Written Statement

Of

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For the Record of the

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Field Hearing of

The United States Senate Committee on Small Business and Entrepreneurship

Entitled

"Reducing the Federal Tax Burden for America's Small Businesses"

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

WRITTEN STATEMENT

OF

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

FOR THE RECORD OF THE

APRIL 15, 2015

HEARING OF

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

ON

TAX REFORM: ENSURING THAT MAIN STREET ISN'T LEFT BEHIND

INTRODUCTION

The American Institute of Certified Public Accountants (AICPA) commends Chairman Chabot, Ranking Member Velazquez, and Members of the House Committee on Small Business for examining the need for and potential economic benefits of comprehensive tax reform. We applaud the leadership taken by the Committee to spur tax reform discussions and 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 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 business, as well as America's largest businesses.

We are a long-time advocate for an efficient and effective tax system based on principles of good tax policy.[1] Our tax system must be administrable, stimulate economic growth, have minimal compliance costs, and allow taxpayers to understand their tax obligations. We believe these features of a tax system are achievable if the ten principles of good tax policy are considered in the design of the system:

- Equity and Fairness
- Convenience of Payment
- Simplicity
- Economic Growth and Efficiency
- Minimum Tax Gap
- Certainty
- Economy in Collection
- Neutrality
- Transparency and Visibility
- Appropriate Government Revenues

We, therefore, appreciate the opportunity to provide input as you begin shaping tax reform policy in the small business income tax area.

In the interest of good tax policy and effective tax administration, specifically focusing on the simplification of small business income tax, we respectfully submit comments on the following key issues:

1. Cash Method of Accounting
2. Tangible Property Regulations – De Minimis Safe Harbor Threshold
3. Civil Tax Penalties
4. Permanence of Tax Legislation
5. Retirement Plans
6. Alternative Minimum Tax Repeal

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[1] AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001.

7. Listed Property
8. Tax Return Due Date Simplification
9. IRS Taxpayer Assistance

AICPA PROPOSALS

1. Cash Method of Accounting

The AICPA wholly supports the expansion of the number of taxpayers who may use the cash method of accounting. The cash method of accounting is simpler in application than the accrual method, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the income. For these same reasons, we are concerned with, and oppose, any new limitations on the use of the cash method for service businesses, including those businesses whose income is taxed directly on their owners' individual returns, such as S corporations and partnerships. Requiring these businesses to switch to the accrual method upon reaching a gross receipts threshold would unnecessarily discourage growth. A required switch to the accrual method would affect many small businesses in certain industries including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.

The AICPA believes that limiting the use of the cash method of accounting for service businesses would:

1) Discourage their natural business growth;
2) Impose an undue financial burden on their individual owners;
3) Impose complexities and increase their compliance burden; and
4) Treat similarly situated taxpayers differently (because income is taxed directly on their owners' individual returns).

As the AICPA has previously stated,[2] 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 (e.g., sole proprietors, personal service corporations, and pass-through entities) that

[2] AICPA comment letter on the "Continued Availability of Cash Method of Accounting," August 15, 2013, http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.08.15_Comments_on_Continued_Availability_of_Cash_Method_of_Accounting.pdf, 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, and AICPA written statement before the House Committee on Small Business, Subcommittee on Economic Growth, Tax and Capital Access, dated July 10, 2014, Hearing on "Cash Accounting: A Simpler Method for Small Firms?"; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA%20WRITTEN%20STATEMENT%20July%2010%202014%20to%20House%20Subcte%20on%20Economic%20Growth%20Tax%20and%20Capital%20Access.pdf.

currently utilize it. We believe that forcing more businesses to use the accrual method of accounting for tax purposes would increase their administrative burden, discourage business growth in the U.S. economy, and unnecessarily impose financial hardship on cash-strapped businesses.

