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April 13, 2016

The Honorable Charles Boustany, Jr.
Chairman
Subcommittee on Tax Policy
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Richard E. Neal
Ranking Member
Subcommittee on Tax Policy
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Re: Today's Hearing on "Fundamental Tax Reform Proposals," the Need to Preserve Cash Accounting for Law Firms and Other Personal Service Businesses, and Concerns Over Burdensome Mandatory Accrual Accounting Proposals

Gentlemen:

On behalf of the American Bar Association ("ABA"), which has over 400,000 members, I am writing to express our views regarding an important aspect of the tax reform legislation that your Subcommittee, the full House Ways and Means Committee, and the House Tax Reform Task Force are in the process of developing. In particular, we strongly oppose those proposals—such as Section 3301 of H.R. 1 introduced during the 113th Congress and other similar proposals now under consideration—that would require personal service businesses with annual gross receipts over $10 million to switch from the traditional cash receipts and disbursements method of accounting to the more complex and costly accrual method. These mandatory accrual accounting proposals are also strongly opposed by over 30 state, local, and specialty bars throughout the country. We ask that this letter be included in the record of today's Subcommittee hearing.

Although we commend you and your colleagues for your efforts to craft legislation aimed at simplifying the tax laws—an objective that the ABA and its Section of Taxation have long supported—we are concerned that mandatory accrual accounting proposals like Section 3301 would have the opposite effect and cause other negative unintended consequences. These far-reaching proposals would create unnecessary new complexity in the tax law by disallowing the use of the cash method; increase compliance costs and corresponding risk of manipulation; and cause substantial hardship to many lawyers, law firms, and other personal service businesses by requiring them to pay tax on income long before it is actually received. Therefore, we urge you and your colleagues not to include these or any other similar mandatory accrual accounting proposals in the new tax reform legislation that is currently being developed.

Under current law, businesses are permitted to use the simple, straightforward cash method of accounting—in which income is not recognized until cash or other payment is actually received—if they are individuals or pass-through entities (*e.g.*, partnerships or Subchapter S corporations) or their average annual gross receipts for a three year period are $5 million or less. In addition, all personal service businesses—including those engaged in the fields of law, accounting, engineering, architecture, health, actuarial science, performing arts, or consulting—are exempt from the revenue cap and can use the cash method of accounting regardless of their annual revenues, unless they have inventory. Most other businesses are required to use the accrual method, in which income is recognized when the right to receive the income arises, not when the income is actually received.

Mandatory accrual accounting proposals like Section 3301 would dramatically change current law by raising the gross receipts cap to $10 million while eliminating the existing exemption for law firms, other personal service businesses, and other pass-through entities. Although these proposals would allow certain small business taxpayers with annual gross receipts in the $5 million to $10 million range to switch to—and thereby enjoy the benefits of—the cash method of accounting (a concept that the ABA does not oppose), the proposals would significantly complicate tax compliance for a far greater number of small business taxpayers, including many law firms and other personal service businesses, by forcing them to use the accrual method.

Partnerships, S corporations, personal service corporations, and other pass-through entities favor the cash method because it is simple and generally correlates with the manner in which these business owners operate their businesses—*i.e.*, on a cash basis. Simplicity is important from a compliance perspective because it enables taxpayers to better understand the tax consequences of transactions in which they engage or plan to engage. In this regard, simplicity helps to mitigate compliance costs, which already are significant, and to improve compliance with the tax code.

If law firms and other personal service businesses are required to use the more complex accrual method of accounting, they would be forced to calculate and then pay taxes on multiple types of accrued income, including work in progress, other unbilled work, and accounts receivable (where the work has been performed and billed but payment has not yet been received). To meet these requirements, law firms and other affected businesses would need to keep much more detailed work and billing records and hire additional accounting and support staff. This would substantially raise compliance costs for many law firms and other personal service businesses while greatly increasing the risk of noncompliance with the tax code.

