errors and frustration. Attempts to adjust tax liabilities through special rules affecting taxable income rather than the rate schedule add to complexity. Business provisions that require retention of records solely for tax purposes increase compliance costs. It is clearly possible to simplify the tax system as evidenced by several of the proposals included in the Tax Reform Act. We are concerned; however, that some of the proposals, such as one to amortize a portion of advertising expenditures, will add new unnecessary complexities. We urge consideration of removing duplicative rules and definitions, and reducing recordkeeping and calculations, to achieve simplicity, without adding new complexities.

*Economic Growth and Efficiency:* Taxes and compliance costs are significant outlays for all individuals and businesses. Taxes can also have an economic impact due to the way they are designed. For example, while both double-declining balance depreciation over five years and straight-line depreciation over twenty years will enable measurement of taxable income, these two approaches will have vastly different effects on economic growth and efficiency. Given the international competitive pressures businesses of all sizes face today, it is important that tax rules do not hinder the ability of any business to compete in today's global marketplace. Consideration of how rules can help promote economic growth, for example rules that encourage research and experimentation (R&E) efforts in the United States (U.S.), is a must.

*Transparency and Visibility:* Many of the changes proposed in the Tax Reform Act, most notably, repeal of the alternative minimum tax (AMT), will make the tax system more transparent. It is important for an effective tax system and informed citizenry that taxpayers understand the tax system and how it affects them. Clarity of the tax consequences of taxpayers' regular activities is a must. Transparency also helps improve voluntary compliance.

We recognize that it is not always possible for each tax provision and the overall tax system to equally meet each of the ten principles of good tax policy. Yet, it is important for lawmakers to carefully balance the principles to achieve a respected and administrable tax system. We hope that dedication to achieving an appropriate balance of the principles of good tax policy governs the decisions on the final version of the Tax Reform Act.

## **Specific Comments**

### **Title I – Tax Reform for Individuals, Subtitle A – Individual Income Tax Rate Reform**

The AICPA supports comprehensive tax reform. As part of these efforts, we support a new, simplified income tax rate structure. We note that the proposed tax system, which includes a new -ten percent surtax, creates unnecessary complexity. We suggest Congress avoid as well as eliminate all surtaxes as they are complicated, confusing, and lack transparency, similar to the alternative minimum tax in the current system. We suggest that Congress apply a simplified rate structure with only one set of rules as opposed to the Proposal which would entail two sets of rules or the current system which arguably includes three vastly different taxation systems.

We also urge Congress to use a consistent definition of taxable income without the use of any phase-outs. The use of phase-outs – in order to increase the effective tax rate – has contributed to the complexity and opaqueness of the present tax law and this Proposal. Phase-outs also unfairly create marginal rates in excess of the statutory rate. We are concerned that provisions to limit or eliminate the use of certain deductions and exclusions in the application of the top tax bracket will exacerbate these flaws. We urge Congress to use tax reform as an opportunity to develop the best definition of taxable income by creating a simple, transparent, possibly higher tax rate schedule that does not include hidden additional taxes and is applied consistently across all rate brackets. We also propose, as part of comprehensive tax reform, the complete removal of all phase-outs as these limitations serve as additional complexities for taxpayer compliance.

1. Sections 1001-1003 – Simplification of individual income tax rates; Deduction for adjusted net capital gain; Conforming amendments related to simplification of individual income tax rates. (As it relates to retirement plans only.)

The AICPA opposes the provision to offer the tax preference on retirement plan contributions to only those taxpayers in the new 25 percent tax bracket. By placing a 25 percent cap on the deductibility of retirement plan contributions, the newly created 10 percent surtax on retirement contributions made to employees in the 35 percent tax bracket effectively taxes these higher income employees twice – once when contributions are made to the plan, and then again when the money is distributed upon retirement (or in the case of Roth individual retirement accounts (IRAs), taxed when earned).

For small businesses owners, this provision is especially troubling. If they are subject to the ten percent surtax, they could decide to eliminate their workplace retirement plan. This procedure would have an undesirable trickle-down effect onto their employees, who would no longer have a workplace retirement plan, resulting in a significant reduction in the retirement savings of lower and middle class employees, who need to increase their retirement savings.

## **Title I – Tax Reform for Individuals, Subtitle C – Simplification of Education Incentives**

The AICPA commends Congresswoman Diane Black and Congressman Danny Davis for introducing the Student and Family Tax Simplification Act ([H.R. 3393](#)<sup>3</sup>) to consolidate certain tax benefits for education expenses. We especially commend the efforts of Chairman Camp for incorporating several of these same education proposals into the Tax Reform Act. The Code currently contains over 13 different education-related incentives, and the requirements, eligibility rules, definitions and income phase-outs vary from incentive to incentive. The complexity of these provisions prevents thousands of taxpayers from claiming tax benefits to which they are entitled or are advantageous to them.<sup>4</sup>

The AICPA encourages Congress to include the provisions within the Tax Reform Act and additional revisions to existing education provisions in order to simplify the tax incentives for higher education and help taxpayers meet current higher education expenses. For our additional suggestions on education incentive simplification, see our submitted testimony on the education incentives to the Senate Committee on Finance<sup>5</sup> and comment letters to both the U.S. House of Representatives and the U.S. Senate.<sup>6</sup>

## **Title I – Tax Reform for Individuals, Subtitle E – Deductions, Exclusions, and Certain Other Provisions**

### 1. Section 1403 – Charitable Contributions.

The AICPA opposes the provision in the Tax Reform Act to permit the deduction of charitable contributions made after the close of the tax year but before the due date of that tax return. We have concerns with the provision from both administrative and efficiency standpoints.

Charitable contributions are subject to extremely strict documentation requirements. Allowing taxpayers to claim a deduction for contributions made up until the return due date will add unnecessary burdens to taxpayers who must obtain these documents and tax preparers who assist the taxpayer in understanding the substantiation required. There is also the potential for discord and confusion related to recordkeeping and documentation by the taxpayer and the preparer.

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<sup>3</sup> Student and Family Tax Simplification Act, H.R. 3393; <https://www.govtrack.us/congress/bills/113/hr3393>.

<sup>4</sup> U.S. Government Accountability Office, Testimony before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives, Higher Education – Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes, dated May 1, 2008, GAO-08-717T. A May 2012 report from GAO indicated that for 2009 returns, about 14 percent of eligible taxpayers failed to claim education incentives resulting in an average lost tax benefit of \$466. GAO, Higher Education: Improved Tax Information Could Help Families Pay for College, GAO-12-560, May 2012.; <http://www.gao.gov/assets/120/119904.pdf>.

<sup>5</sup> The AICPA submitted testimony to the House Committee on Ways and Means hearing dated April 13, 2011, How the Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform; [http://www.aicpa.org/interestareas/tax/resources/taxlegislationpolicy/advocacy/downloadabledocuments/final\\_testimony\\_for\\_nellen\\_april\\_13,\\_2011.pdf](http://www.aicpa.org/interestareas/tax/resources/taxlegislationpolicy/advocacy/downloadabledocuments/final_testimony_for_nellen_april_13,_2011.pdf).

<sup>6</sup> The AICPA submitted a comment letter dated July 25, 2013, HR 2253 and S.1090, Higher Education and Skills Obtainment Act: AICPA Recommendations for Further Simplification of Higher Education Tax Incentives; <http://www.aicpa.org/Advocacy/Tax/Individuals/DownloadableDocuments/AICPA-HR2253-Education-Comments-7-25-13.pdf>.

