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

March 26, 2015

The Honorable Michael Crapo
Senate Committee on Finance
Tax Reform Working Group on
Savings and Investment
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Senate Committee on Finance
Tax Reform Working Group on
Savings and Investment
219 Dirksen Senate Office Building
Washington, DC 20510

RE: AICPA Suggestions to Tax Reform Working Group on Savings and Investments

Dear Senator Crapo and Senator Brown:

The American Institute of Certified Public Accountants (AICPA) applauds the leadership taken by the Senate Committee on Finance to spur comprehensive tax reform efforts through policy-focused working groups. We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options. We also appreciate the opportunity to provide input as you begin shaping tax reform policy in the savings and investment area.

The AICPA is 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 following 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

In the interest of good tax policy and effective tax administration, we respectfully submit comments on the following key issues with respect to the simplification of employer-sponsored retirement plans and individual retirement accounts (IRAs):

1. Create a Uniform Employee Contributory Deferral Plan;
2. Eliminate Certain Nondiscrimination Tests on Employee Pre-tax and Roth Deferrals for 401(k) Plans, Matching Contributions;
3. Eliminate the Top-Heavy Rules;

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

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4. Create a Uniform Rule Regarding the Determination of Basis in Distributions;
5. Create a Uniform Attribution Rule;
6. Create a Uniform Definition of Owners;
7. Change the Required Minimum Distribution Rules During Life and Remove Half-Year Age References; and
8. Create Uniform Rules for Early Withdrawal Penalties

Importance of Employer-Sponsored Retirement Plans

Taxpayers appreciate the opportunity to fund retirement plan accounts and save current tax dollars, the benefits of which are used as a main source of income for many individuals during their retirement years. Employer-sponsored qualified retirement plans are important vehicles used by employers to assist their employees in achieving their retirement goals. Taxpayers are able to make larger contributions to employer-sponsored plans than to IRAs or Roth IRAs. While it is not mandatory for employers to offer retirement benefits to their employees, there are incentives such as current tax deductions that are available to employers who contribute to qualified retirement plans on behalf of their employees. Because qualified retirement plans are such a large source of retirement savings for many Americans, it is important that the tax rules governing the plans are as simple as possible.

Different Types of Retirement Plans

The AICPA urges Congress to consider simplification of the confusing array of employer-sponsored retirement savings options. The Internal Revenue Code (IRC) provides for more than a dozen tax-favored employer-sponsored retirement planning vehicles, each subject to different rules pertaining to plan documents, eligibility, contribution limits, tax treatment of contributions and distributions, availability of loans, portability, nondiscrimination, reporting and disclosure.

The following plans are currently representative of the variety of employer-sponsored plans: simplified employee pension (SEP), salary reduction SEP, savings incentive match plan for employees of small employers (SIMPLE), SIMPLE-401(k), profit sharing, money purchase pension, 401(k), 403(b), 457, target benefit, defined benefit, cash balance and the defined benefit/401(k) combination created in the Pension Protection Act of 2006 (Pub. L. 109-280).

Recommendations

We encourage Congress to consider the following measures for simplifying the operation of retirement plans:

1. 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.

2. Eliminate Certain Nondiscrimination Tests on Employee Pre-tax and Roth Deferrals for 401(k) Plans, Matching Contributions – We propose eliminating the 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:

   a) 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.

   b) 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.

3. 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 percent 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.

4. Create a Uniform Rule Regarding the Determination of Basis in Distributions – The AICPA recommends that Congress create a uniform rule for determining the basis of retirement plan distributions to allow for the distribution of basis first. Currently, depending on the plan type, there are different methodologies used to determine basis in a distribution. For example, in a Roth IRA or 401(k), basis is distributed first while in a traditional IRA or 401(k), basis is distributed pro-rata. The creation of a uniform rule would simplify the determination of tax basis in distributions. Many employees have very little basis in employer provided retirement plans and a rule allowing the immediate recovery of that amount would simplify income taxes for years after this basis has been recovered.