In addition to creating unnecessary complexity and compliance costs, these mandatory accrual accounting proposals would lead to economic distortions that would adversely affect all law firms and other personal service businesses that currently use the cash method of accounting and their clients in several ways.

First, the proposals would impose substantial new financial burdens on many thousands of personal service businesses throughout the country—including law firms—by forcing them to pay taxes on income they have not yet received and may never receive. Requiring these businesses to pay taxes on this "phantom" income—and to borrow money or use their scarce capital to do so—would impose a serious financial burden and hardship on many of these firms. The legal profession would suffer even greater financial hardship than other professions because many lawyers are not paid by the clients until long after the work is performed.

Second, mandatory accrual accounting would adversely affect clients, interfere with the lawyer-client relationship, and reduce the availability of legal services. If law firms are required to pay taxes on accrued income they have not yet received, the resulting financial pressures could force many firms charging on a traditional hourly fee basis to collect their fees immediately after the legal services are provided to the client or at least much sooner than they currently do. As a result, many clients could find it more difficult to afford legal counsel. In addition, many law firms would no longer be able to represent as many accident victims, start-up companies, or other clients on an alternative or flexible fee basis as they now do, and many firms would also have to reduce the amount of pro bono legal services they currently provide to their poorest clients.

Third, the proposals would constitute a major, unjustified tax increase on small businesses and discourage economic growth. The Joint Committee on Taxation estimated that the accrual accounting mandate in Section 3301 would generate $23.6 billion in new taxes over ten years by forcing many thousands of small businesses to pay taxes on income up to a year or more before it is actually received—if it is ever received. Because this acceleration of a firm's tax liability would be permanent and continue year after year, it would constitute a major permanent tax increase for the firm, when compared to the taxes the firm currently pays under the cash method, until the firm eventually dissolves, merges with another firm, or otherwise ceases to exist.

The proposals would also discourage professional service providers from joining with other providers to create or expand a firm, even if it made economic sense and would benefit their clients, because it could trigger the costly accrual accounting requirement. For example, solo practitioner lawyers would be discouraged from entering into law firm partnerships—and existing law firms would be discouraged from growing or expanding—because once a firm exceeds $10 million in annual gross receipts, it would be required to switch from cash to accrual accounting, thereby accelerating its tax payments. Sound tax policy should encourage, not discourage, the growth of small businesses, including those providing legal services, especially in today's difficult economic environment.

For all of these reasons, as discussions on tax reform continue, we urge your Subcommittee, the full Committee, and the Task Force to preserve the ability of law firms and other personal service businesses to use the simple cash method of accounting and not to support any proposals that would require these businesses to switch to the more burdensome accrual method.

Thank you for considering the ABA's views on this important issue. If you have any questions regarding our position, please contact ABA Governmental Affairs Director Thomas Susman at (202) 662-1765 or Associate Governmental Affairs Director Larson Frisby at (202) 662-1098.

Sincerely,

Paulette Brown
President, American Bar Association

cc: Members of the House Ways and Means Subcommittee on Tax Policy
Members of the House Tax Reform Task Force
The Honorable Mark J. Mazur, Assistant Secretary of the Treasury for Tax Policy

American Forest & Paper Association

American Forest & Paper Association
Statement for the Record

Committee on Ways and Means
Subcommittee on Tax Policy

U.S. House of Representatives

Hearing on Fundamental Tax Reform Proposals
April 13, 2016

The American Forest & Paper Association (AF&PA) is the national trade association of the forest products industry, representing pulp, paper, packaging, tissue and wood products manufacturers, and forest landowners. Our companies make products essential for everyday life from renewable and recyclable resources that sustain the environment.

