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WRITTEN TESTIMONY OF JEFFREY A. PORTER

ON BEHALF OF THE

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE

THE UNITED STATES SENATE
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

HEARING ON

TARGETED TAX REFORM: SOLUTIONS TO RELIEVE THE TAX COMPLIANCE BURDEN(S) FOR AMERICA'S SMALL BUSINESSES

JULY 22, 2015

INTRODUCTION

Chairman Vitter, Ranking Member Shaheen, and Members of the Committee, my name is Jeffrey Porter. I am a tax practitioner at Porter & Associates, based in Huntington, West Virginia, Immediate Past Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA) and Chair of the AICPA Tax Reform Task Force. I provide tax planning and business advisory services for local businesses and high net worth individuals, and have clients in a wide range of industries, including contracting, wholesale and retail trade, medical, law, and the food industry. On behalf of the AICPA, I am pleased to have the opportunity to testify today at your hearing on Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America's Small Businesses.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 145 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 business, as well as America's largest businesses.

Tax compliance is particularly burdensome on small businesses. While our tax code has always had a tendency to change, in recent years the rate of change has accelerated. New regulations, revenue procedures and notices come out daily, providing guidance on enacted laws. Extender bills pass annually and then expire within a month, leaving businesses again unsure what the rules are. When a small business client asks a simple question such as "what is my tax rate," you have to explain that it really is not that simple because you have the regular rate, the alternative minimum tax (AMT), the net investment income tax and the variety of phase-ins and phase-outs of various provisions. America's small businesses need a tax code that is certain, simple and transparent. In addition, the inability to receive timely and accurate responses from the Internal Revenue Service (IRS) creates a huge burden on small businesses.

Today, I would like to discuss a number of targeted tax reform and administrative solutions, many of which are included in Chairman Vitter's bill, the Small Business Tax Compliance Act of 2015. We believe that these technical and largely systemic changes are important and will allow entrepreneurs to spend more of their time and resources focusing on operating and expanding their businesses.

We believe that many of the bill's provisions, such as the increase of the safe harbor de *minimis* threshold for the tangible property regulations, will contribute to a more equitable and fair set of rules. We also believe that proposals similar to the penalty waivers in cases

of good faith promote certainty and transparency in the tax law. Such improvements should reduce small businesses' compliance costs and encourage voluntary compliance through a simplification of the rules.

We, therefore, appreciate this opportunity to provide input on targeted tax reform solutions to help relieve tax compliance burdens for America's small businesses. In the interest of good tax policy and effective tax administration, specifically focusing on the simplification of small business income tax, we respectfully submit comments on the following issues:

1. Permanence of Tax Legislation
2. IRS Taxpayer Services
3. Mobile Workforce
4. Cash Basis Method of Accounting
5. Tangible Property Regulations
6. Tax Return Due Date Simplification
7. Civil Tax Penalties
8. Other Small Business Tax Compliance Issues
   - Removing computer equipment from the definition of "listed property";
   - Providing that the executive compensation section 409A rules apply only to public companies;
   - Eliminating the top-heavy rules (for retirement plans); and
   - Providing full deductibility of health insurance.

AICPA PROPOSALS

1. Permanence of Tax Legislation

Taxpayers and tax practitioners need certainty to perform any long-term tax, cash flow or financial planning and reporting.[1] As a practitioner in West Virginia, one of the most common questions I hear from clients is "if I purchase new equipment this year, how much depreciation, will I be able to claim?" Unfortunately, in the last few years, due to the late passage of legislation, I have been unable to answer that question with any certainty until

[1] For example, see AICPA testimony before the U.S. House of Representatives Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access on the September 13, 2012, hearing on Adding To Uncertainty: Small Businesses' Perspectives on the Tax Cliff, and AICPA written statement for the hearing before the U.S. House of Representatives Committee on Ways and Means Subcommittee on Select Revenue on May 15, 2013, on the Small Business and Pass-Through Entity Tax Reform Discussion Draft.

very late in the year. For all businesses, and small businesses in particular, the uncertainty in the tax code impacts their cash flow, and, thus, their ability to hire and expand.

The permanence of tax provisions, such as the enhanced section 179 deduction, would promote the growth of small businesses. The section 179 provision allows small and mid-size business owners to immediately take a tax deduction on qualifying equipment, rather than delaying the deduction and taking it in smaller portions over an extended period of years. With the increased section 179 expense provision, business owners could deduct up to $500,000 of qualifying assets. In 2015, the section 179 expense has reverted back to $25,000. However, over the past several years, Congress has retroactively passed an increased section 179 limit during, or even after, the applicable tax year. The possibility for such a retroactive action in 2015 still exists; however, the uncertainty creates unnecessary confusion, anxiety and administrative and financial burdens.

2. IRS Taxpayer Services

It is imperative that small businesses and their tax return preparers have the ability to communicate with the IRS when preparing their taxes and addressing compliance issues. However, there has been increasingly limited access to the agency and, as reported by IRS Commissioner John Koskinen, an "abysmal" level of taxpayer service this year.[2]

Our members have expressed their deep concerns regarding their ability to effectively represent small businesses and other taxpayers in an environment where the IRS service levels are so degraded that:

- During the 2015 tax season, the IRS answered only 37% of the telephone calls received from taxpayers seeking to speak with an assistor;[3]
- The average hold time for the Practitioner Priority Service telephone line reached 47 minutes;[4] and
- According to the National Taxpayer Advocate, the IRS's ability to process taxpayer correspondence in a timely manner declined by 16% since 2014, leaving a backlog of almost 79,000 cases.[5]

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[2] Commissioner Koskinen, Prepared Remarks of John A. Koskinen Commissioner, Internal Revenue Service, Before the National Press Club, dated March 31, 2015.