2. Tangible Property Regulations – De Minimis Safe Harbor Threshold

The AICPA urges the IRS and Treasury to increase the de *minimis* safe harbor threshold in order to offer meaningful tax compliance relief to small businesses. Final tangible property regulations (T.D. 9636) provide guidance for taxpayers to elect a minimum capitalization threshold, otherwise known as the de *minimis* safe harbor. The safe harbor allows taxpayers to set a minimum capitalization amount under which amounts are not capitalized. To reduce the unnecessary compliance burdens placed on small businesses, the AICPA recommends increasing the de *minimis* safe harbor threshold amount for taxpayers without an applicable financial statement (AFS) from $500 to $2,500.

Additionally, we recommend adjusting the de *minimis* safe harbor threshold amount on an annual basis for inflation.[3]

We understand that the intent of the $500 de *minimis* safe harbor election is to reduce the administrative burden of applying the complex set of capitalization rules for business taxpayers without an AFS (e.g., small business taxpayers). However, we have concerns about the current low amount ($500) of the de *minimis* safe harbor threshold for taxpayers without an AFS:[4]

a. **Reduction of Administrative Burden**
   Many small business owners have stated that repairs are consistently over $500 (parts are at least $250 and labor is at least $250). A cell phone or printer easily cost over $500 and are replaced quickly making it administratively impractical and costly to track. The $500 threshold is too low to effectively achieve any reduction in administrative burden.

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[3] The AICPA previously commented on increasing the safe harbor de *minimis*. A copy of the letter can be found at the AICPA comment letter on $500 de *minimis* Safe Harbor Threshold and Retrospective Application of Final Tangible Property Regulations (T.D. 9636) for Small Businesses, dated October 8, 2014.

[4] An applicable financial statement (AFS) is a financial statement that is (i) a financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders); (ii) a certified audited financial statement that is accompanied by the report of an independent certified public accountant (or in the case of a foreign entity, by the report of a similarly qualified independent professional) that is used for credit purposes, reporting to shareholders, partners, or similar persons, or any other substantial non-tax purpose; or (iii) a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the IRS).

b. Relation with Section 179

The Internal Revenue Service (IRS or "Service") states that the safe harbor de *minimis* threshold, in conjunction with section 179[5] election to expense certain depreciable business assets, provide significant tax simplification to small businesses. Unfortunately, section 179 requires costly and time-consuming tracking of the item on a fixed asset depreciation schedule. Furthermore, not all property qualifies for the section 179 deduction (e.g., air conditioning and heating equipment, and real property such as land, buildings, and permanent structures).

Enhanced section 179 relief was also temporary and is, therefore, arguably unreliable. Currently, the section 179 deduction limit is only $25,000 for tax year 2015, despite having a limit of $500,000 for last year.

c. Clear Reflection of Income Test

To deduct amounts in excess of the $500 threshold, small businesses must prove that expensing such amounts "clearly reflects income." The clear reflection of income test is based on the taxpayer's facts, circumstances, and interpretations of those facts and circumstances by the taxpayer and IRS. Large businesses (e.g., taxpayers with an AFS), however, are allowed the higher ($5,000) threshold without the negative added compliance burdens.

d. Current Capitalization Policies

We also believe the $500 threshold does not accurately reflect the current capitalization policy threshold for many small businesses. An informal survey amongst our members, shows that many of our members and/or their small business clients have a minimum capitalization threshold in excess of $500 since few items costing $500 or less have a useful life of greater than one year. Therefore, we think that the $500 threshold does not provide any impactful relief for many small businesses.

e. Expansion of the AFS Definition for $5,000 Safe Harbor De Minimis Threshold

The AICPA believes the requirement that a taxpayer have an AFS to use the $5,000 de *minimis* threshold unfairly discriminates against smaller taxpayers, and recommends an alternative test to allow such taxpayers to use the de *minimis* rule. The AICPA recommends an expansion of the definition of AFS to include a financial statement that has been reviewed by a certified public accountant.

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[5] All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated there under, unless otherwise specified.

3. Civil Tax Penalties

Congress should carefully draft penalty provisions and the Executive Branch should sensibly administer the penalties to ensure they deter bad conduct without deterring good conduct or punishing the innocent (i.e., unintentional errors, such as those who committed the inappropriate act without intent 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, particularly those administered as part of a system that automatically imposes penalties or that otherwise fails to provide basic due process safeguards, create an atmosphere of arbitrariness and unfairness that is likely to discourage voluntary compliance.

