

April 23, 2013

The Honorable Dave Camp
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander M. Levin
Ranking Member
House Ways and Means Committee
1236 Longworth House Office Building
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin:

On behalf of the National Association of Enrolled Agents (NAEA), which represents the interests of 46,000 enrolled agents, I write to share our suggestions with respect to the ongoing tax reform discussions you are leading. As America's tax experts, enrolled agents represent millions of individual and small business taxpayers, and are tested and licensed to practice by the Internal Revenue Service (IRS). NAEA is dedicated to helping enrolled agents maintain the highest level of knowledge, skills and professionalism in all areas of taxation, so that they may most effectively represent the needs of their clients.

As a profession we provide consultation, preparation, and advocacy services to America's taxpayers. We sit on the front line of tax administration and find ourselves sitting across a desk from explaining any of a number of complex tax code provisions to individual and small business taxpayers. Our members are well placed to provide common sense recommendations for tax reform and our experiences are the basis for this submission.

PRINCIPLES FOR TAX REFORM

In the interest of enrolled agents and their clients, the taxpaying public, we firmly believe the Internal Revenue Code's instability and complexity drives taxpayer frustration and makes IRS' mission nearly impossible. In order to bring about an environment in which taxpayers are no longer either bewildered or enraged by their obligations and in which tax administrators can execute their duties in a timely and predictable fashion, we propose two fundamental principles for your consideration.

Create a stable tax code— Many of the most serious tax administration challenges result from either a) the rapid pace of change or b) uncertainty regarding the fate of far too many "temporary" provisions. Tax reform obviously requires changing the law, after all we cannot make an omelet without breaking a few eggs, so this will naturally be a time of significant change.

We believe, however, any serious tax reform effort requires the elimination of (or radical retrenchment in) temporary provisions. In the past few years, some 50-60

provisions expired, including fundamental items such as the increased AMT exemption amount and the tax credit for research and experimentation expenses. Frankly, this state of affairs is unacceptable.

While NAEA members appreciate the permanent AMT relief Congress provided in January's American Taxpayer Relief Act of 2012, this type of legislation—so late that taxpayers could not plan for the 2012 tax year and so late that IRS had no choice but to delay the start of the filing season—drives the problems taxpayers and tax professionals face. We simply cannot continue this annual ritual of last-minute extensions, or even worse, expiration and then retroactive extensions.

If Congress provides serious reform, then outside of technical corrections, Title 26 should remain stable. Stability in the tax code has intrinsic value to every participant in the tax ecosystem.

Reduce burden on taxpayers and tax administrators— While our tax code creates a number of pain points, we believe the most overlooked ones are burden related. For tax administrators, the issue is whether a provision is administrable and for taxpayers, the issue is how much time and effort will be required to comply with (or take advantage of) the provision. All too often tax law is changed without consideration of how IRS will administer the provisions—or whether the provision is reasonably administrable. At the same time, too little attention appears to be given the hoops through which a taxpayer (individual or business) will have to jump in order to take advantage of or comply with the provision.

With respect to administrability, IRS should be consulted. The agency desperately needs its own burden reduced and best understands what can (and cannot) be done easily. With respect to taxpayer burden, the National Taxpayer Advocate has for many years written thoughtfully on the issue.

A tax code overhaul is a remarkable opportunity to improve the entire tax system, to make it more transparent, predictable, and easier to execute. The way to make a noticeable difference with a broad swath of taxpayers—individual and small business—is to create a code that reduces burden and remains stable.

SPECIFIC REFORMS

During the course of any given year, enrolled agents work with millions of individual and small business taxpayers. For better or for worse, we are well situated to report on the idiosyncrasies of the current tax code and would be remiss if we didn't take advantage of this opportunity to make specific reform recommendations.