U.S. manufacturers of paper and wood products appreciate the opportunity to provide input to the Ways and Means Subcommittee for Tax Policy for the development of bipartisan comprehensive tax reform legislation. The industry supports comprehensive business tax reform that improves economic growth, job opportunities, capital investment, and the competitiveness of U.S. based businesses. Special attention should be paid to ensure that the overall impact of federal tax reform does not result in counter-productive tax increases that will be harmful to economic growth, job creation, capital investment, and global competitiveness.

The U.S. forest products industry – made up of both C-corporations and pass-through entities – is a significant contributor to the U.S. economy, employing nearly 900,000 men and women in above-average wage jobs, investing heavily in equipment and improvements, and exporting products throughout the world. The U.S. forest products industry also supports jobs in other sectors of the U.S. economy. A recent study conducted by the Economic Policy Institute found that each paper industry job supports 3.25 jobs in supplier industries and in local communities as the result of re-spending and tax receipts.

The forest products industry produces more than $200 billion in paper and wood products annually and accounts for approximately 4.0 percent of the total U.S. manufacturing GDP. The industry employs more than 900,000 people and ranks among the top 10 manufacturing sector employers in 47 states. In a typical year, the forest products industry transforms approximately 13 billion cubic feet of wood - the majority of which is purchased from privately-owned forest land – into value-added paper, packaging, lumber and other wood products.

We are highly capital intensive and have made significant investments and facility upgrades in recent years. In 2014, the most recent year for which data is available, the paper and wood products industry invested $8.2 billion in plant and equipment. Items such as recovery boilers, turbine generators, paper machines, and environmental controls are critical to maintaining technologically advanced manufacturing facilities that compete in an extremely competitive global marketplace.

Exports of U.S. pulp and paper result in a net export surplus and exports of paper and wood products account for more than 15 percent of the industry's annual total sales. In 2015, U.S. exports of forest products amounted to $30.3 billion, of which $21.4 billion were exports of pulp and paper products, and $8.9 billion exports of wood and wood products.

Our members are longstanding leaders in making substantial investments in renewable energy equipment and facilities to generate electricity and other usable forms of energy for its operations. On average, about two-thirds of our members' energy needed for forest products production comes from the use of carbon-neutral biomass. Paper and wood products manufacturing facilities account for 62 percent of the renewable biomass energy consumed by all manufacturing sectors.

The U.S. forest products industry provides excellent employee payroll, retirement, and health benefits to its workers. Meeting a payroll of approximately $50 billion, the forest products industry employs about the same number of people as the automotive industry and more people than the chemical and plastics industries. The industry has a generous compensation and benefits structure -- earnings of pulp and paper mill workers exceed the average for all U.S. private sector workers by about 23 percent.

We realize that comprehensive tax reform will not be easy. However, the key goals of lowering the corporate tax rate and a reformed competitive international tax system will help attract and retain business operations and good paying jobs in the United States. Ensuring that the resulting tax code provides a level playing field for all business activity while deflecting attempts to pick "winners and losers" among economic players should be a top priority.

To this end, our industry priorities for fundamental federal tax reform include:

- <u>Tax rates.</u> The United States has the highest statutory corporate tax rate among OECD countries. This is because most other OECD member countries have lowered corporate rates during the past two decades, while U.S. corporate rates have remained nearly stagnant. A significant reduction in statutory corporate income tax rates to at least 25% or lower, which would be more in line with the average among other OECD countries. In fact, a federal rate below 25% may be necessary, since the addition of state and local taxes would result in total tax liabilities exceeding the OECD average. Such a reduced rate is needed for U.S.-based companies to be able to compete in the United States and abroad. A tax system with the lowest possible tax rates for all businesses is desirable to foster capital investment, jobs creation, exports, and economic growth.

- Business investment. Business investment is another crucial driver of economic growth and jobs. Appropriate treatment of depreciation, interest expenses, and research expenditures is important to ensure that capital intensive manufacturers – such as paper and wood products companies – continue to upgrade existing facilities and invest in new and more efficient equipment. In addition, rules reflecting the need for long-term investment in timber by the 22 million family forest owners across America are essential to a sustainable supply of forest resources for manufactured products and are good for the environment, the economy and society. The recent enactment of a permanent research credit and an extended "bonus" depreciation timeline were welcome developments. We encourage Congress to consider ways to build on these provisions to continue bolstering the long-term investment environment in the U.S.

