August 1, 2017

The Honorable Peter Roskam
Chairman
House Ways & Means Committee
Tax Policy Subcommittee
United States House of Representatives
1102 Longworth House Office Building
Washington, DC  20515

The Honorable Lloyd Doggett
Ranking Member
House Ways & Means Committee
Tax Policy Subcommittee
United States House of Representatives
1102 Longworth House Office Building
Washington, DC  20515


Dear Chairman Roskam and Ranking Member Doggett:

The American Institute of CPAs (AICPA) respectfully submits the enclosed statement for the record of the hearing on July 19, 2017 on the “How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families.” We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options.

The AICPA is the world’s largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state, local 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.

If you have any questions, please feel free to contact me at (408) 924-3508, or annette.nellen@sjsu.edu; or Melissa Labant, AICPA Director of Tax Policy & Advocacy, at (202) 434-9234, or melissa.labant@aicpa-cima.com.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee
WRITTEN STATEMENT

OF

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

SUBMITTED FOR THE RECORD OF THE

JULY 19, 2017

HEARING OF

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TAX POLICY

ON

HOW TAX REFORM WILL SIMPLIFY OUR BROKEN TAX CODE AND HELP INDIVIDUALS AND FAMILIES
INTRODUCTION

The American Institute of CPAs (AICPA) applauds the leadership taken by the Tax Policy Subcommittee on tax reform for individuals and families. We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options.

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy.\footnote{AICPA, “Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals,” January 2017.} We need a tax system that is administrable, stimulates economic growth, has minimal compliance costs, and allows 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. It is also important that special care is given to transition rules and grandfathering of existing carryover rules. We note that transition rules are extremely complex, however, they are important for a smooth implementation of new tax laws. We suggest that Congress provide sufficient time to implement transition rules (e.g., alternative minimum tax (AMT) carryovers, suspended and passive losses, etc.).

In the interest of good tax policy and effective tax administration, we respectfully submit comments on tax reform issues related to individuals and families.

AICPA PROPOSALS

1. Simplified Income Tax Rate Structure

One Set of Rules
As part of the comprehensive tax reform efforts, we support a new, simplified income tax rate structure. We also suggest Congress avoid, as well as eliminate, all surtaxes which are complicated, confusing, and lack transparency. For example, the current system’s requirement for taxpayers to compute their income for purposes of both the regular income tax and the AMT is a significant area of complexity in the Internal Revenue Code (“Code”). AMT requires extra calculations and recordkeeping. It also violates the transparency principle by masking what a taxpayer can deduct or exclude, as well as the taxpayer’s marginal tax rate. Congress should apply a simplified rate structure with only one set of rules.

Consistent Definitions; Avoid Phase-Outs
We urge Congress to use a consistent definition of taxable income without the use of any phase-outs. The use of phase-outs, to increase the effective tax rate, has contributed to the complexity of the present tax law. Phase-outs also create marginal rates greater than the statutory rate. We are concerned that provisions to limit or eliminate the use of certain deductions and exclusions for the top tax bracket will continue the flaws of the current system.

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
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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 these overlapping and inconsistent applications, with corresponding definitional distinctions, have existed in the Code for decades. It would reduce complexity and improve compliance if these types of provisions were identified and reduced.

2. Education Incentives

We encourage Congress to modify existing education provisions to simplify the tax incentives for higher education and help taxpayers meet current higher education expenses. Specifically, we recommend the following changes regarding education provisions.

Simplify Tax Incentives Related to Education
Replace tax incentives (i.e., Hope Credit, American Opportunity Tax Credit (AOTC), and Lifetime Learning Credit) intended to help taxpayers meet current higher education expenses with one new or revised credit.

- Allow the credit on a “per student” rather than a “per taxpayer” basis, offering a potentially larger tax benefit per family.

- Allow the credit for any six years of post-secondary education, including graduate-level and professional degree courses. A credit for four years (that includes graduate-level and professional degree programs) is beneficial to many taxpayers, but we suggest increasing the limit to six years.²

- Allow the credit only for students meeting the definition of “student” under section 25A(b)(3).

- Continue to require the reporting of the Social Security Number (SSN) or other Taxpayer Identification Number (TIN) of the student associated with the expenses claimed with respect to the credit taken for the tax year. Accordingly, amounts claimed over time are tracked by the student’s identification number. These changes may result in improved compliance and enforcement.

- Allow a 100% refundable credit.

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- Allow parents to claim the credit on their return provided the child is a qualifying dependent of the parent.

**Repeal Section 221 and Section 222**
Repeal the student loan interest deduction (section 221) and the tuition and fees deduction (section 222) to relieve taxpayer confusion by reducing the number of provisions.