We have concerns[6] about the current state of civil tax penalties and would like to offer the following suggestions for improvement:

a. Trend Toward Strict Liability

The IRS discretion to waive and abate penalties where the taxpayer demonstrates reasonable cause and good faith is needed most when the tax laws are complex and the potential sanction is harsh. This reason is especially true where the taxpayer's state of mind is central to the conduct that is subject to penalty. Because it is not feasible to anticipate every possible situation to which a penalty might apply, permitting a reasonable cause defense and avoiding fixed-dollar amount penalties helps to ensure that a disproportionately large penalty is not applied to an unforeseen and/or unintended set of facts.

Over the past several decades, there has been an exponential increase in the complexity of the tax laws and a proliferation of increasingly severe civil tax penalties, with the Internal Revenue Code (IRC or "Code") currently containing eight strict liability penalty provisions.

b. An Erosion of Basic Procedural Due Process

Penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Judicial review of an IRS decision to impose a penalty or to deny waiver is an important constitutional check on Executive authority. Statutes that prohibit judicial review of agency penalty determinations undermine voluntary compliance by undercutting

[6] See the "AICPA Tax Penalties Legislative Proposals," submitted to Congress in April 2013: http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-legislative-proposals-penalties-2013.pdf; and the "AICPA Report on Civil Tax Penalties," submitted April 2013: http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-report-civil-tax-penalty-reform-2013.pdf.

taxpayers' faith in the system and eliminating an essential and expected avenue of potential redress.

Taxpayers should know their rights to contest penalties and have a timely and meaningful opportunity to voice their feedback before assessment of the penalty. In general, this process would include the right to an independent review by the IRS Appeals office or the IRS's FastTrack appeals process, as well as access to the courts. Pre-assessment rights are particularly important where the underlying tax provision or penalty standards are complex, the amount of the penalty is high, or fact-specific defenses such as reasonable cause are available.

c. Repeal Technical Termination Rule

We recommend[7] the repeal of section 708(b)(1)(B) regarding the technical termination of a partnership.[8] 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 15th day of the fourth month after the month-end in which the partnership underwent a technical termination.[9]

A technical termination most often occurs when, during a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. Because this 12-month time frame can span a year-end, the partnership may not realize that a 30% change (a minority interest) in one year followed by a 25% change in another year, but within 12 months of the first, has caused the partnership to terminate.

In practice, this earlier required filing of the old partnership's tax return often goes unnoticed because the company is unaware of the accelerated deadline due to of the equity transfer. Penalties are often assessed upon the business as a result of the

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[7] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[8] AICPA submitted letters and written statements on Option 1 and Option 2 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Business_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf, and Option 2 comments, dated July 30, 2013; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf.

[9] For example, a partnership that technically terminated on April 30 of the current year due to a transfer of 80% of the capital and profits interests in the partnership to be timely filed must file its tax return for that final tax year on or before August 15 of the current year.

missed deadline. Although ignorance is not an acceptable excuse, this technical termination area is often misunderstood and misapplied. 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.

d. Late Filing Penalties of Sections 6698 and 6699

Sections 6698 and 6699 impose a penalty of $195 per partner related to late filed partnership or S corporation return. The penalty is imposed monthly not to exceed 12 months, unless it is shown that the late filing is due to reasonable cause. 2014 amendments to sections 6698 and 6699 adjust the penalty for inflation beginning after 2014.

The AICPA proposes that a partnership, comprised of 50 or fewer partners, each of whom are natural persons (who are not nonresident aliens), an estate of a deceased partner, a trust established under a will or a trust that becomes irrevocable when the grantor dies, and domestic C corporations, will be considered to have met the reasonable cause test and will not be subject to the penalty imposed by section 6698 or 6699 if:

- The delinquency is not considered willful under section 7423;
- All partnership income, deductions and credits are allocated to each partner in accordance with such partner's capital and profits interest in the partnership, on a pro-rata basis; and
- Each partner fully reported its share of income, deductions and credits of the partnership on its timely filed federal income tax return.