- **Late Forms 1099 have compressed the filing season for many taxpayers—** Many taxpayers receive Forms 1099 from investment firms later every year, which effectively shortens the filing season with each passing year. IRS' complicity in granting extensions far beyond the January 31 deadline for

issuing Forms 1099 is in direct conflict with former Commissioner Shulman's vision for a real-time tax system. The investment firms continue to hold the IRS hostage with the prospect of inevitable deluge of corrected Forms 1099 should the Service decline to extend the filing deadline. This game, however, is zero-sum. IRS cannot give to the Form 1099 issuers without taking from taxpayers and their tax professionals. The fallout is inevitable: taxpayers are charged for multiple amended returns, tax professionals are increasingly harried and prone to error, and the Service, which is left with a higher volume of extended returns and CP-2000 notices, is forced to use resources in a suboptimal manner

- Recommendation: Return to a January 31 deadline for all Forms 1099. Any corrections after that date would be adjustments to the following year's Forms 1099

Investment firms are already tracking the adjustments, which for most clients are insignificant, so the recommendation is merely a question of timing. This proposal would immediately and effectively decompress the filing season for the benefit of all, including the investment firms that issue the sometimes multiple amended Forms 1099. The process that has been compromised by delaying the Form 1099 filing date will be instantly returned to a more desirable state.

- **Brokerage firm reporting needs to be standardized**— Brokerage firm reporting had become the proverbial Tower of Babel with no two forms looking alike. Foreign income tax withholding and exempt mutual funds in particular are vexing. Because little consistency exists across reports from different brokerage firms, preparers are required to search the entire brokerage report to account for this information. Some, but not all, brokerage firms provide applicable percentage for each state (as part of the reporting package) to break out the taxpayers' state information.

- Recommendation: Require IRS to work with the brokerage industry to develop standardized reporting forms.

- **Repeal AMT and Pease/Pep**— The alternative minimum tax is a second, shadow tax system originally designed to make sure fat cats with exotic tax shelters pay at least some income tax. But these days it plagues mostly upper middle class families whose "shelters" are large state and local tax deductions and/or exemptions for children.

An increasing number of their middle class taxpayers are blindsided by falling into this insidious alternative tax system. Many of these taxpayers, who have not engaged an enrolled agent or other competent tax professional, will not even be aware of the requirements of the AMT until they receive a notice from the IRS.

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One of Ohio enrolled agents wrote to us to say how troubled she was to see an elderly client "clobbered by the AMT." The taxpayer was caring for his wife with Alzheimer's, and had to withdraw extra pension money to pay medical bills. The AMT calculation required him to add back into AMT a portion of his otherwise deductible medical bills and his state income and property taxes. This caused the AMT to exceed the regular tax.

In higher tax states such as California, New York, New Jersey, and Massachusetts, we find that many middle-income taxpayers fall unwittingly into the AMT because of high property taxes and high state income taxes. When these taxpayers also happen to be employees who incur ordinary and necessary business expenses and whose employers either do not reimburse expenses or use non accountable plans, they are injured even more, because those miscellaneous deductions are also added back to the AMT base. None of these items, normally allowable deductions, is permitted against AMT.

Enrolled agents are reporting that more and more farm families are being hit with the AMT. Congress saw a need to provide farmers a special income averaging method a few years ago. Unfortunately, when that method lowers the regular tax below AMT, the taxpayer loses the benefits, and must pay the higher AMT.

The Internal Revenue Code provides U.S. taxpayers living outside our country a means to avoid double taxation through the use of foreign tax credits (FTC). Once again, AMT undermines the fairness Congress intended with the credit system by allowing the FTC to offset no more than 90% of the AMT, while the regular tax can be completely offset. The taxpayer is injured once again.

The Pease and personal exemption phaseout requirements make withholding more difficult and are a hidden rate increase that would be simpler and more transparent as just a second or third rate for the high income.