**Consolidate Education Savings Provisions**
Repeal the interest exclusion for educational savings bonds (section 135), and merge Coverdell Education Savings Accounts (section 530) into qualified tuition programs (section 529) by allowing the transfer of savings from Coverdell accounts into section 529 accounts.

**Create a Uniform Definition of “Qualified Higher Education Expenses” (QHEE)**
Create a uniform definition for all education-related tax provisions. Specifically, QHEE should include tuition, books, fees, supplies and equipment. Also, if it is determined that phase-outs are necessary, all education-related tax provisions should have the same adjusted gross income (AGI) limitations.

**3. Identity Theft and Tax Fraud**

We support efforts to combat identity theft and tax fraud. The growing amount of fraudulent tax refunds paid and the economic and emotional impact to individual victims of identity theft is unacceptable.

**Single Point of Contact for Identity Theft Victims**
We suggest a single point of contact at the IRS for taxpayers affected by identity theft. Efficiencies will result as the 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 propose to make it a felony under the Code for a person to use a stolen identity to file a return. This proposal appropriately penalizes those individuals that commit the tax fraud regardless of whether a culprit is a tax preparer or someone else.

**Study of Expansion of a PIN System for Prevention of Identity Theft Tax Fraud**
Congress should require the IRS to provide a report to Congress on its operation and the results of the current identity protection personal identification number (IP PIN) system. This report would encourage and support the expansion of the IP PIN system, which is currently used on a limited basis, to help prevent identity theft.

**Internet Platform for Forms 1099 Filings**
We recommend that Congress instruct the Department of the Treasury (“Treasury”) to make available a website or other electronic medium to allow taxpayers to securely prepare, file and distribute Forms 1099. The website will reduce the cost of compliance, accelerate the receipt of

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information and enable the IRS to more efficiently and effectively match reported amounts against individual tax returns.

4. **“Kiddie Tax” Rules**

The AICPA recommends repealing the provisions linking a child’s taxable income to his/her parents’ and siblings’ taxable income. Income (other than capital gains) subject to this tax should use the income tax rates for estates and trusts. Income from capital gains should use the capital gains rates with one change; the 0% rate for capital gains should not apply to children’s unearned income. Removing the linkage to parental and sibling returns would allow a child’s return to stand on its own, removing complications due to missing information on one return, matrimonial issues, and unintended AMT problems.

We also recommend eliminating the election to include a child’s income on the parent’s return to facilitate the complete de-coupling of the link between the computation of the child’s tax liability and the parent’s tax liability.

Section 1(g) of the Code taxes a portion of the unearned income of a child\(^4\) at the parent’s marginal tax rate (“Kiddie Tax”).\(^5\) Specifically, the provision applies in cases where (1) the child’s unearned income was more than $2,000 (indexed); (2) the child is required to file a tax return; (3) either parent of the child is alive at the close of the year; and, (4) the child does not file a joint return for the taxable year.

Section 1(g)(6) requires the parent to provide his/her TIN to the child for inclusion on the child’s tax return. Parents can elect to include their children’s interest and dividend income (including capital gain distributions) on their tax return. However, the election is not available for parents of a child if the child has any earned income, unearned income of $10,500 or more (for 2016), unearned income other than interest, dividends and capital gain distributions, withholding, or estimated tax payments.

The Kiddie Tax adds significant complexity to the computation of a child’s tax liability\(^6\) and several challenges arise in complying with the rules of the statute:

- Parents may refuse to provide the tax rate. Without this information, the tax preparer is forced to calculate the child’s tax at the highest rate.

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\(^4\) A child is defined as any child who is (1) under the age of 18; (2) age 18 at the end of the year and who did not have earned income that was more than half of the child’s support; or, (3) a full-time student under the age of 24 who did not have earned income that was more than half of the child’s support.

\(^5\) The marginal tax rate of the individual with the greater taxable income is used in the case of parents filing separately. When parents who are not married, the marginal tax rate of the custodial parent is used to determine the tax liability on net unearned income. Net unearned income is the amount of unearned income above $1,000 plus the greater of $1,000 or itemized deductions directly connected to producing unearned income. When the provisions of section 1(g) apply to more than one child in the family, each child’s share of the parental tax is apportioned ratably based on the ratio of the child’s net unearned income to the total net unearned income of all children.

\(^6\) Due to complexity, IRS issued Publication 929 to assist with calculating child’s taxable income and tax liability.
The Internal Revenue Service (IRS or “Service”) requires qualified dividends and capital gain distributions to allocate between the first $2,100 (in 2016) of unearned income and the portion of the child’s unearned income over $2,100, thus making the computation burdensome.