e. Failure to Disclose Reportable Transactions

Taxpayers who fail to disclose a reportable transaction are subject to a penalty under section 6707A of the Code. For penalties assessed after 2006, the amount of the penalty is 75% of the decrease in tax shown on the return as a result of the transaction (or the decrease that would have been the result if the transaction had been respected for federal tax purposes). If the transaction is a listed transaction (or substantially similar to a listed transaction), the maximum penalty is $100,000 for individuals and $200,000 for all other taxpayers. In the case of reportable transactions other than listed transactions, the maximum penalty is $10,000 for individuals and $50,000 for all other taxpayers. The minimum penalty is $5,000 for individuals and $10,000 for all other taxpayers. The section 6707A penalty applies even if there is no tax due with respect to the reportable transaction that has not been disclosed. There is no reasonable cause exception to the penalty. The Commissioner may, however, rescind all or a portion of a penalty, but only in the case of transactions other than listed transactions, where rescinding the penalty would promote efficient tax administration and only after the taxpayer submits a lengthy and burdensome application. In the case of listed transactions, the IRS has no discretion to rescind the penalty. The statute precludes judicial review where the Commission decides not to rescind the penalty.

Under section 6662A, taxpayers who have understatements attributable to certain reportable transactions are subject to a penalty of 20% (if the transaction was disclosed) and 30% (if the transaction was not disclosed). A more stringent reasonable cause exception for a penalty under section 6662A is provided in section 6664, but only where the transaction is adequately disclosed, there is substantial authority for the treatment, and the taxpayer had a reasonable belief that the treatment was more likely than not proper. In the case of a listed transaction, reasonable cause is not available, similar to the penalty under section 6707A.

The AICPA proposes for an amendment of section 6707A to allow an exception to the penalty if there was reasonable cause for the failure and the taxpayer acted in good faith for all types of reportable transactions, and to allow for judicial review in cases where reasonable cause was denied. Moreover, we propose an amendment of section 6664 to provide a general reasonable cause exception for all types of reportable transactions, irrespective of whether the transaction was adequately disclosed or the level of assurance.

f. 9100 Relief

Section 9100 relief, which is currently available with regard to some elections, is extremely valuable for taxpayers who miss the opportunity to make certain tax elections. Congress should make section 9100 relief available for all tax elections, whether prescribed by regulation or statute. The AICPA has compiled a list[10] of elections (not all-inclusive) for which section 9100 relief currently is not granted by the IRS as the deadline for claiming such elections is set by statute. Examples of these provisions include section 174(b)(2), the election to amortize certain research and experimental expenditures, and section 280C(c), the election to claim a reduced credit for research activities. We do not believe taxpayers are likely to abuse or exploit hindsight, as the IRS would continue to have discretion as to whether to grant relief for each specific request.

g. Form 5471 Penalty Relief

On January 1, 2009, the IRS began imposing an automatic penalty of $10,000 for each Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, filed with a delinquent Form 1120 series return. When imposing the penalty on corporations in particular, the IRS does not distinguish between: a) large public multinational companies, b) small companies, and c)

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[10] AICPA letter on "Tax Reform Administrative Relief for Various Statutory Elections," submitted January 23, 2015: http://www.aicpa.org/advocacy/tax/downloadabledocuments/aicpa-letter-to-congress-on-9100-relief-1-23-15submitted.pdf.

companies that may only have insignificant overseas operations, or loss companies. This one-size-fits-all approach inadvertently places undue hardship on smaller corporations that do not have the same financial resources as larger corporations. The AICPA has submitted recommendations[11] regarding the IRS administration of the penalty provision applicable to Form 5471. Our recommendations focus on the need for relief from automatic penalties assessed upon the late filing of Form 5471 in order to promote the fair and efficient administration of the international penalty provisions of the Code.