Possible confusions include which year a donation is reported when made between January 1 and April 15, and the chance of inadvertent double-counting of the deduction.

Subjecting charitable contributions to a two percent of adjusted gross income (AGI) floor is an unnecessary complication as well, especially since section 1412 of the Tax Reform Act proposes eliminating an existing two percent floor on miscellaneous itemized deductions.

### **Title I – Tax Reform for Individuals, Subtitle F – Employment Tax Modifications**

#### 1. Section 1502 – Determination of net earnings from self-employment.

The AICPA opposes the provision in the Tax Reform Act that would characterize 70 percent of a materially participating partner's or shareholder's combined compensation and distributive share of the entity's income as net earnings from self-employment (SE) and, thus, made subject to the Federal Insurance Contributions Act (FICA) or SE tax. The residual 30 percent is deemed a return on capital and, therefore, not made subject to FICA or SE tax. Those non-materially participating owners would have none of their distributive share subject to SE tax.

Additionally, the current legislative language for the 70 percent of the income to be treated as SE income and 30 percent of the income to be treated as return on capital includes a family attribution provision, not described in the section-by-section summary report issued by the Committee on Ways and Means. This family attribution provision extends SE liability to any lineal descendant (or spouse) of a material participant. As a consequence complexity is created making the rules under SE and passive loss to be disjointed.

Furthermore, the proposal provides the portion of any pass-thru income subject to SE will not qualify for lower taxation under the "Qualified Domestic Production Income" provisions. This allows an unfair bias towards passive investors to be taxed at a substantially lower rate than those who are materially participating.

Overall, we support the intent of the provision to separate a flow-through entity owner's compensation from his or her right to a reasonable return on his or her invested capital. However, we are concerned that the proposed mandatory change provides an arbitrary method that is not appropriate in all circumstances to determine net earnings subject to SE tax and the return on invested capital. In an attempt to provide consistency and simplicity in this area, this provision would unnecessarily ignore the underlying economic relationship between the owner and the entity itself. This provision applies a constant amount of capital return regardless of industry. It is well-established in finance that success in different industries requires different amounts of capital. While the provision would provide *Certainty and Simplicity*,<sup>7</sup> the provision would also unjustifiably accomplish these goals at the expense of *Equity and Fairness*.<sup>8</sup> We agree in equally taxing a taxpayer who is also an equity owner in the enterprise the same as an otherwise similarly situated co-worker simply providing personal labor. However, such result through a per se rule is unreasonable.

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<sup>7</sup> AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; <http://www.aicpa.org/taxreform>.

<sup>8</sup> AICPA, *supra*.

Due to our reservations, mentioned above, we advise making the proposal a safe harbor option. The proposal must make it clear that the existence and the amount of the safe harbor is not a maximum amount permitted/allowed but a guideline and that the reasonable compensation standard to C corporations will remain available to pass-thru entities. This provides a uniform treatment between closely-held business entity types.

We also suggest indexing the 70/30 percent allocation of income to the appropriate index for periodic adjustments to have the most current and appropriate measure of contribution of labor and capital.

**Title I – Tax Reform for Individuals, Subtitle G – Pensions and Retirement, Part 1 – Individual Retirement Plans**

The AICPA appreciates the Proposal’s attention to the area of pensions and retirement plans. While we support many of the proposals in the Tax Reform Act, we have some concerns with the specific provisions outlined below. Additionally, we note that in April 2013, the AICPA provided tax reform recommendations related to retirement plans to the House Committee on Ways and Means Tax Reform Working Group on Pension/Retirement.<sup>9</sup>

1. Sections 1601–1603 – Elimination of Income Limits on Contributions to Roth IRAs: No New Contributions to Traditional IRAs: Inflation Adjustment for Roth IRA Contributions.

The AICPA supports the Proposal’s elimination of the income limitation related to funding Roth IRAs as such change will encourage taxpayers to save for their retirement. Currently, employees can elect to make designated Roth deferrals in employer-sponsored qualified retirement plans regardless of their adjusted gross income limit. Eliminating the limitation will allow all taxpayers the ability to make Roth contributions whether or not their employer has a “designated Roth contribution program.”

However, the AICPA opposes the Proposal’s elimination of traditional IRAs. Traditional IRAs are a fundamental retirement tool, and often used as an introduction to retirement savings – regardless of economic status – because they are easy to understand and implement. There are taxpayers who are unfamiliar with, or do not completely understand, Roth IRAs. We are concerned that taxpayers may drastically reduce the amount they save for retirement if traditional IRAs are phased out as provided in the Proposal.

Furthermore, we oppose suspending the inflation adjustment on the annual limits on Roth IRA contributions through 2024 because it will have a significant negative impact on taxpayers’ savings behavior.

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<sup>9</sup> AICPA Tax Reform recommendations on Retirement Plans and Trust, Estate and Gift Tax Issues dated April 2013; <http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/AICPA%20Letter%20to%20WaysMeans%20Pensions%20and%20Retirement%20FINAL.pdf>.



**Title I – Tax Reform for Individuals, Subtitle G – Pensions and Retirement, Part 2 – Employer Provided Plans**

1. Sections 1611-1612 – Termination for New SEPs; Termination for SIMPLE 401(k)s.

The AICPA does not oppose eliminating SIMPLE 401(k) plans; however, we are in favor of continuing to allow employers to establish simplified employee pensions (SEPs). SEPs provide a simple method for small employers to provide a retirement plan for themselves and their employees without getting involved in the details of a more complex qualified plan.

2. Section 1613 – Rules Related to Designated Roth Contributions.

The AICPA does not support the provision in the Proposal that requires employers who sponsor plans covering more than 100 employees to offer Roth accounts. The AICPA also opposes the related provision that limits the pre-tax elective deferrals to 50 percent of the overall limitation, with any contributions above that amount being made as Roth elective deferrals. Missing in the Proposal is a fundamental element of the voluntary employer retirement plan system that allows employers to choose the administrative features they wish to offer (e.g., loans, participant-directed investments, etc.). Similarly, the Proposal unnecessarily imposes different rules related to elective deferrals depending upon the size of the individual’s employer.

**Title II – Alternative Minimum Tax Repeal**

1. Sections 2001 – Repeal of alternative minimum tax.

The AICPA strongly supports the Proposal’s provision to repeal AMT. We agree that the current system’s requirement for taxpayers to compute their income for purposes of both the regular income tax and the AMT is a far-reaching complexity of the Code. AMT is burdensome for small businesses, which often do not know whether they are affected until they file their taxes and, therefore, must maintain a reserve that cannot serve as a resource for hiring, expanding, and giving raises to workers. As noted in the Proposal, the AMT “no longer serves the purposes for which it was intended.”

**Title III – Business Tax Reform, Subtitle B – Reform of Business-Related Exclusions and Deductions**

1. Section 3106 – Net operating loss deduction.

The AICPA opposes this provision in the Proposal, which limits net operating losses to 90 percent of the corporation’s taxable income, because it would impose an additional limitation on corporations’ ability to use a net operating loss (NOL).<sup>10</sup> A number of provisions (e.g., IRC section 382 and section 56) in the current system already limit the utilization of NOLs. As a

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<sup>10</sup> A NOL generally is the amount by which a taxpayer’s current-year business deductions exceed its current-year gross income. NOLs are not deducted in the year generated, but may be carried back two years and carried forward 20 years to offset taxable income in such years.

result, this provision adds an extra level of complexity to a comprehensive tax reform bill that aims to simplify the tax law.

