



Internal Revenue Service TA:TAP
1111 Constitution Avenue NW, Room 1314
Washington, DC 20224

Citizen volunteers valued for improving IRS services

October 15, 2009

Michelle Greene, Designated Federal Officer
President's Economic Recovery Advisory Board
Office of the Under Secretary for Domestic Finance, Room 2326
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Request for Public Comment on Tax Reform

Dear Ms. Greene;

The Taxpayer Advocacy Panel wishes to respond to the President's Economic Recovery Advisory Board's **Request for Public Comment on Tax Reform**. The Taxpayer Advocacy Panel is a Federal Advisory Committee with approximately 100 volunteer members representing the interests of taxpayers throughout the country.

Attached, please find our public response. In submitting this recommendation, I would like to thank TAP members Justin Axelrod, Kay Bell, Dean Condor, Laura Criel, Sandy Finestone, Linda Gambardella, Sabby Jonathan, John Kim, Howard Levine, Robert Mull, Donald Thomas, Chuck Tice, Thomas Walker, Stanley Wernz, Kelly Wingard, and Ken Wright for their work in compiling the opinions and concerns of our entire membership.

We would like to thank you for the opportunity to present our opinion on this important matter. Please feel free to contact me should you have any further questions. Our membership is happy to help in any way possible.

Sincerely,

A handwritten signature in black ink that reads "Charles A. Davidson". The signature is written in a cursive, flowing style.

Charles Davidson, Chair
Taxpayer Advocacy Panel

cc: Nina Olson, National Taxpayer Advocate
Shawn Collins, Acting Director, Taxpayer Advocacy Panel

Attachment: TAP Response to Request for Public Comment



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RE: Request for Public Comment on Tax Reform

Thank you for the opportunity to provide input on the subject of **Tax Reform**. This response is from the Taxpayer Advocacy Panel (TAP), a federal advisory committee comprised of approximately 100 volunteer members located throughout the country. TAP represents the interests of taxpayers to the Internal Revenue Service. While many of our members are tax practitioners, many come from a variety of professions and industries. Our members are as varied as the taxpayers we represent. Our response to your request for comment is based on the top six priorities in tax administration identified by our members: Alternative Minimum Tax, Retirement Plans, Education Credits, the Earned Income Tax Credit, and Tax Code Simplification through Plain Language.

Alternative Minimum Tax

The alternative minimum tax (AMT) no longer serves the function for which it was designed: insuring that high income taxpayers who use certain tax benefits to reduce their income tax liabilities will pay a certain minimum amount of tax. Instead, the AMT has become an additional tax on middle income taxpayers and a device through which Congress manipulates revenue forecasts for purposes of justifying tax cuts. Yet, despite universal recommendations that the AMT be repealed, it remains.

TAP believes that the present AMT contributes significantly to the complexity of the Internal Revenue Code, is viewed as unfair by middle income taxpayers who are subject to it, and has an adverse effect on voluntary compliance.

The Taxpayer Advocacy Panel (TAP) agrees, therefore, that the AMT should be permanently repealed. If it cannot be repealed, it must be reformed and returned to serving its original purpose.

Any reform should be structured in such a manner that taxpayers with regular taxable income below a threshold amount, such as \$250,000 for married filing joint returns, will not under any circumstance be subject to AMT. This would include such things as the following:

- Increase the exemption amount to \$250,000 for married taxpayers filing joint returns, \$125,000 for single taxpayers and married filing separately, and \$200,000 for head of household (or whatever threshold amounts are determined to be appropriate);
- Index the exemption amount for inflation;
- Key the AMT rates to the regular tax rates in such a manner that a change in regular tax rates will cause an automatic corresponding adjustment to AMT rates;
- Eliminate as AMT tax preferences or adjustments anything not related to business or investment activities, such as personal exemptions, the standard deduction, state and local income and property taxes normally deducted on schedule A as itemized deductions, and incentive stock options;
- Make permanent the use of nonrefundable personal credits to offset AMT liability;
- Eliminate private activity bond interest as an AMT preference; and
- Either eliminate phase-out of the exemption amount (such as by increasing the AMT rate) or develop a way to prevent taxpayers who have a significant one-time long-term capital gain from paying excessive AMT.