- International tax rules. The global market place is more competitive than ever and home country tax systems can provide a competitive edge as companies seek to enter new markets and compete in existing markets. Unfortunately, the United States has fallen behind as most OECD countries have moved to competitive tax regimes. The U.S. international tax rules should be reformed to include a competitive territorial tax system like those of many other countries, which would allow U.S.-based companies to compete on a level playing field in vital global markets.

- Employee benefit provisions. The U.S. forest products industry is a leader in providing excellent employee payroll, retirement, and health benefits to its workers. Existing law treatment of employee health insurance benefits and employee retirement contributions are integral to the industry's continued ability to provide these benefits to its workforce.

- Transition relief. A major change in federal tax policy could have a negative impact on existing business investment and create considerable uncertainty. Appropriate transition relief and protections against retroactive tax law changes should be an integral part of any federal tax reform effort. For example, the full benefit of net operating losses and unused tax credits should be protected and allowed to be carried forward to future years.

We would be pleased to discuss these priorities with the committee and answer any questions you may have about our industry.

For more information, please contact:

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April 26, 2016

American Citizens Abroad, Inc. (ACA) submission for the House Ways and Means Committee call for comments on the recent hearing held on tax reform.

ACA is pleased to see that the House Ways & Means Committee is holding hearings on tax reform and encouraging the presentation of a wide range of new revenue source proposals.

The hearing held on March 22, 2016 to examine Cash-Flow and Consumption-Based Tax Reforms presented compelling proposals for a major shift in tax policy; moving away from an income-based approach to taxation and shifting to alternate methods of tax revenue generation through cash-flow and consumption taxes.

The hearings held on April 13th examined the Jump Start America Act, the Tax Code Termination Act, and reviewed the 2014 Camp tax reform proposal; investigating the economic efficiency, potential for economic growth, fairness and ease of administration of these proposals.

In the discussion of all these proposed tax reforms, the issue of how new tax proposals would affect the community of international taxpayers was not addressed. ACA believes that it is critical that all tax reform proposals address how these proposals will be applied to and/or will affect the community of 8 million plus international, overseas American taxpayers.
See: http://travel.state.gov/content/dam/travel/CA%20by%20the%20Numbers-%20May%202015.pdf

Some of the proposals presented to date, by definition (i.e. consumption based taxation), would appear to alleviate the tax filing burden and double imposition on Americans living and working overseas and, would greatly advance the ability of Americans to compete on an equal footing in a global environment. However, none of the proposals directly address how such modeling would apply to Americans living and working overseas.

ACA so far has not studied the idea of tax reform based on alternate revenue sources such as consumption-based taxation and value added taxes. ACA's proposal for residence-based taxation (RBT) rests on the assumption of reforming taxation based on the income tax model.

ACA supports tax reform modeling that simplifies the tax code, empowers individuals to compete on an equal footing in a global economy, reduces the burden of compliance, paperwork and duplicate reporting. However, these proposals must also insure that the tax code eliminates instances of double taxation and removes the burdens that the current citizenship-based taxation code imposes on Americans who are working overseas.

ACA continues to advocate for a territorial or residence-based taxation system. ACA's RBT proposal ensures that Americans overseas will be put on competitive equal footing with both their compatriots stateside and with foreign nationals overseas, in order to advance the economic competitiveness of the United States.

ACA's RBT proposal guarantees that the tax code is fair, allows for mobility in an ever more global work and social environment, and helps to advance US economic interests through facilitating access to new markets for American products and, allowing Americans and American companies to partner in new businesses and new technologies.

