

## Tax Reform Proposals National Association of Enrolled Agents

### Individual Tax Simplification

#### Alternative Minimum Tax

Internal Revenue Code: Sections 55, 56, 57, 58, 59

The Problem: Congress created the Alternative Minimum Tax (AMT) to ensure that wealthy individuals taking advantage of tax shelters pay a minimum amount of taxes. In reality, due to tax law changes over the years, the AMT often affects taxpayers who were not the target of the original proposal: middle-class taxpayers making as little as \$75,000.<sup>1</sup> Additionally, taxpayers from high tax states and with large families are most vulnerable to the AMT. While not common, it is even possible to find examples of taxpayers in the \$50,000 - \$60,000 income range affected by AMT.

Recommendation: The AMT should be repealed or substantially modified to apply only to high income taxpayers paying little or no taxes.

Analysis: The AMT is a parallel tax system, requiring taxpayers to, in effect, do their taxes twice. In conjunction with the elimination of many tax avoidance provisions of the Internal Revenue Code, the AMT can be eliminated or substantially modified to target only high income taxpayers.

#### Personal Exemption Phase-out (PEP) and Limitation of Itemized Deductions (Pease)

Internal Revenue Code: Sections 151 and 68

The Problem: While the Personal Exemption Phase-out (PEP) and Pease are presented as phase-outs for exemptions and itemized deductions, in reality they are hidden additional tax rates. Additionally, these phaseouts unfairly tax large families and people from high tax states.

Recommendation: Congress should repeal PEP and Pease and replace with an applicable tax rate on high income taxpayers.

Analysis: Removing phaseouts that act as hidden marginal rates will bring better transparency and efficiency to the Internal Revenue Code. Additionally, repealing PEP and Pease will remove the large family penalty and will provide tax relief to people living in high tax states.

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<sup>1</sup> Characteristics of Alternative Minimum Tax (AMT) Payers, 2016 - 2018 and 2027 - Tax Policy Center  
<http://www.taxpolicycenter.org/model-estimates/baseline-alternative-minimum-tax-amt-tables-april-2017/t17-0149-characteristics>

## **Child Tax Credit**

Internal Revenue Code: Section 24

The Problem: A taxpayer may claim a tax credit for each qualifying child under the age of 17. In most families, teenagers do not graduate from high school until age 18 or even 19. These years can be expensive as the child prepares to enter college or the workforce.

Recommendation: The age limit for each child should be increased from under the age of 17 to under the age of 19.

Analysis: Increasing the child age limit will help families transition children from high school to work or college.

## **Unearned Income of a Child, “Kiddie Tax”**

Internal Revenue Code: Section 1(g)

The Problem: The additional tax revenue to the Treasury does not outweigh the extreme complexity added to a family’s tax compliance.

Recommendation: Congress should substantially increase the current threshold for unearned income subject to the Kiddie Tax from \$2,100 to \$6,000 (subject to annual indexing) while lowering the maximum age subject to the tax to 14.

Analysis: The intent of current law is to discourage transfers of wealth, purely for tax avoidance purposes. Changing the current threshold to \$6,000 would better reflect the original threshold adjusted for inflation.

## **Mileage Rates**

Internal Revenue Code: Sections 162, 213, 217, and 170(i)

The Problem: The IRS determines annually the allowable mileage rate as an ordinary and necessary business expense, which is currently 53.5 cents per mile. The IRS also sets a standard rate for the medical and moving deduction, which is currently 17 cents. Since 1984, the mileage rate for the charitable deduction is set by statute at 14 cents per mile.

Recommendation: The standard mileage rate deduction should be consistent for all uses.

Analysis: The proposal would treat similarly situated taxpayers equally. When charitable or medical transportation is necessary, reasonable rates should be allowed and adjusted annually.