- o Recommendations: Repeal the individual AMT and the Pease and PEP requirements. If total repeal is too expensive, the Congress should consider removing the "non-preference" items from the provisions not deductible under the AMT: the standard deduction, personal exemptions, state and local taxes and miscellaneous itemized deductions.
- **EITC is too complicated and attracts fraud**— On the annual IRS list of top tax return errors, Earned Income Tax Credit issues make up almost half the list. It is easy to see why. While the rules governing eligibility, calculating income, and establishing dependent status are some of the most complicated in the Internal Revenue Code, the target for the credit is by and large the most

unsophisticated set of taxpayers in the economy. When these taxpayers are brave enough to venture forward into this unforgiving territory, they can be comforted knowing that Congress has provided hundreds of millions of dollars to the IRS over the last few budgets cycles to find them and ensure that they are in full compliance down to crossing every *t* and dotting every *i*.

For the majority of these taxpayers the outcome of all of this complexity is a growing dependency on unlicensed, unregulated return preparers. Many of these preparers are only too glad to assist in "working the system" to obtain benefits to which the taxpayers are not entitled. Enrolled agents continually lose business when they refuse to compromise their standards. EAs are held to strict codes of professional conduct, from our own organization and in Circular 230. Unfortunately, the vast number of paid preparers in this country simply hangs out a shingle without demonstrating even minimal competency and without educating themselves on the ever-changing tax code.

- Recommendations: NAEA urges Congress to make simplifying EITC one of its top priorities by starting with the following reforms
 - Eliminate the use of Adjusted Gross Income and define "Earned Income" as wages, salaries, tips and self-employed income;
 - The term "qualifying child" should be consistent with current law rules governing a dependent child;
 - Eliminate the rule requiring that when two possible eligible individuals live in the same house, only the individual with the highest AGI shall qualify for the credit; and,
 - Eliminate all age restrictions above 18 years of age.

- **Education tax benefits—** Some 14 different incentives for higher education are provided in the tax code. The instructions for parents and students are as long as they are abstruse. Because of the level of complexity in this area of the tax code, many families do not take advantage of what is offered claim a benefit which they are not entitled, or chose one that does not provide them with the maximum tax benefit.
 - Recommendation: Consolidate all education benefits into three simple provisions
 - A super 529 savings vehicle (including tuition prepayment plans), which could include elective payroll deductions;
 - A single college tax credit with a single earnings phaseout that would consolidate American Opportunity Credit/Hope Credit, Lifetime Learning Credit, and tuition and fees deductions; and,
 - A deduction for student loan interest.

- **Standardize phase outs and definitions—** A multitude of phaseout calculations affect taxpayers. Because each of these phaseouts is different many taxpayers become frustrated with the tax system when they find that an often-promised benefit is not available to them (e.g., limits for deductible

- IRA contributions, limitations on the use of education credits, child credits, elderly credits, personal exemptions, itemized deductions, passive activity losses and credits). Additionally, the Internal Revenue Code does not treat single, head of household and married filers consistently with some code provisions providing a single phase-out for all filers, while others provide varying degrees of relief from the “marriage penalty.”
- Recommendation: Provide a standardized schedule for phasing out tax benefits under the Internal Revenue Code. This schedule should provide phase-out ranges for both low income and middle class taxpayers and should be marriage neutral.
 - **Kiddie tax**— The so-called kiddie tax is designed to keep very high earners from shifting income to their children, but ends up creating a mountain of extra paperwork for middle class families, too. Once the dust settles, though, over half of the tax returns filed for children owe less than \$50 in taxes.
 - Recommendation: Provide a high tax threshold for investment income (\$2,000 to \$5,000) of children subject to the kiddie tax.
 - **Simplify foreign tax requirements for middle class individuals**— The tax filing and income tax rules for middle class Americans are needlessly burdensome, especially for the many students and teachers living abroad. For example, a U.S. taxpayer abroad earning less than \$100,000 from work and less than \$8,000 from investments under current law will likely owe no U.S. taxes (because the taxes in most European countries are higher than the US.) but will have to file a complicated return with dozens of pages, including Form 1040, with Schedules A, B, and D, as well as Forms 2555, 1116, 5471, 3520, 3520-A, 8833, 8938, and TD F 90-22.1. Many of these documents (e.g., Forms 5471, 8938, 3520, 3520-A, and TD F 90-22.1) have draconian penalties for failure to file.
 - Recommendation: Waive filing requirements for lower income individuals who live abroad in tax treaty countries.
 - **Simplify mortgage deductibility rules**— Qualified residence interest is the total of acquisition indebtedness and home equity indebtedness. Most taxpayers simply do not understand the difference between home acquisition debt and equity debt, they only understand the broad concept of a mortgage interest deduction. If a taxpayer refinances a mortgage or takes a home equity loan, the interest on the loan may be acquisition debt or equity debt or some combination of the two. Further, some of that loan interest may be a preference item for the purposes of the alternative minimum tax.
 - Recommendation: Provide a simplified definition for what constitutes deductible mortgage interest.