If the parents or siblings file amended returns, the child must file an amended return.

The Kiddie Tax provisions only consider regular tax and not AMT resulting in the child’s income taxed at a higher rate than applies to the parent.

The additional tax revenue generated by the Kiddie Tax is insignificant when compared to the complexity of the calculations. Taxing the net unearned income of a child at the tax rates for estates and trusts rather than at a rate linked to that of family members would eliminate a significant amount of complexity and several compliance challenges, while still accomplishing the original intent behind the Kiddie Tax.  

5. Permanent Disaster Relief

Permanent Disaster Relief Tax Provisions
Without established relief through the tax code system (e.g., allowing casualty losses and medical expenses in the year of death) catastrophic and involuntary type situations can affect people’s ability to pay their taxes. Therefore, the AICPA urges Congress to enact permanent tax legislation that would take effect immediately when a declaration of a federal disaster occurs, rather than providing delayed tax relief through separate individual bills following each disaster. We have previously submitted comments on the need for permanent tax provisions that are triggered when a taxpayer resides, or has a principal place of business located, in a Federal Emergency Management Agency’s (FEMA) “Disaster Declaration” area for which individual “Disaster Assistance” is available.

We recommend the following permanent tax provisions applicable to individuals and families:

- **Waive Individual Casualty Loss Limitations**
  Waive the casualty loss floor of 10% of AGI (section 165(h)(i)) and the $100 per loss floor (section 165(h)(2)) for losses attributable to a disaster event. The purpose of this provision is to extend adequate relief to the affected taxpayers under section 165(h)(i).

- **Increase Property Replacement Period to Five Years**
  Allow a five year replacement period (increased from two) under section 1033(a)(2)(B) for property damaged or destroyed by a disaster event. For certain disasters that have occurred,

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7 The Tax Reform Act of 1986 lowered tax rates and broadened the income tax base by eliminating various tax shelters used by high income individuals.
8 Federal Emergency Management Agency’s Disaster Declarations.
9 FEMA Disaster Assistance information is included in the Disaster Assistance and Emergency Relief Program for Individuals and Businesses.
A five year replacement period is already in place. This provision makes five years the standard replacement period. Also, allow this revision to the replacement period to cover trade/business property, real property, and/or principal residences that are involuntarily converted during a disaster event.

- **Waive the Penalty for Early Retirement Withdrawal**
  Impose no tax on qualified disaster victims who withdraw up to a specified amount ($100,000) from a qualified plan or individual retirement account (IRA) and repay that amount within five years. Any amount not repaid within five years of the date of withdrawal is taxable income during that fifth year unless a taxpayer chooses to report the amount as income and pay the tax in any earlier year. Any income recognized under this section is not subject to the 10% early withdrawal penalty under section 72(t) for distributions up to a specified amount ($100,000). Such favored distributions were previously allowed under section 1400Q(a) for hurricane disasters; however, this provision would include all federally declared disaster events, including but not limited to hurricanes. One purpose of this provision is to allow affected taxpayers to access their own funds immediately while waiting for government assistance and insurance reimbursements that are not immediately forthcoming.

- **Allow a Housing Exemption for Displaced Individuals**
  Allow a partial or full exemption (as defined under section 151(d)) to individuals who provide at least 60 days of temporary rent-free housing to a person dislocated by a disaster event. Taxpayers may claim this exemption only once for each such persons and shall claim the exemption for the tax year which contains the latter of the 60th day or the day that the temporary housing period ends. The exemption amount is calculated as the number of rent-free days (up to 365) provided divided by 365 and multiplied by the personal exemption allowed a single taxpayer during the applicable year. The maximum number of individuals for which a taxpayer may claim this exemption is four individuals per disaster event. Furthermore, no phase-out under section 151(d)(3) would apply to this exemption.

- **Allow Discharge of Indebtedness**
  Allow disaster victims to exclude from taxable income, under section 108, cancellation of debt income for non-business debts provided that the cancellation occurs within one year of the beginning date of the disaster event. The discharging entity must certify that the discharge is a direct result of loss, property damage, or other factors caused exclusively by the disaster event. Currently, the Code provides only limited exclusions for discharge of indebtedness income. This recommendation would allow for a necessary provision recognizing that if individuals affected by a disaster are unable to repay their outstanding loans, they are also likely unable to pay tax on the phantom income.