Americans overseas are living and working in a new global world economy but are operating with an old world taxation structure, both from a business and personal perspective. If the United States wants to set free the powerhouse of economic development that Americans working globally can provide, which will create jobs and opportunity for workers in the United States, then the tax committees must consider territorial or residence-based taxation as the model for income tax reform.

For a link to ACA's full proposals for RBT please see:
https://www.americansabroad.org/media/files/files/9960ba5d/ACA_RBT_proposal_for_submission_to_Senate_Finance_April_2015.pdf

Summary of ACA's Residence-based taxation proposal

Individual and corporate tax reform is at the top of the agenda of Congress, on both domestic and international levels. ACA looks forward to contributing to this debate to advance three key objectives:

- Fairness – to eliminate double taxation and costly double reporting burdens.

- Mobility – the exercise of the fundamental right to choose one's place of residence, whether for professional, family, educational or other reasons should be as frictionless as possible.
- Advancing U.S. Economic Competitiveness – to empower overseas citizens to paly their natural and historic role as vectors of export promotion and job creation in the United States.

To this end, ACA produced and circulated a detailed discussion document in political and academic circles as a constructive step in the process. This proposal, which was referenced in a 2013 Senate Finance Committee Report comprised the following elements:

Replacement of the present system of taxation of overseas Americans usually referred to as Citizenship-Based Taxation (CBT), by a system of Residence-Based Taxation (RBT): Americans overseas would be taxed by the U.S. on U.S.-source income.

- Treatment of bona fide Non-Resident Americans in a manner analogous to that of Non-Resident Aliens (NRAs). The system is in place and has proven its workability, and include provision for:

    1. withholding taxes at source on unearned income – dividends, interest, royalties, etc.;
    2. 1040NR taxation of earned income "effectively connected" with the United States;
    3. taxation of rental income and capital gains on U.S. situs real estate.

- Anti-abuse provisions would prevent RBT from being used as a loophole to avoid U.S. taxes.
- Residents of designated tax haven countries, overseas military personnel, U.S. diplomatic corps and Puerto Rico residents with U.S. income would continue to be taxed as U.S. residents. A departure tax based on mark-to-market valuation of unrealized capital gains at the time of departure may be a condition imposed by Congress. ACA has argued against it, on the grounds that it would work against, the objectives of fairness, mobility and national economic interest. But if a departure tax is included in legislation, ACA's position is that:

    1. a "grandfather" clause shielding overseas Americans meeting certain residency minima from the departure tax would be an essential element of the legislation;
    2. high asset exclusion thresholds for Americans leaving the U.S. and measures to help holders of illiquid assets meet the tax obligations are needed to maintain international mobility of Americans.

In light of our analysis of IRS statistics, ACA is of the considered opinion that, the switch from CBT to RBT would be revenue neutral. Under CBT, the U.S. currently recognized the first right of taxation of the country of residence, and hence, due to crediting of foreign taxes, collects no tax from the vast majority of Americans abroad.

Tax revenue from Americans abroad accounts for less than 0.2% of the total U.S. budget. Under RBT, the U.S. would be able to claw back, mostly through withholding taxes on financial assets and taxes on U.S. effectively connected income, revenues which today remain with foreign governments under CBT.

April 27, 2016

<u>Submitted electronically to waysandmeans.submissions@mail.house.gov</u>.

STATEMENT FOR INCLUSION IN THE HEARING RECORD OF
HEARING ON INCOME TAX REFORM PROPOSALS

CONGRESS SHOULD STRONGLY CONSIDER POTENTIAL RAMIFICATIONS THAT TAX REFORM MAY HAVE ON LARGE EMPLOYERS AND THEIR ABILITY TO CONTINUE TO OFFER RETIREMENT PLANS FOR MILLIONS OF AMERICA'S WORKERS

Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee, thank you for the opportunity to voice the point of view of major employers that directly sponsor voluntary retirement benefit plans for millions of Americans. My name is Annette Guarisco Fildes and I am President and Chief Executive Officer of The ERISA Industry Committee (ERIC).