One of the purposes of the NOL carryback and carryover rules is to allow a corporation to better reflect its economic position over a longer period of time than generally is allowed under the restraint of the annual reporting period. Since 1987, our experience with the 90 percent AMT limitation<sup>11</sup> on the use of NOLs shows that this limitation often imposes a tax on a corporation that is still struggling economically. As a result, the limitation imposes an artificial restriction on a company's use of an NOL that discriminates against companies with volatile income which could potentially pay more tax than companies with an equal amount of steady income over the same period and could affect financial statements adversely.<sup>12</sup>

## 2. Section 3108 – Amortization of certain research and experimental expenditures.

The AICPA opposes this proposal, which eliminates the election to currently deduct certain R&E costs. A mandatory requirement to amortize such costs over five years (actually, six years due to the mid-year convention) significantly increases the cost of R&E and creates disparity between tax treatment of R&E and the required current expensing under Generally Accepted Accounting Principles (GAAP). Given the inherently uncertain outcomes of experimental research, companies need the ability to deduct the costs associated with these risky expenditures in the year in which they are incurred.

The current system encourages R&E at a time when such activities are of global economic importance. The Organization for Economic Cooperation and Development (OECD) makes note of the competition among countries for R&E investment by companies and observes that R&E is “a crucial investment for the long-run growth of economies,” and also states that “generous incentives through R&E tax incentives can make a country a relatively more attractive location for R&E investments than its competitors.”<sup>13</sup> This provision creates a competitive disadvantage for U.S. companies and further risks the movement of research investments and jobs abroad to countries that provide incentives that are more attractive. Many countries provide incentives for R&E in the form of current deductions, credits, and what has been termed a “super” deduction.<sup>14</sup>

To promote economic growth in the U.S., protect U.S. R&E jobs, improve the global competitiveness of U.S. companies, and maintain consistency between GAAP and tax treatment of R&E expenses, we urge Congress to not change IRC section 174 as part of tax reform (other than to clarify that software development constitutes R&E, a clarification that we support).

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<sup>11</sup> The AMT rules provide that a taxpayer's NOL deduction may not reduce the taxpayer's AMT income by more than 90 percent.

<sup>12</sup> For example, a company with a large taxable income in a preceding tax year is able to get a refund attributable to the NOL; a company with a smaller taxable income in a preceding tax year might run into the 90 percent limitation in obtaining a refund from the same amount of NOL.

<sup>13</sup> Research & development (R&D) is used interchangeably with R&E. OECD, *R&D tax incentives: rationale, design, evaluation*, November 2000; <http://www.oecd.org/sti/ind/46352862.pdf>.

<sup>14</sup> A 2013 survey of R&D incentives by Deloitte notes various examples among countries; Deloitte, *2013 Global Survey of R&D Tax Incentives*, March 2013; [http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/US\\_Tax\\_RD\\_Global\\_RD%20Survey\\_March\\_2013.pdf](http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/US_Tax_RD_Global_RD%20Survey_March_2013.pdf).

### 3. Section 3110 – Amortization of certain advertising expenditures.

The AICPA opposes the proposed provision to require the amortization of 50 percent of current advertising expenditures over 10 years because it would add a new layer of complexity to the tax law, would rely on data of questionable availability, and would reduce economic efficiency and competitiveness.

The proposed definition of specified advertising expenditures creates complexities.<sup>15</sup> For example, a precise definition of advertising would require extensive regulations and judicial interpretation – guidance that may take years to develop. In addition, taxpayers, in general, do not currently track for non-tax purposes, which advertising expenses, such as those for an employee engaged in advertising but not “primarily” engaged, are subject to amortization and which advertising expenses are currently deductible. Such tracking would add undue administrative burden, lead to uncertainty in the calculation, and result in controversy with the Internal Revenue Service (IRS).

Advertising is a key expenditure for a business in order to promote its product, mission, values, and business. The requirement to amortize current year advertising expenditures effectively increases the cost of advertising, which can result in a competitive disadvantage in the local, national, and international marketplaces.

### **Title III – Business Tax Reform, Subtitle C – Reform of Business Credits**

#### 1. Section 3203 – Research credit modified and made permanent.

The AICPA supports the provision to make permanent the alternative simplified credit (ASC) component of the research credit and increase the ASC credit percentage to 15 percent. This provision would provide businesses greater certainty when committing to investments in research and experimentation and enhance the incentive effect of the credit.

We oppose the provisions that would no longer treat amounts paid for supplies as qualified research expenses (QREs). Since the original enactment of the credit, Congress has recognized that supplies at times are an integral part of conducting scientific research and thus are treated as QREs. Many research activities require the creation of physical representations or pilot models of a new design and subsequent testing of the design in actual operating conditions. As a result, section 3203 would exclude from the credit a substantial proportion of research spending because the cost of supplies, including the cost of prototypes and supplies used during testing, can comprise a significant portion of taxpayers’ research and experimentation expenses.

Additionally, we oppose the provision that would no longer treat computer software development as QREs. The development of computer software is an integral part of virtually every key industry in the United States. Making software development activities ineligible for the research credit dramatically reduces the research incentive for large sectors of the U.S.

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<sup>15</sup> For example, it is likely difficult for companies to determine which wages are “primarily related” to advertising and which wages are not – a subjective determination that could lead to uncertainty and controversy.

economy, reduces high-quality jobs, and encourages taxpayers to move those jobs and economic activity to lower-cost countries.

We oppose repealing the special rules that allow 75 percent of amounts paid to a qualified research consortium and 100 percent of amounts paid to eligible small businesses, universities, and Federal laboratories to qualify as contract research expenses. This provision in the Proposal would serve as a disincentive for research and innovation at, and negatively impact, such entities, thereby hurting growth of U.S. businesses and the economy.

Finally, we oppose repealing the election to claim a reduced research credit in lieu of reducing deductions otherwise allowed because this change would substantially increase the complexity associated with the computation of the research credit. For example, the current system election enables taxpayers to compute their taxable income and then separately compute their research credit. This current system separation has several benefits. For example, under the current system, electing taxpayers can conduct the allocation and apportionment of IRC section 174 costs required for foreign tax credit purposes without regard to the determination of the research credit. Electing taxpayers also are able to segregate the computation of the research credit from the determination of the various limitations that are based on federal taxable income, including the limitations on the use of foreign tax credits, the IRC section 199 deduction, and/or the corporate charitable contribution deduction, thereby avoiding otherwise circular calculations. Without this current system election, the Proposal would result in multi-state companies that are typically larger companies engaging in significant research and experimentation needing to recalculate their tax liabilities in numerous states after completing their research credit computation.

Alternatively, the AICPA supports [H.R. 4438](#)<sup>16</sup> as it incentivizes domestic research and experimentation, promotes growth of U.S. businesses and the economy, and also comports with the legislative history behind IRC section 41. We believe [H.R. 4438](#) provides the appropriate approach for incentivizing domestic research and experimentation through making the credit permanent and retroactive and making the ASC the default method for calculating the credit.