4. Permanence of Tax Legislation

Taxpayers and tax practitioners need certainty to perform any long-term tax, cash-flow or financial planning and reporting.[12] The permanence of tax provisions, such as the enhanced section 179 deduction, can have impacts on the growth of small businesses. The section 179 provision allows small and mid-size business owners to immediately take a tax deduction on qualifying equipment, rather than delaying the deduction and taking it in smaller portions over an extended period of years. With the increased section 179 expense provision, business owners could deduct up to $500,000 of qualifying assets. In 2015, the section 179 expense has reverted back to $25,000. However, over the past several years, Congress has retroactively passed an increased section 179 limit during or even after the applicable tax year. The possibility for such a retroactive action in 2015 still exists; however, the uncertainty creates unnecessary confusion, anxiety and administrative and financial burdens.

Without permanency in the Code, we are concerned about the following consequences:

a. **Impact on a Company's Financial Accounting and Reporting**
The retroactive extension of tax deductions and credits has implications for a company's financial accounting and reporting. For financial accounting purposes, "the effect of a change in tax laws or rates shall be recognized at the date of enactment."[13] Accordingly, even if Congress signals that it plans to extend various

[11] AICPA submitted comments to the IRS, dated March 26, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-Form-5471-Penalties-3.26.13.pdf.

[12] For example, see the AICPA testimony before the U.S. House of Representatives Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access on the September 13, 2012, hearing on Adding To Uncertainty: Small Businesses' Perspectives on the Tax Cliff, and AICPA written statement for the hearing before the U.S. House of Representatives Committee on Ways and Means Subcommittee on Select Revenue on May 15, 2013, on the Small Business and Pass-Through Entity Tax Reform Discussion Draft.

[13] See Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, Income Taxes (https://asc.fasb.org/ and http://www.uic.edu/classes/actg/actg593/Cases/ASC/Standards/ASC-740-10- Income-Taxes.pdf), 740-10-25-47, September 29, 2011, page 15.

tax credits and other tax incentives, because these tax credits and other tax incentives were not signed into law by the end of 2014, companies must calculate their 2015 tax provisions without regard to the extended tax credits and other tax incentives. Where the relevant credits and incentives are material, the failure to extend the expired provisions in a timely manner creates unnecessary and undesirable ambiguity for financial markets.

b. Complexity and Administrative Burden for Taxpayers and the IRS

When Congress enacts extensions of these provisions late in the year or in the beginning of the following year, after IRS has already finalized the income tax returns for the tax year, it causes confusion, complexity, and compliance burdens for taxpayers and practitioners, and the IRS. If the tax forms have already been released, the IRS may need to provide additional instructions or revised forms to clarify the new law and reporting. This instructions and forms delay causes the filing season to be even more compressed and taxpayers are not able to file and receive their tax refunds until later in the year.

If taxpayers have already filed their tax returns prior to the change in the law, they may need to file amended tax returns, reflecting the newly enacted tax rules for the prior tax year. Those taxpayers may have to pay additional costs for an amended tax return, and the IRS will have additional costs and burdens to process the amended tax returns. For example, a March 31, 2015 fiscal year corporate filer will likely have to (1) report 9/12ths of the research credit on the originally filed return and (2) amend the return when the credit is reinstated to claim the credit for the additional three months (assuming the credit is reinstated after the tax return is filed, which was the case for the provisions that expired in 2010).

c. Adverse Impact on Small Businesses and Ultimately Jobs and Growth

These ever-changing, often expiring, short-term changes to the tax laws make it increasingly difficult for small businesses and their owners to perform any long-term tax, cash-flow or financial planning. If businesses are not able to rely on these tax benefits for the long term, they are limited in their ability to plan, invest, grow and expand, and hire additional workers. Therefore, we urge Congress to extend these provisions sooner rather than later.

While taxpayers have come to anticipate the retroactive reinstatement of expiring provisions (e.g., the research and development credit and the enhanced section 179 expense deduction) and may act under the assumption that Congress again may extend the provisions, an incorrect assumption may prove costly. While a prudent small business owner may wait until Congress provides certainty, the delay may result in the small business owner postponing equipment acquisitions and research expenditures from 2015 to 2016. The intended impact and reason for these provisions as an incentive for small businesses to replace aged equipment and pursue research and development are not achieved when the tax incentives are not available all or much of the year.