5. Create a Uniform Attribution Rule – We encourage Congress to use IRC section 267(c) as the rule of attribution for qualified retirement plans. Currently, the rules of attribution are

governed by different sections of the IRC and each have slight subtleties that are used for different purposes; for example:

a) The attribution rules in section 267(c) are used in determining a disqualified person under prohibited transaction rules.

b) The attribution rules in section 318 are used for the determination of highly compensated and key employee status.

We recommend the IRC section 267(c) rule be used since it is easier to apply and in many cases broader than the more complicated IRC section 318 rules.

6. Create a Uniform Definition of Owners – We urge Congress to use a consistent definition to define owners. Currently, there are different definitions for the terms "highly compensated employee" and "key employee." A defining factor in determining if someone is a "highly compensated employee" is if they are a 5 percent owner, which is further defined as an individual with a direct or indirect ownership interest of more than 5 percent. The ownership rules governing who is considered a "key employee" also use the 5 percent ownership rule but only consider persons owning directly or indirectly more than 1 percent with compensation of $150,000.

7. Change the Required Minimum Distribution Rules During Life and Remove Half-Year Age References – We recommend that Congress increase the age at which plan participants and IRA account holders must begin taking distributions from their retirement plan accounts in order to avoid penalties. Currently, account holders must begin taking withdrawals by April 1st following the attainment of age 70 ½.

   a) We suggest changing the age at which participants are required to begin taking distributions from 70 ½ to 80 since life expectancy has increased over the years. An increase in the age requirement will provide incentive for retirement plan account holders to save longer and better enable retirement savings to last for our longer life expectancies, or

   b) We suggest changing the age at which participants are required to begin taking distributions from 70 ½ to 80 and only if the account balance exceeds $500,000.

   At a minimum, we recommend that Congress modify the rules to tie initial distributions to a specific birthday as opposed to the current regulations which utilize a "half-year birthday" convention.

   There are no minimum distribution rules governing the timing of distributions related to a Roth IRA. In the case of qualified plans, a less than 5 percent owner who continues employment may defer taking distributions until his or her subsequent separation from service. The death distribution rules should continue to apply.

8. Create Uniform Rules for Early Withdrawal Penalties – The AICPA urges Congress to standardize the rules for the early distribution of retirement funds. There are currently different rules governing penalties depending on whether an account is an IRA or a qualified plan. For example, there is no 10 percent excise tax on the distribution of funds used for higher education expenses, first-time homebuyer distributions, or for distributions for medical insurance for unemployed persons with respect to an individual retirement plan. However, these exceptions do not apply to qualified plan distributions. Thus, while a participant in a qualified plan can roll over an amount received to an IRA and take advantage of the exceptions, there is no exception for amounts distributed from a qualified plan.

Complex Rules and Need for Simplification

Federal tax laws and regulations governing retirement plans are overly complex, compounding the difficulty for employers who wish to offer retirement plan options to their employees and employees who receive distributions. In order to increase the incentive for employers to set up and maintain retirement plans for their employees, it is imperative that the laws and rules governing retirement plans are as simple and straightforward as possible.

Small businesses are especially burdened by the overwhelming number of rules inherent in adopting and operating a qualified retirement plan. While most small businesses use advisors to determine the best plan for their needs and the needs of their employees, participants receiving distributions are often ill-equipped to deal with the variety of planning opportunities available to them. Our suggestions are designed to encourage the operation of qualified retirement plans by small business, expanding retirement savings for all employees.

* * * * *

We understand 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. While retirement plan complexity has long been a topic of discussion, not nearly enough has been done to address the issue. The rules governing the plans should be simplified, with appropriate transition rules as needed.

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 businesses, as well as America's largest businesses.