## Education

Internal Revenue Code: Sections 25A, 221, 222, 529, and 530

The Problem: The Internal Revenue code includes such a myriad of complex tax incentives for education that it is often too expensive and time consuming for many taxpayers to simply sort them all out. As a result, many families without sophisticated advice and tax preparation from competent and highly-trained practitioners simply forego using these incentives.

Recommendation: Congress should consider consolidating the various education benefits into three provisions:

1. An enhanced super 529 savings vehicle (including tuition prepayment plans), with elective payroll deductions;
2. A college tax credit with a single earnings phase out that would consolidate American Opportunity Credit/Hope Credit, Lifetime Learning Credit, and tuition and fees expenses; and
3. An expanded deduction for student loan interest.

Any savings from this consolidation of tax expenditures should be dedicated to making all three of these provisions available to as wide of an income group as possible.

Analysis: The proposal would simplify the tax code, reduce taxpayer burden and would more fairly treat taxpayers of similar economic situations.

## Earned Income Tax Credit (EITC)

Internal Revenue Code: Section 32

The Problem: The EITC has increased work, reduced poverty, and lowered welfare receipts.<sup>2</sup> At the same time, it is one of the most complex parts of the Internal Revenue Code. Overpayments often result from the complexities of families' lives. The Department of Treasury estimates that 70 percent of improper EITC payments stem from issues related to the EITC's residency and relationship requirements; filing status issues; and issues relating to who can claim a child in non-traditional family arrangements.

Recommendation: Congress should simplify the EITC by making the definition of "qualifying child" for EITC consistent with current law governing a dependent child under Internal Revenue Code Section 152(c). The minimum age should be reduced to 18 for non-dependent taxpayers and the maximum age (currently under age 65) for EITC eligibility should be eliminated. Additionally, Congress should create a commission made up of Circular 230 practitioners and low-income advocacy groups to make recommendations on simplifying the residency rules to decrease the incidences of mispayments and to better reflect complex family arrangements.

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<sup>2</sup> Council of Economic Advisers, "The War on Poverty 50 Years Later: A Progress Report," January 2014. Table 2 on page 27 highlights that the EITC and its sibling, the Child Tax Credit, lift more Americans out of poverty than any other program except Social Security.

Analysis: The proposal would simplify an extremely complicated section of the Internal Revenue Code, which should lessen the need for practitioners and the IRS to be involved in sorting out complex family relationships and thus lowering the incident of mispayments due to unintentional noncompliance. Expanding the eligible age range would create parity for similarly situated taxpayers.

## **International**

Internal Revenue Code and U.S. Code: 31 U.S.C. § 5321(a)(5), sections 6038, 6038B 6038D, 6039F, 6046, 6046A, 6048(b)

The Problem: The reporting rules for American citizens living abroad are extremely complex and the penalties for noncompliance far outweigh the offense in most instances. Congress needs to reform these rules to make both the reporting and the inadvertent noncompliance less draconian.

Recommendation: The Internal Revenue Code should provide relief from the penalties in the following situations:

- The taxpayer has not filed a FinCEN 114 or IRS forms 926, 5472, 8938, 8865, 8858, 5471, 3520, or 3520A, but has reported all income from all sources.
- The taxpayer has not filed a FinCEN 114 or IRS forms 926, 5472, 8938, 8865, 8858, 5471, 3520 or 3520A, but there is zero balance due related to the various foreign entities.
- If the taxpayer should have filed a FinCEN 114 or IRS forms 926, 5472, 8938, 8865, 8858, 5471, 3520 or 3520A and there is a de minimis balance due as a result of the missing income, the penalty should be the greater of 20 percent of the tax due or \$100.

Analysis: The proposal will mitigate the penalties associated with inadvertent noncompliance with the requirements of the Foreign Account Tax Compliance Act.

## **Self-Employed Health Insurance**

Internal Revenue Code: Section 162

The Problem: Self-Employed Health Insurance premiums are deductible as an adjustment to income in determining AGI, and not a business expense, absent a complex (and often expensive) employer-provided medical expense reimbursement plan.