d. **Effect on Economic Decisions and Tax Payments**
Uncertainty concerning whether Congress will extend certain tax provisions also adversely impacts tax planning and economic decisions made by individuals. These planning challenges are further compounded when tax laws are changed after the year has already begun but are slated to take effect that same year. When tax laws are issued late in the year or at the last minute, individuals try their best to comply, with no ability to plan for such provisions, no matter how well-intentioned. Incorrect assumptions may result in underpayments of estimated taxes and potential penalties or overpayment of taxes.

e. **Lack of Transparency and Certainty with Short-Term, Retroactive Extensions**
The AICPA continues to support long-term tax reform simplification efforts as we strongly believe the short-term, retroactive extension of tax provisions on an annual basis is counter to the AICPA's Guiding Principles of Good Tax Policy, which promote certainty, as well as transparency and visibility. We also generally urge Congress to enact future tax changes with a presumption of permanency, except in rare situations in which there is an overriding and explicit policy reason for making provisions temporary, such as short-term stimulus provisions or when a new provision requires evaluation after a trial period. Providing long-term certainty will provide simplification. Eliminating the need to constantly extend expiring provisions, such as the research and experimentation credit, will decrease the current state of confusion and, in many cases, reaffirm (rather than undermine) the policy reasons behind these incentives. Eliminating the on-again-off-again nature of these provisions, coupled with the often retroactive tax law changes, will better support long-term planning, reduce the number of amended returns, and significantly decrease the overall complexity of the tax rules.

5. Retirement Plans

Small businesses are especially burdened by the overwhelming number of rules inherent in adopting and operating a qualified retirement plan. Therefore, we encourage Congress to consider the following measures for simplifying the operation of retirement plans:

a. **Create a Uniform Employee Contributory Deferral Plan**
The AICPA suggests that Congress create a uniform contributory deferral plan. Currently, there are four employee contributory deferral plans: 401(k), 403(b), 457(b), and SIMPLE plans. Having four variations of the same plan type causes confusion for many plan participants and employers. Congress could eliminate the unnecessary complexity by reducing the number of choices of the same type of plan

while keeping the desired goal intact; affording employers the opportunity to offer a contributory deferral plan to their employees and allowing employees to use this type of retirement plan to save for their retirement.

b. Eliminate Certain Nondiscrimination Tests on Employee Pre-tax and Roth Deferrals for 401(k) Plans, Matching Contributions

We propose eliminating the following nondiscrimination tests since they artificially restrict the amount higher-paid employees are entitled to save for retirement on a tax preferred basis by creating limits based on the amount deferred by lower-paid employees in the same plan. The tests result in placing greater restrictions on the ability of higher-paid employees to save for retirement than those placed on lower-paid employees. Although the 403(b) plan is of a similar design, there is no comparable test on deferrals for this type of plan.

Specifically, we recommend elimination of the following nondiscrimination tests:

- The actual deferral percentage (ADP) test – The ADP test limits the amount highly compensated employees can defer pre-tax or through Roth after-tax contributions by reference to the amount deferred by non-highly compensated employees. This test applies only to a 401(k) plan.
- The actual contribution percentage (ACP) test – The ACP test similarly limits, for highly compensated employees, the amount of employer matching contributions and the amount of other employee after-tax contributions (which are based on employee contributions). This test is applicable for both 401(k) and 403(b) plans.

c. Eliminate the Top Heavy Rules

We propose eliminating the top heavy rules because they constrain the adoption of 401(k) and other qualified retirement plans by small employers. Since the top heavy rules were enacted in 1982, there have been a number of statutory changes which have significantly decreased their effectiveness. The sole remaining top heavy rule is a required minimum contribution or benefit. The determination of top heavy status is difficult and the required 3% minimum contribution is often made for safe harbor 401(k) plans. The effect of the top heavy rules is to deter a small business from adopting a qualified retirement plan, including a non-safe harbor 401(k) plan. Without the top heavy rules, more small businesses would adopt plans to benefit their employees.

6. Alternative Minimum Tax Repeal

The AICPA supports repeal of the alternative minimum tax (AMT).[14] We believe 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. Small businesses, including those businesses operating through pass-through entities, are increasingly at risk of being subject to AMT.