Retirement Plans

The Taxpayer Advocacy Panel (TAP) recommends simplification of the tax code as it relates to the numerous provisions related to retirement and saving for retirement. With over five different “types” of saving plans and three types of IRAs (Individual Retirement Accounts)¹, each with its own set of rules, restrictions, eligibility requirements and distribution rules, American taxpayers are often confused and make mistakes that can have significant financial ramifications.

Standardization (or possibly consolidation) would improve this area of finance and taxation by improving taxpayer satisfaction, creating greater compliance, and providing for greater retirement security. A number of taxpayers avoid participation in the various saving plans due to the unnecessary

¹ For example: 401(a), 401(k), 403(b), 457(b), 457(f), SEP IRA, Roth IRA, Simple IRA and defined benefit plans.

complexity, but by simplifying the tax code in this area, taxpayers will be encouraged to save for retirement and feel less frustrated by multitude of various rules.

Past experience has shown that when provisions are simple and direct, the Internal Revenue Service experience greater tax compliance - with this greater compliance comes increased revenue and less cost.

Phase-Out Provisions

Most people would agree that the Tax Code is voluminous and complicated. What makes it even more challenging for well-meaning taxpayers to properly compute their taxes are the numerous and complicated phase-out provisions.

Nearly every deduction and credit now has a phase-out provision. Many of these require complicated calculations to determine the correct amount of the deduction or credit. Here are a few examples:

IRA Deduction: The calculation of the IRA deduction is so complicated, the instructions to Form 1040 actually provide a two page worksheet. Even understanding when the phase-out of the deduction applies is complicated. It is different if a spouse is covered by a retirement plan, and it starts at different levels depending on filing status. Additionally, the allowable deduction differs based on age.

Exemptions. Calculating the deduction for exemptions is also so complicated that again, a worksheet is provided in the instructions to Form 1040. While the basic deduction for tax year 2008 was \$3,500 per exemption, the allowable deduction is phased out at different income levels, depending on filing status.

Education Credits. The Hope and the Lifetime Learning Credits are popular and widely claimed. They are complicated to compute, however. And to make matters worse, again, they are phased out at different income levels, depending on filing status.

These are but a few examples. The majority of deductions and credits contain phase-out provisions. It is a daunting task for most taxpayers to understand the various provisions of the Tax Code that may or may not apply to them. But once they have determined which deductions and/or credits

they qualify for, taxpayers have an additional level of complexity to contend with; the phase-out provisions.

The Tax Code would be greatly simplified by eliminating phase-out provisions. To the extent eliminating phase-out provisions results in reduced revenue to the government, deductions and credits could be reduced or eliminated to make up the difference.

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a tremendous benefit for low-income working families. It is, however, extremely difficult to calculate and claim EITC due to complicated definitions and requirements of the law. TAP recommends the following changes:

Defining Earned Income. Define earned income as income subject to Social Security or Medicare tax. The income must be shown on Form 1040, line 7 on Schedule SE. Disability income should not be considered earned income unless it is subject to Medicare tax. Scholarship income should not be shown on line 7 of Form 1040 because of the confusion it causes in identifying earned income since it is not earned income, but currently is co-mingled with the most common types of earned income (i.e., W-2 wages).

Qualifications and Restrictions. Define a qualifying child as a child or grandchild by birth, adoption or by legally appointed guardianship. The taxpayer and the qualifying child must have been physically members of the same household for more than half the year (except for temporary absences as defined in the dependency sections of the Code). If the child's parent was a member of that household for more than half the year, the qualifying child cannot be the qualifying child of anyone except the parent unless the parent had no filing requirement. If both parents are in the household for more than half the year and are not filing jointly, the parent with the higher earned income (prior to adjustments) is the only person eligible to claim the qualifying child for EITC.

A person who meets the tests to claim EITC cannot be the qualifying child of any other taxpayer.

The qualifying child must be under 19 years of age as of the last day of the tax year. The exceptions are for those who were full-time students during a minimum of one term as defined by the qualified institution that he or she attended. This would eliminate the confusing requirement of "some part of any 5 months" which is currently in place. If this is post-secondary, this enrollment requirement

must be indicated on the Form 1099T of the qualifying child. The other age exception is for a dependent child who is totally and permanently disabled. No age limit applies, but all other tests for EITC must be met. If this qualifying child (disabled) does not meet the tests to be a dependent, the age requirement applies as it would for any qualifying child for EITC.