ERIC is the only national trade association advocating solely for the employee benefit and compensation interests of the country's largest employers. ERIC supports the ability of its large employer members to tailor retirement, health, and compensation benefits for millions of workers, retirees, and their families. ERIC's members provide comprehensive retirement benefits to millions of active and retired workers and their families. Preserving and enhancing the voluntary employer-provided retirement system and the tax incentives that support it are key policy goals of ERIC and its members.

The employer-sponsored retirement plan system is helping over 130 million American workers get ready for retirement. Congress should protect, support and expand the retirement system to allow future generations to prepare for retirement. We urge Congress to proceed with caution when considering any cutbacks to the tax incentives relating to the current retirement system in order to avoid the risk and strong possibility of major unintended adverse consequences to the country and the financial and personal security of working Americans. The effects of significant changes for individuals, employers and the system as a whole are simply too harmful and must be avoided. In addition, we encourage Congress and policymakers to take this opportunity to further strengthen and support the U.S. employer-sponsored retirement system.

ERIC believes that as tax reform proposals are developed, this Subcommittee and Congress should strongly consider potential ramifications that changes in current law may have on large employers and their ability to continue to offer voluntary employer-sponsored retirement plans for millions of American workers. I would like to highlight key aspects of the current employer-sponsored retirement system that support the ability of large employers to continue providing retirement benefits to millions of workers and make recommendations regarding them.

ERIC recommends that Congress consider the following with respect to retirement plans as tax reform plans are developed:

1) *Preservation of the voluntary nature of employer-sponsored retirement plans.*

The voluntary nature of the retirement plan system is critical to the continued success of the employer-sponsored retirement system. The voluntary nature of the current retirement plan system provides the flexibility needed for employers to tailor plans to their workers.

Employers establish retirement plans to compete for and retain quality workers and to ensure workers are able to retire with adequate retirement savings. The voluntary nature of the private-sector retirement system is vital to its success. No two employers are identical; some employ thousands of workers, while others employ only a few. Employers are engaged in different industries, located in different geographical regions; some operate in the global market, while others operate only in their local community. A "one-size-fits-all" approach to rules and regulations often will not address the challenges of every company that wants to offer retirement benefits to their workers.

Flexibility is critical in retirement plans. It allows employers to design plans that work effectively and efficiently based on the needs of their diverse workforces. Rules that are too onerous or overly restrictive can chill an employer's commitment to offer and a participant's interest to participate in an employer-sponsored plan.

The voluntary nature of the current employer-sponsored private retirement system and the flexibility employers have in establishing and maintaining retirement plans for their workers are vital to America's private retirement system. Congress should ensure the current private retirement system remains voluntary and flexible to encourage continued and new employer participation.

2) *Preservation of current tax incentives for retirement benefits.*

The current tax incentives for private retirement plans drive savings for workers across the country. Removing the current tax incentives for retirement plans will discourage plan establishment and maintenance and reduce the participation of employees contributing to their retirement savings.

Unlike tax expenditures where tax is completely avoided (i.e., deductions), taxes on retirement plan contributions are generally merely *deferred* until the participant receives a distribution of the funds, which is typically during retirement. In the unusual event a participant takes a pre-retirement distribution, there is an additional tax penalty, absent a qualifying case of hardship, which results in additional revenue for the government. Tax revenue is not completely lost when workers contribute to their retirement plans—it is merely delayed.

When measuring the cost of tax deferrals in retirement plans, such as 401(k) plans, the calculations performed by the Joint Committee on Taxation (JCT) and the Treasury Department cannot adequately reflect that there is only a deferral of taxation because revenue from most distributions at retirement occur outside of the 10-year budget window. As a result, the majority of the costs for deferrals is "scored" as lost revenue in the budget window. The approach used by the JCT and the Treasury Department significantly exaggerates the actual cost to the government with respect to the tax incentives for retirement plans and ignores the real long-term value of the plans to the country and working Americans. Intricacies in the federal budget rules unfortunately result in retirement plan tax deferrals being counted as a revenue loss without taking into account the corresponding deferred gain.