This tax was created to ensure that all taxpayers pay a minimum amount of tax on their economic income. However, small businesses suffer a heavy burden because they often do not know whether they are affected until they file their taxes. They must constantly maintain a reserve for possible AMT, which takes away from resources that could be allocated to business needs such as hiring, expanding, and giving raises to workers.

The AMT is a separate and distinct tax regime from the "regular" income tax. Code sections 56 and 57 create AMT adjustments and preferences that require taxpayers to make a second, separate computation of their income, expenses, allowable deductions, and credits under the AMT system. This separate calculation must be done on all components of income including business income for sole proprietors, partners in partnerships and shareholders in S corporations. Small businesses must maintain annual supplementary schedules used to compute these necessary adjustments and preferences for many years to calculate the treatment of future AMT items and, occasionally, receive a credit for them in future years. Calculations governing AMT credit carryovers are complex and contain traps for unwary taxpayers.

Sole proprietors who are also owners in pass-through entities must combine the AMT information from all their activities in order to calculate AMT. Including adjustments and preferences from pass-through entities contributes to AMT complexity. The computations are extremely difficult for business taxpayers preparing their own returns and the complexity affects the IRS's ability to meaningfully track compliance.

AICPA supports repealing the AMT for corporations and individuals altogether. As AMT complexities increase, so do the tax regime's impact on unintended taxpayers[15] and related compliance problems.

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[14] AICPA written testimony before the House Committee on Ways And Means, Subcommittee on Select Revenue Measures, dated March 03, 2011, "Hearing on Small Businesses and Tax Reform," http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/FINALTESTIMONYFORTHOMPSONMarch32011.pdf; and AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[15] Although most sophisticated taxpayers are aware of the AMT and that they may be subject to its provisions, the majority of middle-class taxpayers has never heard of the AMT and is unaware that the tax may apply to them. Unfortunately, the number of taxpayers facing potential AMT liability is expanding exponentially due

7. Listed Property

We recommend the removal of "computer or peripheral equipment" from the definition of "listed property" in order to simplify and modernize the traditional tax treatment of computers and laptops. Classifying computers and similar property as "listed property" under section 280F is clearly outdated in a business environment where employees are increasingly becoming expected to work outside of traditional business hours. Various forms of technology, including laptops, tablets and cell phones, are all converging to serve similar purposes and cost roughly the same prices to purchase. The costs for the internet and service plans are now frequently sold in "bundles" and shared between multiple devices so it has become arguably impossible to segregate the cost of service between a cell phone, tablet, and laptop. The AICPA believes legislative change to update the treatment of mobile devices is the best simplification, similar to section 2043 of the Small Business Jobs Act of 2010, where cell phones were removed from the definition of listed property for taxable years beginning after December 31, 2009.

Additionally, guidance is needed to simplify the determination of when an employer-provided cell phone or similar device is considered a working condition or de *minimis* fringe benefit under section 132. A safe harbor approach is recommended for simplification purposes and in light of the fact that cell phones often allow for unlimited phone calls making any personal use de *minimis*. When taxpayers do not meet the safe harbor for treating a device as a non-taxable fringe benefit, additional guidance is needed to help determine the taxable amount of the benefit in a simple manner.

8. Tax Return Due Date Simplification

Taxpayers and preparers have long struggled with problems created by the inefficient timeline and flow of information. Federal Schedules K-1s are often delivered late, sometimes within days of the due date of taxpayers' personal returns and up to a month after the due date of their business returns. Late schedules make it difficult, if not impossible, to file a timely, accurate return. The current inefficient timeline of tax return due dates is a problem for taxpayers as well as their tax practitioners.

The AICPA recommendation would alleviate the problems mentioned above by establishing a logical set of due dates, focused on promoting a chronologically-correct flow of information between pass-through entities and their owners. Our proposal includes the changes as follows:

Current Tax Due Dates:

- March 15: S corporation and C corporation Forms 1120S and 1120; and

to: (1) "bracket creep;" (2) classifying as "tax preferences" the commonly used personal and dependency exemptions, standard deductions, and itemized deductions for taxes paid, some medical costs, and miscellaneous expenses; and (3) the inability to use many tax credits to offset AMT.