We welcome the opportunity to discuss these comments or to answer any questions that you may have. I can be reached at [redacted]; or you may contact Jeffrey Porter, Chair of the Tax Reform Task Force, at [redacted]; or Kristin Esposito, AICPA Senior Technical Manager, at [redacted]

Sincerely,



Troy K. Lewis, CPA
Chair, Tax Executive Committee
cc: The Honorable Orrin G. Hatch, Chairman of the Senate Committee on Finance
The Honorable Ronald L. Wyden, Ranking Member of the Senate Committee on Finance
Senate Committee on Finance Members

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Addendum

AICPA is a Resource on Tax Reform

The American Institute of Certified Public Accountants (AICPA) looks forward to working with the 114th Congress and the tax-writing committees as you address tax reform. 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 Internal Revenue Service. We encourage you to examine all aspects of the tax code to improve the current rules. We stand for a code that is simple, practical, and administrable. 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 are available to Members of Congress and staff as a resource. For example, we are available to:

- Offer suggestions from an administrative standpoint;
- Identify potential pitfalls of a particular provision;
- Discuss the "small business" perspective;
- Provide informal feedback on legislative language; and
- Support legislative provisions which are officially approved by our Tax Executive Committee.

AICPA Positions on Tax Reform Issues

The AICPA actively is pursuing or has published positions on a number of tax reform issues, has developed a 10-principle framework for analyzing proposals, and is available as a resource to assist you as you consider various proposals and options.

Specifically, we would like to highlight some of our tax reform proposals and resources for your consideration:

A. AICPA Compendium of Legislative Proposals ("Compendium") [1] – These recommendations promote simplification, efficient and effective administration, and fairness; are technical in nature; and are generally noncontroversial.

[1] AICPA's Compendium of Legislative Proposals is available at: http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA_Compendium_of_Legislative_Proposals-2015.pdf.

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B. The AICPA has developed 10 guiding principles of good tax policy[2] – Congress should consider these principles to analyze and compare proposals to change a tax rule. Proposals for changes to the tax law should strive to incorporate all 10 principles to yield a simpler, more equitable, and transparent tax system. The AICPA guiding principles for good tax policy are:

1. *Equity and Fairness*. Similarly situated taxpayers should be taxed similarly.
2. *Certainty*. The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. *Convenience of Payment*. A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. *Economy in Collection*. The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. *Simplicity*. The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. *Neutrality*. The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. *Economic Growth and Efficiency*. The tax system should not impede or reduce the productive capacity of the economy.
8. *Transparency and Visibility*. Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. *Minimum Tax Gap*. A tax should be structured to minimize noncompliance.
10. *Appropriate Government Revenues*. The tax system should enable the government to determine how much tax revenue will likely be collected and when.

C. The AICPA has developed a number of proposals that we have shared with the tax-writing committees regarding such important matters as:

- Due dates of tax returns;
- 9100 relief for missed elections;
- Simplification of the *Kiddie Tax*;
- Disaster relief legislation;
- Consolidation and simplification of retirement plans; and
- Harmonization of education incentives.

[2] AICPA's Tax Policy Concept Statement No. 1: Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, issued March 2001, is available at: http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Tax_Policy_Concept_Statement_No.1.doc. Note that the AICPA principles of good tax policy are equal in importance; the numbered order of the principles is for reference only and should not be taken as an indication of the order of importance of these principles. A more detailed explanation of each of the 10 principles is provided in the AICPA's Tax Policy Concept Statement No. 1. The statement also notes some of the challenges that exist in achieving each of the 10 principles.

The AICPA also has testified and commented on legislative proposals concerning:

- The 113th Congress House Ways and Means Chairman Camp's February 2014 discussion draft tax reform proposals;
- The continued availability of the cash method of accounting;
- Tax return identity theft;
- Repeal of the alternative minimum tax (AMT);
- Penalty reform;
- Small business tax reform; and
- Retirement savings for small employers.

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If you would like to discuss any of our legislative proposals or principles of good tax policy in more depth or have any questions or would like more information, please contact Troy Lewis, Chair, AICPA Tax Executive Committee, at [redacted] you may contact Jeffrey Porter, Chair of the Tax Reform Task Force, at [redacted]; or Melissa Labant, AICPA Director of Tax Advocacy, at [redacted]