Recommendation: Self-employed individuals should be able to deduct health insurance costs in determining net earnings subject to self-employment tax (Old-Age, Survivors, and Disability Insurance tax (OASDI) and Hospital Insurance (HI) tax).

Analysis: Self-employed individuals (who file Schedule C or F) cannot deduct their own health insurance premiums as an ordinary and necessary business expense even though premiums paid for employees' health coverage are deductible.

# **Pension Simplification**

## **Retirement and Deferred Compensation Plans**

Internal Revenue Code: Sections 401(k), 403(b), 408(p), and 457

The Problem: The proliferation of retirement plans that provide for taxpayer elective deferrals contain different rules and requirements. This has become a barrier for small businesses to provide retirement benefits to their employees as the small businesses compete with larger companies for the best employees of small businesses.

Recommendation: The Internal Revenue Code sections governing employee contribution plans elective deferrals should be simplified into a uniform simplified employee contributory deferral plan.

Analysis: The proposal would simplify the tax code and would more fairly treat taxpayers of similar economic situations.

## **Determination of Basis**

Internal Revenue Code: Sections 401, 403(b), 408, 408A, 457

The Problem: Depending on the type of retirement plan, there are separate rules for determining the basis of pension distributions.

Recommendation: Tax reform should include a uniform rule regarding the determination of basis in distributions from retirement plans.

Analysis: The proposal would simplify the tax code and would more fairly treat taxpayers of similar economic situations.

## **Early Withdrawal Penalties**

Internal Revenue Code: Section 72(t)

The Problem: The rules governing the 10 percent penalty for early withdrawals, such as for college costs and first-time homebuyers, from qualified retirement plans are applied differently for IRAs and pension plans. Additionally, some plan types have larger penalties for early withdrawals. These rule differences can lead to confusion and penalties could be avoided if the exceptions to the 10 percent penalty are consistent for all qualified plans covered under §72(t).

Recommendation: The penalty rules for early withdrawals should be standardized for distributions from all types of deferred accounts-qualified retirement plans.

Analysis: The proposal would simplify the tax code and will fairly treat taxpayers of similar economic situations.

## **1099/ K-1 Reform**

### **Brokerage Firm Filing Deadline**

Internal Revenue Code: Section 6045

The Problem: Even with the date change made by section 403 of the Energy Improvement and Extension Act of 2008, brokerage firms are resending updated forms 1099 throughout the tax filing season and occasionally, even later. These actions often necessitate changes and amendments or result in taxpayer requests for extensions of time to file, based on uncertainty of forms they have received.

Recommendation: The February 15th deadline for filing all forms 1099 from investment brokerages should be changed back to January 31. Brokerage firms should be required to report the most accurate income and basis known as of January 31. If insignificant corrections and adjustments are reported by brokerages subsequent to the January 31 deadline, there should be a de minimis safe harbor amount, under which the taxpayer is not required to file an amended or superseding return.

Analysis: The proposal would reduce burden and costs to taxpayers and reduce the government's burden of processing amended returns with insignificant changes.

### **Uniform 1099-B**

Internal Revenue Code: Section 6045

The Problem: Lack of standardization of the 1099-B in the brokerage industry causes confusion and misapplication of the information provided.

Recommendation: The IRS should provide a required uniform 1099-B for the brokerage industry.

Analysis: The proposal would lead to more accurate and complete information on the taxpayer's return. It would reduce taxpayer burden by reducing the number of IRS CP-2000 Notices mailed to taxpayers.

### **K-1 Simplification**

Internal Revenue Code: Section 6031

The Problem: Many unsophisticated taxpayers unwittingly invest in units of partnerships in real estate, oil and gas, timber, and such commodities and futures that generate unique deductions and credits that must be reported but rarely if ever affect the tax liability. These deductions and credits also add nothing to IRS's matching abilities.