OTHER ISSUES TO CONSIDER

We provided both broad principles and specific tax code provisions desperately in need of attention. We did not provide three items, though, that require Congressional attention: 1) IRS funding; 2) civil and criminal penalty reform; and, 3) return preparer regulation. Each of these is also worthy of consideration.

1. **Adequate IRS Funding**— IRS requires adequate levels of funding in order to carry out its tax administration duties: namely, to inform, educate, and assist those taxpayers who attempt to comply voluntarily with the tax laws, and to compel compliance from those who fail to file returns, report income accurately, and pay their tax obligations.

We appreciate that coming to IRS' budget defense in any environment, far from the current spending environment, is challenging. The fact remains that IRS interacts with more citizens than any other agency of the government, and America's unique system of self-assessment requires a tax administrator that is capable of providing timely, complete, and accurate responses to taxpayer queries, whether in response to taxpayer instigated pre-filing questions or IRS-prompted post-filing actions. IRS cannot provide the requisite numbers of trained personnel without appropriate budgets. See-sawing budgets, rising and falling year after year, makes it difficult for IRS to hire, train and retain the best workforce for the American taxpayer.

2. **Civil and Criminal Penalty Reform**— In the many years since civil and criminal penalties have been evaluated, we have seen an alarming trend away from proportionality (*i.e.*, the more egregious the infraction, the more severe the penalty) and a foggy in assessing penalties (*i.e.*, inconsistent penalty assessment and a lack of understanding by IRS enforcement personnel why the penalties exist).
3. **Support Return Preparer Oversight**— Further, we must comment on a topic near and dear to enrolled agents' hearts, return preparer oversight. We have for years provided a consistent voice, insisting that initial competency testing and ongoing continuing education were necessary to protect taxpayers and to help close the nation's tax gap (*i.e.*, the difference between what taxpayers self assess and pay in taxes and the true amount of taxes due). We are not alone and have been joined by a chorus of voices, including the General Accountability Office and the National Taxpayer Advocate, which have both highlighted the importance of ensuring that all tax preparers are subject to minimal standards. To that end, we urge Congress to send a strong signal that the Department of Treasury in fact has and has always had the authority to move forward with a common sense return preparer oversight program.

CONCLUSION

We are reminded of the Chinese proverb that tells us the best time to plant a tree is twenty years ago, but that the next best time is now. In the quarter century since the last significant tax code overhaul, many have suggested the time for reform was ripe. Enrolled agents have seen how constant tax code gyrations in addition to destabilizing temporary provisions and retroactive changes hobble taxpayers' decision-making and undermine confidence in our government.

On behalf of enrolled agents, America's tax experts, and on behalf of the millions of taxpayers we represent, we offer these suggestions and thank you for establishing a transparent process in which to consider tax reform. We urge you to move forward with vigor and to plant the tree now, not later.

We welcome the opportunity to discuss our recommendations and our front line, practical experiences as America's tax experts. To that end, please contact our Senior Director, Government Relations Robert Kerr at 202/822.6232 or rkerr@naea.org.

Sincerely,

A handwritten signature in green ink that reads "Francis X. Degen".

Francis X. Degen, EA, USTCP
President