Continuing to provide tax incentives encourages both employer and worker participation in America's retirement system. Because taxes are merely deferred, not excluded, Congress should ensure that employer-sponsored retirement plans continue to receive the long-standing protections on which employers and workers rely.

3) *Ensuring appropriate deferral and contribution limits that reflect current inflation rates and economic circumstances.*

Workers need flexibility to be able to save more when they are able and less when they are under financial constraints. For example, an individual may be able to save more when they are younger or once their children become adults, but have less money to contribute when paying for their children's college education or caring for their elderly parents.

Under the current system, employees are able to make elective deferrals up to $18,000 annually. Congress recognized the need for older workers to save more as they are nearing retirement. As a result, workers age 50 and older can currently save up to $24,000 annually. Policymakers have acknowledged that the "savings cycle" can be different depending on an individual's unique circumstances.

Current deferral limits have not kept up with inflation. The limit on contributions made on an individual's behalf to a defined contribution plan was set at $25,000 (and indexed to inflation) when ERISA was enacted in 1974.[1] By 1982, the limit had increased to $45,475.[2] However, the Tax Equity and Fiscal Responsibility Act of 1982 reduced the limit to $30,000 and postponed indexation until after 1985. Indexation was again deferred until after 1987 by the Deficit Reduction Act of 1984. Then, in 1986, the contribution limit was frozen at $30,000 through 2000 as a result of the Tax Reform Act. Since 2001 the limit has gradually increased to

[1] 26 U.S.C. 415(c) 1974.
[2] Investment Company Institute, *401(k) Plans: A 25-Year Retrospective*, 12 RESEARCH PERSPECTIVE (Nov. 2006), *available at* https://www.ici.org/pdf/per12-02.pdf.

$53,000,[3] not much above the 1982 limit of $45,475, and far below the amount that the 1974 limit of $25,000 would represent in 2016 dollars—$133,673.[4]

Proposals that would limit the amount of retirement plan contributions, reduce the current contribution deferrals, or limit the value of the retirement benefits would undermine the success of the current employer-sponsored retirement system by discouraging employers from establishing and maintaining plans and causing some participants to decrease their contributions. The result would be reduced savings balances at retirement by 6 to 22 percent for workers currently age 26-35 with the greatest reductions for those in the lowest-income quartile[5] —the demographic that Congress seeks to encourage to save more.

In the 1980s, we saw the significant negative consequences when a well-intentioned Congress set out to limit retirement contributions. When Congress restricted the eligibility requirements for individual retirement accounts (IRAs), deductible contributions declined from $37.8 billion in 1986 to only $14.1 billion in 1987 and continued to steadily decline thereafter.[6] Workers have shown that they will respond to increased restrictions in retirement plans by saving less.

It is critical that Congress recognize the value of the current system that reflects typical lifetime savings habits and consider increasing the elective deferral limit. We urge the Subcommittee to continue to support and expand the ability of individuals to save through their workplace retirement plans by continuing COLA increases to deferral limits and reviewing the adequacy of the 402(g) limits in the Internal Revenue Code. Any changes to retirement savings incentives must focus on policy that will result in better long-term retirement outcomes for Americans, rather than on raising federal revenue.

We look forward to working together to enhance employer-provided retirement savings and to ensure that tax reform is enacted in a way that does not jeopardize the retirement readiness of American workers.

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[3] 26 U.S.C. 415(b) (1974). *See* EMP. BENEFIT RESEARCH INST., *EBRI's Fundamentals* of Employee Benefit Programs 50 (2009), *available at* https://www.ebri.org/pdf/publications/books/fundamentals/2009/05_Ret-Plans_RETIREMENT_Funds_2009_EBRI.pdf.