### **Title III – Business Tax Reform, Subtitle D – Accounting Methods**

#### 1. Section 3301 – Limitation on use of cash method of accounting.

As the AICPA has previously [stated](#),<sup>17</sup> we believe that Congress should not further restrict the use of the long-standing cash method of accounting for the thousands of U.S. businesses that currently utilize it. We also oppose the Proposal's limitation on the use of the cash method of accounting and the Proposal's elimination of exceptions for personal service corporations.

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<sup>16</sup> American Research and Competitiveness Act of 2014; <http://www.gpo.gov/fdsys/pkg/BILLS-113hr4438ih/pdf/BILLS-113hr4438ih.pdf>.

<sup>17</sup> AICPA written statement before the House Committee on Ways And Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft; <http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf>.

Determining income and expenses under the cash method<sup>18</sup> is widely acknowledged as the simplest, most objective method of determining taxable income. Additionally, the cash method respects the “wherewithal to pay” principle by aligning tax liabilities for the same tax period for which taxpayers have the resources to pay. Accrual accounting is an appropriate, but not the exclusive, method of measuring economic income.<sup>19</sup> However, the accrual method involves additional compliance costs, administrative burden and subjectivity that can lead to controversy, particularly due to differing opinions about the realization of income in the future. Our tax laws have consistently recognized the appropriateness of the cash method of accounting for smaller businesses and qualified personal service businesses (corporations, partnerships, trusts and individuals) regardless of their gross receipts.

If enacted, the Proposal would:

- Place a financial burden on qualified personal service businesses and their owners, requiring them to borrow or invest funds to pay tax on hypothetical income they have not yet received. This is a particular hardship in the service business because estimated revenues are seldom fixed and often subject to further negotiation and adjustment after the services are performed.
- Create hardship for those professional, qualified personal service businesses that cannot raise capital from outside sources because they are subject to state regulations that limit ownership to individuals who actively participate in the business.<sup>20</sup>
- Discourage natural business growth of small businesses from a sole proprietorship to a partnership or other pass-thru entity because exceeding \$10 million in annual receipts triggers an accounting change and a commensurate substantial requirement for capital (or borrowings) to pay taxes in advance of receipts.<sup>21</sup>
- Significantly increase the amount of compliance costs and government administrative resources required to determine income for businesses that could no longer use the simple and objective cash method.

In summary, the cash method of accounting is simpler in application, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the cash or other proceeds being taxed. This method of accounting with its broad application should be maintained as provided under the current law.

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<sup>18</sup> Under the cash method, income is recognized when it is actually or constructively received, and expenses are recorded when paid.

<sup>19</sup> Under the accrual method, income is recognized when the right to receive the income exists, and expenses are recorded when they are fixed, determinable and economically performed.

<sup>20</sup> For example, in many states, an accountancy firm may not have any passive (investor) ownership and a majority of the owners must hold active CPA licenses. As a result, many accounting firms must raise capital solely by the individual professionals who together own the firm; they cannot raise capital from outside investors.

<sup>21</sup> Consider a sole proprietor operating a successful business with more than \$10 million of gross receipts. If the sole proprietor adds a new partner to the business, the business is no longer operating as a natural person (sole proprietor), creating a disincentive to expand the business.

**Title III – Business Tax Reform, Subtitle G – Pass-Thru and Certain Other Entities, Part 1 – S Corporations**

1. Section 3601 – Reduced Recognition Period for Built-In-Gains Made Permanent.

The AICPA [continues](#)<sup>22</sup> to support this provision that permanently reduces the built-in-gain (BIG) tax recognition period to five years from ten years. In addition, we support making permanent the rule that installment sales are governed by the provision applicable in the tax year that the sale was made.

The AICPA believes that the proposed change would provide more clarity and continuity for taxpayers affected by the BIG tax. This provision is consistent with the legislation passed by Congress over the past few years, including multiple pieces of legislation to temporarily reduce the recognition period in an effort to provide tax incentives to many S corporations. The American Recovery and Reinvestment Tax Act of 2009 reduced the recognition period from ten years to seven years for 2009 and 2010. The Small Business Jobs Act of 2010 temporarily reduced the recognition period to five years for 2011. The American Taxpayer Relief Act of 2012 maintained the five-year recognition period for 2012 and 2013.

2. Section 3602 – Modifications to S Corporation Passive Investment Income Rules.

The AICPA continues to support this provision to increase to 60 percent (from 25 percent) the portion of an S corporation's income that is considered passive without incurring an entity-level tax and eliminate the current rule that terminates an S corporation's pass-thru status if the S corporation has excess passive income for three consecutive years.

Furthermore, the personal holding company (PHC) regime has a provision that applies an additional 15 percent tax when at least 60 percent of adjusted ordinary gross income for the tax year is personal holding company income. Because PHC income includes dividends, interests, royalties, and annuities, as passive income, we believe the Proposal's modification aligns the S corporation passive income provision with those relating to PHCs, and meets the historical tax policy behind the taxation of undistributed earnings and profits for PHCs.

The AICPA also supports the Proposal's elimination of S corporation status termination due to excessive passive investment income (PII). In today's economic environment, such a harsh restriction puts S corporations at a distinct disadvantage. Other pass-thru entities, such as limited liability companies and limited partnerships, do not have such a restriction and achieve a single level tax at the individual level. As a result, the Proposal's modification would eliminate the uncertainty of an involuntary termination of the S election related to PII for many S corporation shareholders and would allow the shareholders to concentrate on growing their businesses.

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<sup>22</sup>AICPA written statement before the House Committee on Ways And Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft; <http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf>.

### 3. Section 3603 – Expansion of Qualifying Beneficiaries of an Electing Small Business Trust.

The AICPA supports the provision and recommends broadening it by allowing nonresident aliens as direct owners of S corporation stock. To effectuate this change, we suggest amending IRC section 1361 by deleting (b)(1)(c) and the text “who is a citizen or resident of the United States” from (c)(2)(A)(i). Conforming amendments to sections 1441 and 1446 are necessary to include nonresident alien shareholders of S corporations.

S corporations have always imposed strict limitations on who qualifies as an eligible shareholder. Among those entities that currently are not permitted as an S corporation shareholder are nonresident aliens and trusts that would otherwise qualify as an Electing Small Business Trust (ESBT) except for the fact that one of the beneficiaries is a nonresident alien. Nonresident aliens may be beneficiaries but not potential current beneficiaries. Partnerships, however, permit nonresident alien partners whether through direct ownership or indirectly through a trust.

We are pleased that the Proposal provision provides an expansion of potential current beneficiaries of an ESBT to include nonresident aliens. However, as drafted, the Proposal still does not permit the direct ownership of S corporation stock by a nonresident alien. The expansion of the current potential beneficiaries of an ESBT to permit nonresident aliens could cause the termination of an S election upon the termination of the ESBT if the nonresident alien were to then own the S corporation stock directly. To avoid this treatment, the nonresident alien must immediately dispose the stock. Accordingly, the proposed expansion is inadequate and should allow nonresident aliens as beneficiaries of an ESBT and also as direct shareholders of S corporation stock.

### 4. Section 3604 – Charitable Contribution Deduction for Electing Small Business Trusts.

The AICPA supports this provision and continues to support allowing an ESBT to deduct charitable contributions made by the S corporation subject to the contribution limits and carryover rules applicable to individual donors.

Section 3604 of the Tax Reform Act provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carry-forward provisions applicable to individuals would apply to contributions made by the portion of an ESBT holding S corporation stock. We believe conforming the charitable contribution deduction rules to individual rules would provide simplification and avoid administrative burden on small business taxpayers.