- **Permit the Use of Prior Year’s Income to Calculate the Earned Income Tax Credit (EITC), Child Tax Credit (CTC), and Premium Tax Credit**
  Allow affected taxpayers in the disaster area to use either their current year or previous year’s income amounts for purposes of calculating the EITC (section 32), the CTC (section 24) and the Premium Tax Credit (section 36B). With this suggested provision, the affected
taxpayer would have the opportunity to use a more beneficial income year, thus allowing the affected taxpayer the opportunity to benefit from various credits that might not have been available to the taxpayer because of the fluctuation of income caused by the disaster.

- **Increase the Medical Expense Deduction**
  
  Eliminate the medical deduction floor percentage (as defined under section 213(a), generally 10% of AGI) for an individual who incurs deductible medical expenses directly related to an injury caused by the disaster event. This reduction is available only for the directly-related expenses incurred for up to two tax years (the year of the event and the subsequent year). The purpose of this provision is to provide relief from the deduction limitations for taxpayers incurring unexpected disaster related medical expenses.

  We suggest adjusting annually for inflation, any dollar amount provided in permanent disaster relief provisions.

**IRS Deadlines Related to Disasters**

Similar to the authority of the IRS to postpone certain deadlines in the event of a presiden
tially-declared disaster, Congress should extend that limited authority to state-declared disasters and states of emergency. We recommend that Congress allows the IRS to postpone certain deadlines in response to state-declared disasters or states of emergency.

Currently, the IRS’s authority to grant deadline extensions, outlined in section 7508A, is limited to taxpayers affected by federally-declared disasters. State governors will issue official disaster declarations promptly but often, presidential disaster declarations in those same regions are not declared for days, or sometimes weeks after the state declaration. This process delays the IRS’s ability to provide federal tax relief to disaster victims. Individuals can request waivers of penalties on a case-by-case basis; however, this process causes the taxpayer, tax preparer, and the IRS to expend valuable time, effort, and resources which are already in shortage during times of a disaster. Granting the IRS specific authority to quickly postpone certain deadlines in response to state-declared disasters allows the IRS to offer victims the certainty they need as soon as possible.

**6. Tax Administration**

**Modernize Internal Revenue Service**

Whether addressed within or outside of tax reform, we urge Congress to address IRS taxpayer services, and recommend that any effort to modernize the IRS and its technology infrastructure should build on the foundation established by the [Report of the National Commission on Restructuring the IRS](https://www.irs.gov/About-Irs/Newsroom/Reports-and-Studies).

As tax professionals, we represent one of the IRS’s most significant stakeholder groups. As such, we are both poised and committed to being part of the solution for improving IRS taxpayer

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10 60% of all e-filed returns in 2016 were prepared by a tax professional, according to the [Filing Season Statistic for Week Ending Dec.2, 2016](https://www.irs.gov/About-Irs/Newsroom/Filing-Season-Statistics-Week-Ending-Dec-02-2016).
services. In April, we submitted a letter\(^{11}\) to House Ways and Means Committee and Senate Finance Committee members in collaboration with other professional organizations. Our recommendations include modernizing IRS business practices and technology, re-establishing the annual joint hearing review, and enabling the IRS to utilize the full range of available authorities to hire and compensate qualified and experienced professionals from the private sector to meet its mission. The legislative and executive branches should work together to determine the appropriate level of service and compliance they want the IRS accountable for and then dedicate appropriate resources for the Service to meet those goals.

Additionally, we recommend that Congress direct the IRS to create a new dedicated practitioner services unit to rationalize, enhance, and centrally manage the many current, disparate practitioner-impacting programs, processes, and tools. Enhancing the relationship between the IRS and practitioners would benefit both the IRS and the millions of taxpayers served by the practitioner community. As part of this new unit, the IRS should provide practitioners with an online tax professional account with access to all of their clients’ information. The IRS should offer robust practitioner priority hotlines with higher-skilled employees who have the experience and training to address complex issues. Furthermore, the IRS should assign customer service representatives (a single point of contact) to geographic areas in order to address challenging issues that practitioners could not resolve through a priority hotline.

**Due Diligence Requirements**

The Protecting Americans from Tax Hikes Act (“PATH Act,”) (P.L. 114-113 (12/18/15)) added the CTC and the AOTC to the due diligence requirements of paid preparers for the preparation of tax returns that claim these refundable credits. This new requirement for paid preparers involves completing Form 8867, *Paid Preparer’s Due Diligence Checklist*, a form that many tax preparers were already required to complete for returns where the EITC was claimed.

However, this additional checklist (Form 8867) is an unnecessary burden to professional preparers who are already subject to multiple levels of due diligence requirements. These existing requirements include the section 6694 preparer penalty regulations, the Treasury’s Circular 230 rules, professional association ethical standards, and state licensing board regulations.