[4] *Inflation Calculator with U.S. CPI Data*, http://www.calculator.net/inflation-calculator.html?cstartingamount1=25000&cinyear1=1974&coutyear1=2016&calctype=1&x=57&y=8 (last visited Feb. 2, 2016).

[5] Jack VanDerhei, *Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances*, 33 EMP. BENEFIT RESEARCH INST. NOTES (Mar. 2012), *available at* https://www.ebri.org/pdf/notespdf/EBRI_Notes_03_Mar-12.Ktaxes-PThlthCvg1.pdf

[6] Sarah Holden, et al., Investment Company Institute, *The Individual Retirement Account at Age 30: A Retrospective*, 11 RESEARCH PERSPECTIVE (Feb. 2005), *available at* https://www.ici.org/pdf/per11-01.pdf.

NATIONAL CONFERENCE of STATE LEGISLATURES

The Forum for America's Ideas

April 14, 2016

The Honorable Charles Boustany
Chairman
Tax Policy Subcommittee
Ways and Means Committee
United States House of Representatives
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
Tax Policy Subcommittee
Ways and Means Committee
United States House of Representatives
Washington, DC 20515

RE: Hearing on Fundamental Tax Reform Proposals

Dear Chairman Boustany, Ranking Member Neal and Members of the Tax Policy Subcommittee:

The National Conference of State Legislatures (NCSL) urges the House Subcommittee on Tax Policy to support provisions in the federal tax code that preserve the fiscal viability and sovereignty of state governments. Federal and state tax systems are inextricably linked, and any federal reform will likely have serious fiscal and administrative ramifications on states. NCSL believes that federal tax reform should preserve the ability of state and local governments to adopt fair and effective tax systems, and the framework should encourage work, savings, equity and simplicity.

As the subcommittee considers tax reform proposals, NCSL urges the subcommittee to adhere to the following principles:

- **NCSL asks that any reform provides state legislatures adequate transition time.** State legislatures must have sufficient time (no less than three years) to make an assessment of and any necessary changes to state law. It is critical that state legislative calendars be taken into consideration as this process moves forward.

- **Ensure that all federal tax law changes be prospective:** This is important so that states do not suffer unexpected revenue losses that would emanate from a retroactive application.

- **Protect the state and local income tax, sales tax and property tax deductions for federal income tax purposes:** The need to protect and preserve state and local tax deductibility is even more imperative when considering the adverse impact its elimination would have on state and local government fiscal conditions. Eliminating state and local income and sales tax deductibility could cause states harm by limiting abilities to fund vital programs to educate our children, maintain state infrastructure and ensure the health and safety of our citizens.

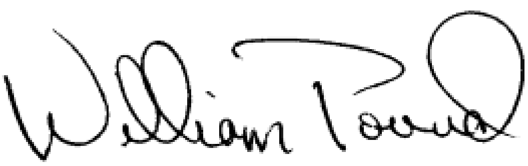
- **Maintain the tax-exempt status of state and local government bonds for infrastructure and capital projects:** State and local bonds are the most beneficial and productive instrument for governmental infrastructure and capital needs purposes. If the current status of municipal bonds is either modified or eliminated, economic development would be suppressed through increased costs and less investment activity.

- **Maintain and improve the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit:** NCSL strongly supports the Earned Income Tax Credit (EITC), which provides needed financial support to low-income families while encouraging and rewarding work.

- **Preserve unique designs and protections inherent in state pension plans and avoid increased federal regulation:** NCSL believes the exemption of state pension and benefits plans from federal taxation is a sound component of federal policy that should continue. Congress should not enact any legislation that imposes annual federal reporting and funding requirements on state governments regarding aspects of their public employee pension plans.

NCSL welcomes the opportunity to work collaboratively with you to ensure that tax reform benefits not only the national economy but our states' economies as well.

Respectfully,



William T. Pound
Executive Director
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