### 5. Section 3605 – Permanent Rule Regarding Basis Adjustment to Stock of S Corporations Making Charitable Contribution of Property.

The AICPA supports this provision that makes permanent a statutorily sanctioned fair market value deduction for a charitable contribution but would limit the decrease in the shareholder’s stock basis to the adjusted basis of the contributed property. This modification provides a

uniform rule for both S corporation shareholders and partners in partnerships in deducting charitable contributions of appreciated property.

#### 6. Section 3606 – Extension of Time for Making S Corporation Elections.

The AICPA supports the principles set forth in section 3606, modifying the due date for the S election to align with the due date for filing the tax return including extensions and providing relief for late S corporation elections.

The AICPA also supports the provision in section 3606 that allows the IRS to accept as timely-filed a late-filed revocation if reasonable cause is shown, which is consistent with [Rev. Proc. 2013-30](#).

Rev. Proc. 2013-30 provides simplified methods for taxpayers to request relief for late S corporation, ESBT, qualified subchapter S trust (QSST), qualified subchapter S subsidiary (QSub), and corporate classification elections. In general, the revenue procedure expands the time for requesting relief for late S corporation, ESBT, QSST and QSub elections to 3 years and 75 days after the intended effective election date. As a condition of relief under Rev. Proc. 2013-30, taxpayers must submit a statement that describes its reasonable cause for failure to timely file an election, or that the failure to timely file the election was inadvertent (in the case of late QSST or ESBT elections), and its diligent actions to correct the mistake upon discovery.

We recommend that the provisions of Rev. Proc. 2013-30 become part of the regulations if section 3606 is enacted because it provides much needed relief provisions for late elections and has been well-received by the S corporation community.

### **Title III – Business Tax Reform, Subtitle G – Pass-Thru and Certain Other Entities, Part 2 – Partnerships**

#### 1. Section 3619 – Repeal of technical termination.

The AICPA supports the repeal of IRC section 708(b) regarding the technical termination of a partnership.

Under current law, when a partnership is technically terminated, the legal entity continues but for tax purposes, the partnership is treated as a newly formed entity. The current law requires the partnership to select new accounting methods and periods, restart depreciation lives, and make other adjustments. Furthermore, under the current law, the final tax return of the “old” partnership is due the 15<sup>th</sup> day of the fourth month after the month end in which the partnership underwent a technical termination.<sup>23</sup>

In practice, this earlier filing of the old partnership often goes unnoticed because the company is unaware of the accelerated filing deadline because of the equity transfer. Penalties are often

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<sup>23</sup> For example, a partnership that technically terminated on April 30 of the current year due to a transfer of 80 percent of the capital and profits interests in the partnership must file its tax return for that final tax year on or before August 15 of the current year.



assessed upon the business as a result of the missed deadline. Although ignorance is not an acceptable excuse, this technical termination area is often misunderstood and misapplied by most taxpayers. The acceleration of the filing of the tax return, to reset depreciation lives and to select new accounting methods serves little purpose in terms of abuse prevention and serves more as a trap for the unwary. Therefore, we believe that the Proposal's repeal of technical termination promotes simplicity.

## 2. Section 3622 – Partnership audits and adjustments.

Currently, partnerships are subject to three different audit regimes. Despite the multiple alternatives, adjustments with respect to certain partnerships are cumbersome and difficult to administer (e.g., partnerships with a large number of partners subject to the TEFRA<sup>24</sup> regime).

The AICPA supports the Proposal's intent to reduce complexity but recommends:

- Allowing all partnerships to make the election provided by IRC section 6221(b) at the beginning of the audit (i.e., not with the timely filed return for the year under exam);
- Refunding of taxes to include interest, with respect to a decrease in taxable income;
- Extending joint and several liability only to those partners who were partners during the year under exam;<sup>25</sup>
- Requiring netting of adjustments for all years under exam when computing the tax due pursuant to section 6225(b)(1).<sup>26</sup>

Our recommendations are fair, allow the partnership to analyze the facts as they exist at the time of the exam, and hold the appropriate partner liable for the period in which they were a partner. Our recommendation also prevents the shift of one set of complexities for another and avoids a transfer of the complexity from the Treasury to partnerships and their partners.

### **Title III – Business Tax Reform, Subtitle I – Provisions Related to Compensation, Part 1 – Executive Compensation**

#### 1. Section 3803 – Excise tax on excess tax-exempt organization executive compensation.

This provision is designed to place not-for-profit organizations on parity with for-profit entities as to the lack of a deduction for compensation in excess of \$500,000. However, for-profit organizations have various workaround options that are not available to tax-exempt organizations. For example, shareholder approval of the compensation is not available to tax-

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<sup>24</sup> The Tax Equity and Fiscal Responsibility Act of 1982; <http://history.nih.gov/research/downloads/PL97-248.pdf>.

<sup>25</sup> For example, assume a professional partnership with three equal partners in the year under exam is selected for examination and that one of the partners has withdrawn in the intervening period. Assuming an election is excluded and was not made when the return for the year under exam was filed, the partnership and all the partners are jointly and severally liable for any tax assessed the partnership pursuant to IRC section 6225(b)(1). This example is the case despite the fact that 1/3<sup>rd</sup> of the amount due is attributable to a departed partner.

<sup>26</sup> A common example is a repair that requires capitalization as a result of an exam which would result in depreciation in the next year. The proposal would require a payment with respect to the first year and an adjustment to taxable income with respect to the second year.

exempt organizations but is available to for-profit entities. Accordingly, the AICPA is not in favor of this provision because it does not accomplish the goal of *Equity and Fairness*.<sup>27</sup>

#### **Title IV – Participation Exemption System for the Taxation of Foreign Income**

Consistent with the AICPA’s support of simplicity and comprehensive tax reform, we recommend a simpler more efficient system that encourages job creation, productivity, and entrepreneurship.

Under the current system, the United States taxes corporate income on a worldwide basis, but in some circumstances allows domestic corporations to defer taxation of foreign income until it is remitted to the U.S. As a result of the ability to defer U.S. tax until repatriation and high corporate income tax rates when compared to our peer nations, there is minimal incentive for corporations to repatriate foreign cash to reinvest in domestic infrastructure or jobs when the same earnings sometimes are deployed more efficiently overseas. To the extent there is a need, it encourages corporations to engage in complex transactions to reduce the U.S. tax cost associated with repatriation. The current system relies on extraordinarily complex rules to determine where income is earned, when income has been repatriated, and what creditable foreign taxes are considered against the U.S. tax on foreign source income.

The proposed Participation Exemption System would tax income earned in the United States at normal corporate rates and foreign income at much lower rates, with insignificant incentive to defer foreign profits indefinitely because of the lower rate. Rather than postpone tax indefinitely, the Participation Exemption System would assess a relatively small additional tax on worldwide income for the privilege of being incorporated in the U.S. Once fully implemented, the system would mitigate complex foreign tax credit rules and the incentive to avoid tax indefinitely by reinvesting in foreign operations. A benefit of the proposed changes is the potential for the IRS to focus its efforts on determining the appropriate allocation of income between U.S. and foreign jurisdictions, reducing the significance of the complex rules related to foreign tax credits and repatriation of profits.