The AICPA recommends that Congress modify section 6695(g) by adding an additional sentence as follows:

> “The Secretary must consider simplified approaches that recognize that taxpayers are responsible for the accuracy of their return and that certain tax return preparers are already subject to additional due diligence requirements.”

**Information Reporting and Forms 1099**

Taxpayers and the tax practitioner community are burdened by the growing volume of corrected and delayed information returns. Taxpayers receiving corrected Forms 1099 are obligated to file amended tax returns in order to report the corrected amounts. This process compresses the tax

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filing season and causes time-consuming and expensive efforts for corrections that often result in insignificant differences.

- **De Minimis Error Safe Harbor for Taxpayers (Recipients of Information Returns)**
  
  Congress should not require taxpayers that receive corrected information returns to file amended tax returns for relatively minor dollar amounts. Under the current rules, there is a *de minimis* safe harbor established under sections 6721 and 6722 which only applies to the issuers of information returns. However, there is no safe harbor for recipient taxpayers. If the issuer decides to issue a corrected Form 1099 for an immaterial amount (even if not required), the taxpayer must file an amended tax return.

  The AICPA recommends adding a *de minimis* safe harbor for recipients of corrected information returns such that small changes do not require the filing of amended Form 1040, *U.S. Individual Income Tax Return*, Form 1041, *U.S. Income Tax Return for Estates and Trusts*, Form 1065, *U.S. Return of Partnership Income*, Form 1120-S, *U.S. Income Tax Return for an S Corporation*, or Form 1120, *U.S. Corporation Income Tax Return*. Thus, if corrected amounts on any information return do not change by more than $100 or change tax withholding by more than $25, the recipient of the corrected information return would not incur penalties for failure to file an amended tax return (these are the same *de minimis* amounts used for issuers at sections 6721 and 6722). A *de minimis* safe harbor for recipients would reduce burdens on taxpayers and practitioners who repeatedly correct returns and reduce the expenditure of IRS resources in processing these returns.

- **Simplification for Issuers of Information Returns**

  Under Notice 2017-09, penalties are waived if an error made by the payor (or “issuer”) in the preparation of information returns does not exceed $100 or an error in reporting taxes withheld does not exceed $25. However, if the payee (recipient of the incorrect information return) elects to receive a corrected statement and if one is not issued, the penalty is not automatically waived.

  The election process outlined in the statute and notice creates compliance burdens for information return issuers since they need to track if elections were made to waive the *de minimis* error safe harbor. The AICPA proposes a simplified approach for the *de minimis* error safe harbor rules under sections 6721 and 6722 applicable to issuers of information returns, as follows:

  - If a recipient of an information return notifies the issuer of an error, the issuer has thirty days in which to provide a corrected document to the recipient. If the issuer fails to provide a corrected document, it is subject to the penalties (unless the IRS determines there is other justification for a penalty waiver).

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12 Many information return issuers are large brokerage firms with thousands of individual recipients.
13 Issuers could still file corrected information returns addressing *de minimis* errors.
Recipients of incorrect information returns have 18 months from the original issuance date to request corrected information returns from the issuer. This timeline protects issuers from incurring penalties many years past their original year of error.

- Allow reporting entities (including employers, partnerships, S corporations, estates and trusts) to have the ability to “rollover” small information return errors, contained on Forms 1099 and W-2 and Schedules K-1, in the following year, rather than filing amended or corrected forms. We propose that Congress provide an exception to file or furnish a corrected information return in the current year if a single error amount differs from the correct amount for a recipient by no more than $200 in income. The reporting entity would report the differential amount in the year following the error. The identified error and corrected information should also include the original date and transaction to which it relates.

**Corrected and Late Forms 1099**

An important concern to both taxpayers and tax preparers is also the growing problem of delayed information reporting. Tax filing seasons have become increasingly challenging for practitioners because brokerage firms issue “preliminary” Forms 1099. The “final” versions of these forms are generally provided after the February 15th information reporting deadline. Additionally, some brokerage firms have begun to routinely, each year, request extensions from the IRS to issue Forms 1099 after the reporting deadline. Congress should require the IRS to publicly release, on the IRS.gov website, an updated list of the brokers and other information reporting agents that received an IRS extension beyond the information reporting due date.

**CONCLUDING REMARKS**

The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will reduce compliance costs and fuel economic growth. The AICPA appreciates the opportunity to submit this written testimony and we look forward to working with the Subcommittee as you continue to address the needs of individuals and families.

The AICPA is the world’s largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state, local 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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14 Section 6722(c)(2)(B) would need to include this time limit.