AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Tax Reform Recommendation on Inflation

Submitted to the House Committee on Ways & Means
Tax Reform Working Group on Income and Tax Distribution

April 2013

AICPA's Tax Reform Recommendation on Inflation April 2013

Proposal: Adopt a uniform approach to determine whether an annual adjustment for inflation is necessary to the various dollar amounts provided in the Internal Revenue Code (IRC or "Code")

Present Law

Over the past 30 years, the Code has called for annual inflation adjustments to the non-corporate income tax brackets. In addition, several other provisions of the tax law include adjustments for specified dollar amounts. Examples of inflation adjustments for 2013 as presented in Rev. Proc. 2012-41 include the following:

- Kiddie Tax – Kiddie Tax thresholds increased by $50 in 2013.
- Gift tax exclusions – Annual gift tax exclusion increased to $14,000 in 2013. This is the first increase since 2009.
- Expatriation – The average annual net income tax for determining whether a taxpayer is a covered expatriate in 2013 increased by $4,000 to $155,000. The amount excludable from gross income for purposes of calculating the exit tax increased by $17,000 to $668,000.
- Foreign income exclusion – The foreign earned income exclusion in 2013 increased by $2,500, to $97,600.

The major retirement plan adjustments under IR-2012-77 are as follows:

- Qualified retirement plans – 2013 contribution limits for 401(k) and 403(b) plans increased by $500, to $17,500, with the $5,500 catch-up contribution for those 50 and older unchanged.
- Traditional individual retirement account (IRA) limits – The 2013 phase-out ranges for the deductibility of IRA contributions are:
  - -Single and head of household – increased by $1,000;
  - -Joint filers where contributing spouse is covered by workplace plan – increased by $3,000; and
  - -Joint filers where contributor is not covered by a work plan but the spouse is covered – increased by $5,000.
- Roth IRA income limits – Phase-outs for contributing to a Roth IRA in 2013 were increased by $5,000 for joint filers and $2,000 for single and head-of-household filers.
- Pension plans – The annual benefit limit for defined benefit plan increased by $5,000 to $205,000. The annual contribution limit for defined contribution plans increased by $1,000 to $51,000.

Description of Proposal

Provisions denominated in dollar amounts should be reviewed periodically to determine whether adjusting them automatically for inflation would improve the fairness of the tax system and prevent the erosion of incentives and benefits. Some provisions may need a one-time adjustment before being indexed because the dollar amount has been in existence for over ten years with no adjustment. We recommend the adoption of a uniform approach to inflation-indexing among Code sections that is consistent and based on the same criteria. When new provisions denominated in dollar amounts are enacted, an analysis of whether the amount should be adjusted automatically for inflation should be considered.

Analysis

Indexing the income tax rate structure, exemptions, and other individual provisions offsets the inflation-induced increase in real tax liabilities for many taxpayers. Despite a good number of tax provisions with dollar amounts that are adjusted annually for the effects of inflation, there are several provisions for which amounts are not adjusted. Some of these provisions, such as the $1 million amount provided in section 1244, *Losses on Small Business Stock*, have never been adjusted for inflation (section 1244 was enacted in 1958).

In general, inflation adjustments are rounded to the next lower multiple of $50, so if the adjustment produces an increase of less than the $50, no increase is made. The "Kiddie Tax" threshold level only increased five times in the years 2001 through 2012. Another area for inflation adjustment is the gift tax exemption. The exemption will increase only when the inflation adjustment produces an increase of $1,000 or more. It is clear that there is inconsistent treatment across various tax provisions on when inflation based adjustments can be made and at what rate.

Conclusion/Recommendation

All dollar amounts in the Internal Revenue Code should be reviewed periodically to determine whether they should be adjusted for the effects of inflation to improve the fairness of the tax system and prevent the erosion of tax incentives and benefits. Some provisions may need a one-time adjustment before being indexed because the dollar amount has been in existence for over ten years with no adjustment.

A specific system for any recommended changes should be provided. The adoption of such a uniform approach would eliminate the inconsistencies in these areas and would create an expectation and understanding of what the changes in the law will be for inflation adjustments into the future, and the timing of those adjustments. When new provisions denominated in dollar amounts are enacted, an analysis of whether the amount should be adjusted automatically for inflation should be considered, and reasons should be provided (such as in the legislative history) for any dollar amounts that are not required to be adjusted for inflation.