Although we offer no view as to the appropriate tax rates, we believe this proposed system is one of the appropriate alternatives to the current system and is, in general, simpler and more efficient, collecting tax more transparently with less administrative burden. As the Proposal moves forward, Congress should give careful consideration to the effective tax rate assessed on corporations for the privilege of being formed in the United States. Similarly, Congress should define fairly the tax base for business attributable to the U.S. by considering base erosion rules and appropriate transfer pricing protocols. The AICPA acknowledges that a number of comments have been submitted by taxpayers regarding the base erosion provisions contained in the Proposal, and we would be pleased to work with you and your staff as these provisions are further analyzed.

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<sup>27</sup> AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; <http://www.aicpa.org/taxreform>.

We note that the transition rules are extremely complex, which is not surprising, and an expected price to pay for the long-term benefits that simplification can attain. We suggest that Congress provide sufficient time to implement transition rules.

**Title V – Tax Exempt Entities, Subtitle A – Unrelated Business Income Tax**

1. Section 5002 – Name and logo royalties treated as unrelated business taxable income.

The AICPA opposes this provision because we oppose taxation of passive income, like other passive income excepted from unrelated business income (UBI) under IRC Section 512 and other sections. Additionally, if this royalty income is treated as unrelated business taxable income and is “substantial,” this situation can jeopardize the exempt status of an organization.

Currently, most items of passive income are excluded from UBI. Additionally, there are two concerns about taxing royalties that exempt organizations face: 1) the actual tax and 2) revocation of the tax exempt status if the organization has too much UBI. If Congress wants to assess tax on this passive income, perhaps they should impose the tax in a manner similar to the Net Investment Income of IRC section 1411. This method would preserve the exempt status of the organization. Since the income is passive, we think it should not count toward the prohibition for an exempt organization of having more than “insubstantial” amount of unrelated business income.

2. Section 5005 – Parity of charitable contribution limitation between trusts and corporations.

The AICPA opposes the provision as it prevents a tax-exempt trust from deducting up to 50 percent of the entity’s unrelated business taxable income (UBTI), which is the same limitation that applies to individuals. The provision would only allow a deduction up to a ten percent as is common for corporations.

Enacting legislation to modify the income tax rules specifically for tax-exempt organizations that generate taxable income is contrary to the overarching stated goal of tax simplification and thus, the goal of tax reform.

3. Section 5006 – Increased specific deduction.

The AICPA supports the provision to raise the gross receipts threshold for filing the Form 990-T, Exempt Organization Business Income Tax Return, from \$1,000 to \$10,000. This provision reduces the government’s burden for processing tax returns which have negligible amounts of unrelated business income. In addition to the current proposal, we ask that this legislation also provide an inflationary index figure that can adjust over time, therefore allowing the standard deduction increase to adjust for inflation. This would further reduce compliance burdens (including recordkeeping and tax preparation costs) for organizations with relatively minor amounts of UBI.

#### 4. Section 5008 – Qualified sponsorship payments.

The AICPA opposes the provision because tax-exempt organizations should not have sponsorship income taxed as unrelated business income and have concerns about whether the such income jeopardizes the exempt status of the organization because it has generated too much unrelated business income.

The provision appears aimed primarily towards colleges and universities and it would hinder exempt organizations from raising the support and funding they need to operate.

In addition, the IRS has spent significant time addressing these items and issuing regulations that are workable and consistent with IRC section 513. Tax-exempt organizations have spent a lot of time learning to comply with the rules and have structured arrangements accordingly. To change the rules now would waste that effort and impact not only large organizations but smaller ones that often depend on sponsorship payments as a significant source of their operating revenue.

#### **Title V – Tax Exempt Entities, Subtitle B – Penalties**

##### 1. Section 5101 – Increase in information return penalties.

The AICPA opposes the provision to double the penalties for failure to file various returns, disclosures or public documents on organizations and managers since existing penalties are already at a significantly high rate to encourage compliance. Also, a lack of compliance is often due to reasonable cause. Raising the penalties will only increase the number of tax-exempt organizations that will seek waiver due to reasonable cause, which will add to the burden on the IRS.

##### 2. Section 5102 – Manager-level accuracy-related penalty on underpayment of unrelated business income tax.

The AICPA opposes the provision to create a tiered penalty specifically for managers of a tax-exempt organization because an accuracy-related penalty is applied to the organization for any substantial understatement of UBIT. We also believe managers are dependent upon others for an accurate estimate of unrelated business income therefore this provision would be unfair. Many times, accurate estimates are not available or provided due to the fact that the unrelated business income is generated by pass-thru investments and not through direct activities of the tax exempt organization. Therefore, this provision is not an equitable tax as it would unfairly tax and penalize managers for actions beyond their ability to manage and control.

#### **Title V – Tax Exempt Entities, Subtitle C – Excise Taxes**

##### 1. Section 5201 – Modification of intermediate sanctions.

The AICPA opposes a portion of the provision to disallow managers from being able to rely on the professional advice safe harbor under the Treasury regulations. The provision will remove important protections currently offered to managers of tax exempt organization who are able to

create a safe harbor presumption of reasonableness by conducting specific due diligence steps and reliance on the advice of professionals. Removal of this safe harbor creates significant and unnecessary uncertainty around the assessment of intermediate sanctions.

2. Section 5202 – Modification of taxes on self-dealing.

The AICPA opposes the provision to impose an excise tax of 2.5 percent on a private foundation since the self-dealing tax is already imposed on a disqualified person. We do not believe that the enactment of this provision will directly correlate to an increase in taxpayer compliance. These taxes are often triggered by inadvertent violations of obscure and arcane tax laws prohibiting financial transactions between disqualified persons and private foundations. To assess an additional tax on the private foundation itself as well as the managers and the disqualified persons will not lead to improved compliance, but will increase burden on the foundation which itself does not have the ability to act except through the individuals already subject to the self-dealing penalties.

3. Section 5203 – Excise tax on failure to distribute within five years contribution to donor advised fund.

The AICPA opposes the provision which would require donor advised fund sponsors to implement an inventory management system for contributions.

There are significant costs related to implementing new systems that would result in reducing the amount of dollars used for charitable purposes and increase the amount spent on administrative costs. In addition, the provision does not address the change in value of the fund. The value may decrease in such a way that it is impossible to distribute the funds received. Based upon the data available on the amount of funds actually distributed from donor advised funds, it already far exceeds the five percent of value required of private foundations. If the behavior this provision is attempting to influence is payout, it may prove less costly to impose a payout based upon value rather than time.

4. Section 5205 – Repeal of exception for private operating foundation failure to distribute income.

The AICPA opposes the provision to repeal the special exclusion for private operating foundations (POFs) to distribute their income (i.e., to prevent abusive transactions). We would appreciate additional information on the behavior Congress is attempting to influence through this specific provision to allow us an opportunity to provide recommendations that may better target Congress's goals.

A POF must already meet two tests (the first test is the income test and the second test has three potential subparts). The proposed legislation oversimplifies the requirement qualifications for a POF and creates greater administrative burdens for exempt organizations that are often limited by minimal resources.

5. Section 5206 – Excise tax based on investment income of private colleges and universities.

The AICPA opposes the provision to subject certain private colleges and universities to a one percent excise tax on net investment income because it is contrary to the public policy of making colleges and universities affordable for students.