Siblings and other relatives are not qualifying children for this credit unless the taxpayer is the court-appointed guardian of that person and all other tests are met. These relatives must be the dependents of the taxpayer if they are to be used as qualifying children for EITC.

If a person has a qualifying child for EITC, he or she is not eligible to take the credit for those without a qualifying child. This is true even if the taxpayer does not claim the credit for those with qualifying children. Taxpayers who claim this credit using this provision should confirm on the EITC worksheet or similar document that, in fact, they do not have a qualifying child. This would help eliminate the "marriage penalty" advantage for those who live together, but are not married. Often one parent takes the credit claiming the qualifying child and the other claims the credit for those without a qualifying child. A married couple does not have the option of splitting their income nor allocating the children to give themselves better credits.

Claiming the Credit. All taxpayers claiming EITC must file with a physical address. If a post office box is used, a physical address must be supplied. This could provide a deterrent to claiming the credit while having no connection to a United States household with a qualifying child. It would cause some taxpayers to reconsider claiming the credit if they thought they might be required to demonstrate that they and the qualifying child lived in the same residence.

The EITC worksheet should have a short version for those whose income is wages only and whose qualifying children are their own and who lived with them all year.

Other Related Suggestions. All refunds should be deposited into accounts owned only by the taxpayer(s).

The age at which a child ceases to be a qualifying child should be the same for EITC, Child Tax Credit and for Child and Dependent Care Credit and for dependency exemption.

Plain English Language and Simplification of the Tax Code

Seeking to be precise, we become redundant. Seeking to be cautious, we become verbose.² However, our sentences do not have to twist on with legalese. It is the TAP's recommendation that, at a minimum, Title 26 of the United States Code be redrafted in plain English—to promote clarity and understanding to practitioners and ordinary taxpayers.

In the National Taxpayer Advocate's 2008 Annual Report to Congress, the Office of the National Taxpayer Advocate reported that the most serious problem encountered by taxpayers is the complexity of the tax code.³ The tax code has become so complex and unclear that the Treasury Inspector General for Tax Administration (TIGTA) reported last year that 65% of the tax returns it examined that had been prepared by tax professionals contained mistakes that were made by human error and/or a misinterpretation of the tax laws.⁴

The National Taxpayer Advocate (NTA) recommended simplifying the tax code⁵, and TAP urges The President's Economic Recovery Advisory Board to help further the NTA's recommendation. It is imperative that education and retirement savings tax incentives are streamlined. It is important that we take a look at the AMT, as discussed earlier in this report. However, if these recommendations are implemented and are drafted in an ambiguous and capricious manner, then we have done nothing to alleviate the complexity that is so prevalent in the tax code.

Redrafting a statute is nothing new. In 2007, the Federal Rules of Civil Procedure underwent an overhaul.⁶ The meaning of the rules did not change, however, the style did. This created a set of rules that were more understandable to the average citizen, as well as seasoned professionals.

² WYDICK, RICHARD, *PLAIN ENGLISH FOR LAWYERS 3* (Carolina Academic Press 2005).

³ Taxpayer Advocate 2008 Annual Report to Congress, http://www.irs.gov/pub/irs-utl/08_tas_exec_summ0108v2.pdf,

⁴ Treasury Inspector General for Tax Administration, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*, 2008, <http://www.natptax.com/2008tigareport.pdf> (This study was done on a limited scale and involved unenrolled preparers)(for more information see Taxpayer Advocate 2007 Annual Report to Congress, Vol. 2, p. 44, 2008).

⁵ *Id.*

⁶ Eichhorn, Lisa, *Clarity and the Federal Rules of Civil Procedure*, 2008, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1268434 (last visited on October 14, 2009).

Another agency, the Securities and Exchange Commission, also urges its employees to draft disclosures in plain English so that the general public and professional understand the drafter's true intent⁷.

The outcome is a document that is easier to understand and lessens the guesswork in interpreting what the tax code is intending to accomplish. It is understandable that licensed tax professional might feel that redrafting the tax code impinges on their autonomy, but basic knowledge of tax principles will still be necessary to practice effectively.

⁷ SEC, *A Plain English Handbook, How to Create a Clear Disclosure Form*, <http://www.sec.gov/pdf/handbook.pdf>.