- April 15: Individual, Trust and Estate, and Partnership Forms 1040, 1041, and 1065

Proposed Tax Due Dates:
- March 15: Partnership Form 1065;
- March 31: S corporation Form 1120S; and
- April 15: Individual, Trust and Estate, and C Corporation Forms 1040, 1041, and 1120

We recommend the extended due dates to be six months after the original filing due dates for all these forms, except the trust and estate Form 1041, which we recommend be extended five and half months.

The AICPA supports[16] the proposal to change due dates for tax returns of partnerships, S corporations and C corporations because it would:
- Improve the accuracy of tax and information returns by allowing corporations and individuals to file using current data from flow-through returns that have already been filed rather than relying on estimates;
- Better facilitate the flow of information between taxpayers (i.e., corporations, partnerships, and individuals);
- Reduce the need for extended and amended tax returns; and
- Simplify tax administration for the government, taxpayers, and practitioners.

9. <u>IRS Taxpayer Assistance</u>

To further reduce the burdens of income tax compliance, the AICPA urges Congress to address the "taxpayer service" issues at the IRS. Specifically, Congress should consider dedicating supplemental funds to ensure IRS is responsive to the needs of all taxpayers, including small businesses.

In order for small businesses (and their tax practitioners) to receive the assistance they need on tax issues, it is essential for the IRS to respond to them in a timely manner. At a minimum, for example, the IRS should improve (1) wait times for incoming telephone calls and (2) the time required for them to respond (in a substantive manner) to taxpayers'

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[16] We are pleased that this due dates proposal has wide bipartisan support and has been included in proposed legislation introduced by Sen. Enzi and Rep. Jenkins, including in 2013 (S. 420 and H.R. 901) and in 2011 (S.845 and H.R. 2382). It was also included in the Senate Finance Committee Tax Reform options paper on Simplifying the Tax System for Families and Businesses dated March 21, 2013; the Senate Finance Committee staff discussion draft on tax reform of tax administration provisions dated November 20, 2013; and the House Ways and Means Committee Chairman comprehensive tax reform discussion draft "Tax Reform Act of 2014" dated February 26, 2014. See AICPA webpage for recommendations on Change to Return Due Dates:
http://www.aicpa.org/interestareas/tax/resources/taxlegislationpolicy/pages/duedatesproposal2010.aspx.

written correspondence on tax notices. The current levels of service for these two areas are simply unacceptable.

The AICPA also recommends that Congress provide the IRS with dedicated, traceable and supplemental funds for specified "taxpayer service" purposes only. We recognize that the IRS budget is oftentimes the subject of debate, and may be even more now given the various events that have occurred over the last few years. However, the need to provide assistance to taxpayers and tax practitioners remain important responsibilities.

We are concerned that the IRS is spending a significantly lower percentage of its limited budget on taxpayer services (e.g., Individual Income Tax Line, Refund Hotline, Practitioner Priority Hotline, etc.) than in prior years. We understand that the IRS has new initiatives and vital responsibilities (such as addressing identity theft), but taxpayer service must remain a priority in a voluntary compliance system, such as the U.S. income tax system, which relies on individuals and businesses to properly report their income.

CONCLUDING REMARKS

The AICPA understands the challenges that 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 small business 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.[17] While there are costs associated with simplification reforms, it is also important to recognize the elimination of significant compliance burdens by such reforms.

The proliferation of new income tax provisions since the 1986 tax reform effort has led to compliance hurdles for taxpayers, administrative complexity, and enforcement challenges for the IRS. We encourage you to examine all aspects of the tax code to improve the current rules. The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will significantly reduce taxpayers' compliance costs and encourage voluntary compliance through an understanding of the rules. We look forward to working with the 114th Congress and the tax-writing committees as you address tax reform.

[17] AICPA testimony on the House Committee on Ways And Means hearing on "How the Tax Code's Burdens on Individuals and Families demonstrate the need for Comprehensive Tax Reform," dated April 13, 2011; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/FINAL_TESTIMONY_FOR_NELLEN_April_13,_2011.pdf.