This provision seems to exist for revenue generation purposes and, therefore, does not take into account that if enacted, monies paid for this tax may reduce funding for scholarships and ultimately increase tuition costs. Additionally, this provision is easily circumvented by creating a separate entity that is not classified as a private college or university.

**Title V – Tax Exempt Entities, Subtitle D – Requirements for Organizations Exempt from Tax**

1. Section 5304 – Repeal of Type II and Type III supporting organizations.

The AICPA opposes the provision to repeal Type II and Type III supporting organizations. This provision forces organizations that support public charities to qualify as a supporting organization that is operated, supervised, or controlled by a publicly supported organization (a Type I supporting organization), or they would be treated as a private foundation. Under current laws, certain organizations that provide support to another public charity may also be classified as public charities rather than private foundations, even if not publicly supported. These categories of supporting organizations are needed in order to help public charities gain a variety of much needed donors and resources. Therefore, we do not support the repeal of Type II and Type III supporting organizations.

**Title VI – Tax Administration and Compliance**

The AICPA has consistently supported and remains committed to legislative changes that result in a simpler, more easily-administered income tax system. Even before the publication of our [Tax Policy Concept Statement Number 1: Guiding Principles of Good Tax Policy](#)<sup>28</sup> in March, 2001, we commented on proposed legislation by analyzing its stated purposes and also considering the impact it would have on the administration of the entire tax system. The principles we espouse – including Equity and Fairness, Certainty, Economy of Collection, Simplicity, and Neutrality, to name a few – are grounded in improving the functioning of the tax system to ensure that it is efficiently and effectively meeting the expected levels of government services demanded by citizens.

Unnecessary complexity is added to our tax system when legislation that addresses legitimate tax policy issues is enacted without full consideration of alternatives that are less burdensome and still responsive to the purposes of the legislation. While there are many examples, perhaps no situation illustrates unneeded complexity better than the proliferation of terms that have similar meanings but contain vastly different tax consequences. We recognize that there are legitimate anti-abuse justifications for differences in the application of, for example, small business status, family relationships, entity ownership, and entity attribution operating rules. However, many of

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<sup>28</sup> AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; <http://www.aicpa.org/taxreform>.

these overlapping and inconsistent applications, with corresponding definitional distinctions, have been in the IRC for decades. We believe that it would reduce complexity and increase compliance if these types of provisions are identified and reduced. In addition, the policy analysis should determine if the requisite anti-abuse rationales still exist and are resolvable by alternative means.

Another collateral effect of complex legislation is the growth of deadwood language. It is necessary for Congress to prune obsolete language regularly in order for the Code not to become overgrown with superfluous and outdated language.<sup>29</sup> Since deadwood language has almost no budgetary impact and repealing these sections comes only at the cost of drafting the necessary language, we recommend addressing obsolete language with a regular, disciplined program. Congress should require the Joint Committee on Taxation to present a Deadwood Bill for enactment no less than once every five years.

We applaud Congress for considering comprehensive tax reform as we understand the challenges Congress faces as it tackles the complex issues inherent in drafting tax legislation, and note that both taxpayers and tax practitioners are interested in, and need, tax simplification. Compliance burdens for individual taxpayers are too heavy, both in terms of time required and out-of-pocket cost. Likewise, complexity increases the “Tax Gap” and may impair the efficiency of tax administration.<sup>30</sup> While there are revenue costs associated with simplification reforms, it is also important to recognize the elimination of significant compliance burdens by such reforms.

#### **Title VI – Tax Administration and Compliance, Subtitle B – Taxpayer Protection and Service Reform**

The measured amount of fraudulent refunds paid and the unmeasured economic impact to individual victims of identity theft are currently unacceptable and growing and we think it is necessary to abate this behavior. Overall, we support the following general legislative actions:

- Single Point of Contact for Identity Theft Victims – Efficiencies will result as a single point of contact will identify areas of duplication and areas causing delays.
- Criminal Penalty for Misappropriating Taxpayer Identity in Connection with Tax Fraud – We recommend making it a felony for a person to use a stolen identity to file a return.
- Extend IRS Authority to Require Truncated Social Security Numbers (SSN) on Form W-2 – We recommend modification of the statutes that mandate the use of a SSN, IRS individual taxpayer identification number (TIN), or IRS adoption TIN to allow the truncation of the identifying number.

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<sup>29</sup> The AICPA supports the TRA of 2014 which identifies numerous sections of the IRC where adjustment is a must. We have analyzed those provisions and identified other provisions not included in the TRA language. Upon request, we would be pleased to provide this listing to the staff in a separate document.

<sup>30</sup> AICPA written testimony before the House Committee on Ways And Means, dated April 13, 2011, Hearing on How the Tax Code’s Burdens on Individuals and Families demonstrate the need for Comprehensive Tax Reform; [http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/FINAL\\_TESTIMONY\\_FOR\\_NELLEN\\_April\\_13,\\_2011.pdf](http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/FINAL_TESTIMONY_FOR_NELLEN_April_13,_2011.pdf).

We also suggest clarification of section 170(f)(12), regarding contributions of cars, boats and airplanes to allow the truncation of the SSN on the acknowledgement letter to the donor.

- Study of Expansion of PIN System for Prevention of Identity Theft Tax Fraud – A review of industry practices to provide security of client personal information may reveal opportunities for the IRS to verify the taxpayer’s identity.<sup>31</sup> Legislation requiring taxpayers or returns requesting a refund (but not to apply an overpayment) to obtain an identity protection PIN would reduce fraudulent returns and is a must.

The AICPA previously provided detailed comments regarding the provisions for the single point of contact for victims, truncating SSN<sup>32</sup> on Forms W-2, and the expansion of the IP PIN system. We also recommended further validation of a taxpayer’s address or change of address.<sup>33</sup> Immediate implementations of these measures are only the first steps, and we realize no system will eliminate all identity theft and tax fraud. However, the expense of establishing such a system is offset by the long-term benefits in terms of direct cost savings and overall trust in the integrity of the tax system.

#### 1. Sections 6103 – Pre-populated returns prohibited.

The AICPA does not support the Proposal’s prohibition on pre-populated returns. Pre-populated returns are a valuable, modern tool that the IRS can use to encourage voluntary compliance and that can reduce the cost and burden to many individuals and practitioners. Also, delinquent taxpayers are often motivated to file a correct return when presented with a pre-populated return. Any concern that a taxpayer will file the pre-populated return that omits some of his or her income is not a new concern, and penalties for non-compliance would continue to apply.

Furthermore, we support the IRS developing a system to pre-populate Form 1040 EZ, Income Tax Return for Single and Joint Filers with No Dependents, for qualifying individuals from information received by third parties and calculate the taxpayer’s income tax liability. According to statistics gathered by the IRS, approximately 16 percent<sup>34</sup> (20 million returns), of

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<sup>31</sup>AICPA Comment letter dated September 30, 2013 on Treasury Inspector General for Tax Administration Report Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds. Reference Number: 2013-40-122; <http://www.treasury.gov/tigta/auditreports/2013reports/201340122fr.html>.

<sup>32</sup> AICPA Comment letter dated February 20, 2013 on Truncating SSN; <http://www.aicpa.org/interestareas/tax/resources/irspracticeprocedure/downloadabledocuments/truncated%20tins.pdf>.