Recommendation: IRS should be directed to review and simplify K-1 reporting for partnerships in real estate, oil and gas, timber, and commodities and futures for limited partners with a capital account of less than \$50,000.

Analysis: The proposal would reduce complexity and taxpayer burden.

## **Indexing**

Internal Revenue Code: All sections of the Internal Revenue Code

The Problem: Many parts of the Internal Revenue Code are not indexed for inflation, eroding the value of numerous provisions over time.

Recommendation: The Internal Revenue Code should be amended as necessary to provide uniform indexing requirements.

Analysis: More uniform indexing of the Internal Revenue Code would ensure that taxpayers of similar economic situations would be treated fairly and provide stability.

## **Withholding**

Internal Revenue Code: Section 3402

The Problem: Employers withhold a percentage of employees' income from their paychecks, simplifying the remittance of taxes to the Treasury. Self-employed taxpayers must submit payment through estimated taxes.

Recommendation: The Internal Revenue Code should provide for optional withholding and reporting for independent contractors, partners and non-employee S-corporation shareholders. This could be done through a simple check-the-box election on the W-9 Form.

Analysis: The proposal would reduce taxpayer burden, would assist taxpayers in compliance with the "pay as you go" requirement, would reduce the number of end-of-year balance due amounts, and would more fairly treat taxpayers of similar economic situations.

## **IRS Future State, Practitioner Accounts**

Internal Revenue Code: Section 6061(b)

The Problem: The IRS has developed online accounts for individuals that when fully functional, will allow taxpayers to see their transcripts, communicate through secure portals for webmail, and submit payments in full or by an installment agreement. Accounts for tax professionals are being developed at a much slower pace. Additionally, all powers of attorney and disclosure authorizations are still being submitted through the IRS Centralized Authorization File (CAF) using inked signatures while requiring manual input from IRS employees. It is NAEA's concern that the delay in modernizing online accounts for tax practitioners will discourage taxpayers from exercising all their rights for representation.

Recommendation: Congress should require the following:

1. The IRS should debit online accounts for tax practitioners at the same time as individual accounts.
2. Individual online accounts should display a Publication 1 equivalent when taxpayers utilize payment options in their accounts.
3. The IRS shall provide an electronic option for taxpayer authorizations of Circular 230 practitioners.
4. The IRS shall provide guidance on the use of electronic signatures for Forms 2848 and 8821 for Circular 230 practitioners.

Analysis: The proposal would ensure equal treatment for taxpayers being represented by tax practitioners and would ensure that taxpayers can fully exercise their rights under the Internal Revenue Code.

## **Minimum Standards for Unenrolled Tax Preparers**

U.S. Code: Title 31, section 330

The Problem: Unscrupulous unenrolled preparers are harming the integrity of the tax administration system through incompetency and fraud. The General Accountability Office, the Treasury Inspector General for Tax Administration and the Taxpayer Advocate have all commented on the need to provide minimum standards for tax preparation. Unfortunately, in *Loving v. Commissioner* and subsequent cases, the courts ruled that the Internal Revenue Service does not have authority to regulate tax return preparers under title 31. The case overturned the regulatory framework for registered tax return preparers and severely limited the agency's ability to regulate all individuals—even lawyers, certified public accountants and enrolled agents—in the preparation of tax returns.

Recommendation: Congress should override *Loving* and all subsequent cases relying on its holdings and provide specific authority for the IRS to require all non-credentialed paid tax preparers to meet minimum standards. Such standards should include passing a one-time competency exam administered under the auspices of the Department of Treasury, requiring tax compliance background checks, setting continuing education requirements, and requiring compliance with strict ethical standards.

Analysis: Requiring minimum standards for all paid tax return preparers will increase compliance and the overall professionalism of the tax preparation industry. Establishing IRS's authority will help protect taxpayers, the tax administration system and the US Treasury.