<sup>33</sup> AICPA Comment letter dated June 27, 2013 on the Identity Theft and Tax Fraud Prevention Act of 2013 and Recommendations on Efforts to Combat Identity Theft; <http://www.aicpa.org/Advocacy/Tax/IRSPracticeProcedure/DownloadableDocuments/AICPA-Identity-Theft-Comment-Letter--6.27.13.pdf>. The AICPA most recently submitted comments on Truncated Taxpayer Identification Numbers; <http://www.aicpa.org/interestareas/tax/resources/irspracticeprocedure/downloadabledocuments/truncated%20tins.pdf>, to the IRS on February 20, 2013. See AICPA Testimony on Tax Fraud, Tax ID Theft and Tax Reform: Moving Forward with Solutions, April 16, 2013; <http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA%27S%20TESTIMONY%20ON%20SENATE%20FINANCE%20COMMITTEE%20HEARING%20ON%20APRIL%2016,%202013.pdf>.

<sup>34</sup> IRS, SOI Tax Stats – Historical Table 1, <http://www.irs.gov/uac/SOI-Tax-Stats-Historical-Table-1>.



all 2011 individual income tax returns filed were on Form 1040 EZ. We think this is a realistic proposition because all of the information necessary to file a 1040 EZ return is mandatorily reported to the IRS by third parties. In January, we proposed to the U.S. Senate Committee on Finance to [accelerate due dates of information returns](#).<sup>35</sup> If implemented, this provision will further facilitate the pre-population of 1040 EZ returns with accuracy. The taxpayer can either accept the return or can opt to file an income tax return prepared by themselves or a practitioner.

Granting the IRS the authority to calculate the taxpayer's tax liability, as is provided in other countries, as noted in the [1996 GAO](#) report on alternative filing, will dramatically decrease the cost and burden to individuals and practitioners and will encourage voluntary compliance.

### **Title VI – Tax Administration and Compliance, Subtitle C – Tax Return Due Date Simplification**

1. Sections 6201-6203 – Due dates for returns of partnerships, S corporations, and C corporations; Modification of due dates by regulation; Corporations permitted statutory automatic 6-month extension of income tax returns.

The AICPA supports the Proposal's due dates provision and suggests two recommendations to align it completely with [H.R. 901](#).<sup>36</sup> The Proposal's provision would better facilitate (versus the current system) the flow of information between taxpayers and reduce the need for extended and amended corporate and individual tax returns.

The AICPA appreciates the Proposal's efforts to improve the tax return filing process. Both the Proposal and [H.R. 901](#), a bill introduced by Representative Jenkins, would improve the prospects for the timely filing of tax returns of individuals, partnerships, S corporations, and C corporations and correct the mismatch of information flow that persists in the system today.

However, we recommend revising the Proposal's current March 15 S corporation deadline to March 31, as provided in [H.R. 901](#), to stagger the deadlines for S corporations that are partners in partnerships to allow them two weeks after receiving the Partnership Schedules K-1s to file the S corporation return and provide needed information to the S corporation shareholders two weeks prior to the April 15 individual tax filing deadline. The extra two weeks are needed to prepare accurate and complete S corporation tax returns. Without that extra time, more S corporation tax returns will need to be extended or amended. Additional amended S corporation tax returns will result in additional costs to the taxpayer and additional administrative and processing burdens for the IRS. We suggest a March 31 filing deadline for S corporations.

In addition, we prefer that the Proposal not include a special rule for C corporations with fiscal years ending on June 30, as it adds complexity.

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<sup>35</sup> AICPA Comment letter dated January 16, 2014 on the Tax Reform Discussion Draft on Tax Administration; <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-Discussion-Draft-on-Tax-Administration.pdf>.

<sup>36</sup> U.S. Government of Accountability Office, Tax Administration Alternative Filing Systems Report, dated October 16, 1996; <http://www.gao.gov/products/GGD-97-6>.

## **Title VI – Tax Administration and Compliance, Subtitle D – Compliance Reforms**

Our tax system’s success depends upon voluntary compliance with the tax laws. “Civil tax penalties should exist for the purpose of encouraging voluntary compliance and not for other purposes, such as the raising of revenue.”<sup>37</sup>

There is a worrisome trend that new penalties continually appear in legislation as a “balancing tool” to generate the necessary revenue to neutralize the tax impact of legislation. Consequently, to raise additional revenue, the “stacking” of penalties results and makes the penalties inconsistent with their original purpose with little consideration of their effect on voluntary compliance. Furthermore, this trend has increased the burden on IRS personnel, taxpayers, and practitioners.

In general, we support the Proposal’s compliance reform provisions<sup>38</sup> that encourage good behavior and voluntary compliance and that are fair and consistent. Below are recommendations to a few of the Proposal’s provisions to ensure the above measures are attained if the provisions are implemented.

### 1. Section 6301 – Penalty for failure to file.

We recommend revising the provision to clarify that the minimum penalty for failure to file will be equal to the lesser of \$400 or 100 percent of the amount of tax due as shown on the return. Our recommendation will ensure a penalty that is fair and proportionate to the degree of misconduct.

### 2. Section 6302 – Penalty for failure to file correct information returns and provide payee statements.

The AICPA encourages elimination of the time period and multi-tier penalty structure for failure to file correct information returns and failure to provide payee statements because it is not proportional to the misconduct. We recommend a standard penalty to minimize burden and confusion. In addition, we think that preservation of the intentional failure to file penalty is appropriate for those instances and recommend maintaining it as part of this penalty structure.

### 3. Section 6303 – Clarification of six-year statute of limitations in case of overstatement of basis.

The AICPA supports extending the six-year statute of limitations in cases of overstatement of adjusted basis of property. Nonetheless, the AICPA recommends applying the penalty in a manner consistent with similar provisions, such as section 6662(e) regarding transfer pricing,

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<sup>37</sup> Commissioner’s Executive Task Force on Civil Penalties, Internal Revenue Service, *Report on Civil Tax Penalties*, p.1 (February 21, 1989), available at 89 TNT 45-36, Doc 89-1586.

<sup>38</sup> AICPA Comment Letter dated April 11, 2013 on Tax Penalties Legislative Proposals; <http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-legislative-proposals-penalties-2013.pdf>. AICPA Report on Civil Tax Penalties: The Need for Reform, <http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-report-civil-tax-penalty-reform-2013.pdf>, dated April 11, 2013.

where the transactional penalty is assessed when the price for any property or services claimed on the return is over 200 percent more, or 50 percent less, than the correct price. The current provision assesses a penalty when an adjusted basis for any property is more than 125 percent of the correct adjusted basis. A simple calculation error or incorrect information could lead to an excess 25 percent overstatement while the 200 percent overstatement is clearly a reckless or intentional misrepresentation.

Fair and consistent penalty provisions, as the [AICPA previously proposed](#),<sup>39</sup> are the key to deterring bad conduct without deterring good conduct or punishing the innocent (i.e., unintentional errors, such as those who committed the act subject to the penalty without intending to commit such act). Targeted, proportionate penalties that clearly articulate standards of behavior and that are administered in an even-handed and reasonable manner encourage voluntary compliance with the tax laws. On the other hand, overbroad, vaguely-defined, and disproportionate penalties fail to provide basic due process safeguards, create an atmosphere of unfairness, and discourage voluntary compliance.

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<sup>39</sup> AICPA comment letter on Tax Penalties Legislative Proposals, dated April 11, 2013; <http://www.aicpa.org/advocacy/tax/taxlegislationpolicy/pages/penaltiesreform.aspx>.