[3] National Taxpayer Advocate Report, Volume I: FY 2016 Objectives Report to Congress; Part II: Review of the 2015 Filing Season, dated July 14, 2015.

[4] Joint Operations Center, Customer Account Services, Account Management Paper Inventory Reports, Inventory Age Report, (Jan 1 – Apr 6 statistics).

[5] *Id.*

Through an informal membership survey conducted earlier this year, we learned that over half of our members were either somewhat dissatisfied or very dissatisfied with the services they received from the IRS this filing season. This is no surprise considering that only 17% of our members responded that the IRS generally answered their telephone calls within 30 minutes. Most of our members were on hold for extended periods of time and other members noted that they generally had to end their own calls because they did not have the time to wait on hold for an IRS agent to answer.

Many of our members also experienced what the IRS refers to as "courtesy disconnects." According to the IRS, they terminate telephone calls from small businesses and other callers, without taking a message or getting contact information, if the caller has been on hold for two hours. As of April 18th this year, approximately 8.8 million calls received by the IRS were subject to their "courtesy disconnect" policy, which represents an increase from approximately 544,000 over last year.[6] Nothing is more discouraging, frustrating or inefficient to a caller (whether they are a small business or a tax preparer calling on behalf of a small business) than being disconnected by the IRS after waiting on hold for two hours.

Our survey indicated similar, unacceptable patterns with regards to delays in written correspondence. On average, over half of the correspondence sent to the IRS is not responded to within 90 days of receipt.[7] Meanwhile, the taxpayer waits for a response to their written correspondence and the IRS continues to send notices demanding payment of the tax. These delays often cause the taxpayer or their advisers to need to contact the IRS multiple times to postpone collection activities until the IRS responds to the correspondence. Furthermore, the longer the response time by the IRS, the more interest and penalties are accrued as the small business attempts to resolve their issue.

We appreciate and understand that the IRS has new initiatives and vital unmet obligations and responsibilities (such as addressing identity theft), but taxpayer service must remain a high priority in order for small businesses to receive the assistance they need on tax issues. We are pleased that the Small Business Tax Compliance Relief Act of 2015 includes a provision directing the IRS to produce a report with specific ideas on how to improve its customer service to small businesses.

3. Mobile Workforce

Another burden on small businesses that Congress should address involves the tremendous burden of tracking and complying with the different state non-resident employee tax

[6] National Taxpayer Advocate Report, Volume I: FY 2016 Objectives Report to Congress; Part II: Review of the 2015 Filing Season, dated July 14, 2015.
[7] Joint Operations Center, Customer Account Services, Account Management Paper Inventory Reports, Inventory Age Report, (Jan 1 – Apr 6 statistics).

withholding and reporting rules for just a few days of work by an employee in a non-resident state. The state personal income tax treatment of nonresidents is inconsistent and often bewildering to multistate employers and employees.

S. 386, the Mobile Workforce State Income Tax Simplification Act of 2015, introduced by Senators Thune and Brown on February 5, 2015, addresses this issue. We are pleased that Senator Peters, a member of this Committee, is a cosponsor of this bill, and hope many others of you will also be cosponsors on it. The AICPA strongly supports S. 386 and urges Congress[8] to enact this legislation to help small businesses in this country ease their non-resident state income tax withholding and compliance burdens.

Small businesses must understand each states' treatment of non-resident employee withholding and assessment of taxes and the unique de *minimis* rules and definitions. Currently, 43[9] states plus the District of Columbia impose a personal income tax on wages, and there are many different requirements for withholding income tax for non-residents among those states. There are seven states that currently do not assess a personal income tax.[10] Employees traveling into all the other states are subject to the confusing myriad of withholding and tax rules for non-resident taxpayers.

Where many businesses once tended to be local, they now have a national reach. This change has caused the operations of even small businesses to move to an interstate basis. Because of the interstate operations of these companies, many providers of services to these companies, such as certified public accountants (CPAs), find that they are also operating on an interstate basis. What once were local taxation issues have now become national in scope, and burdens must be eased in order to promote interstate commerce and ensure businesses run efficiently.

Having a uniform national standard for non-resident income taxation, withholding, and filing requirements, as S. 386 provides, will enhance compliance and significantly relieve these unnecessary administrative burdens on businesses and their employees. Additionally, S. 386 provides a needed 30-day de *minimis* exemption before an employee

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[8] AICPA written testimony before the House Committee on the Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law on Nexus Issues: Legislative Hearing on H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act of 2015," H.R. 1643, the "Digital Goods and Services Tax Fairness Act of 2015," and H.R. __ the "Business Activity Tax Simplification Act of 2015", dated June 2, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-written-statement-mobile-workforce-subcomte-judiciary-6-2-15-hearing-e-CDB.pdf.

[9] Note that New Hampshire and Tennessee, which are included in the 43 states, do not tax wages and only subject to tax interest and dividends earned by individuals.

[10] The seven states with no personal income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

is obligated to pay taxes to a state in which they do not reside. Many small businesses need Congress to enact this legislation.

4. Cash Basis Method of Accounting

Another need of businesses is the continued use of the cash basis method of accounting. We are pleased to see that the Small Business Tax Compliance Act of 2015 would increase the threshold for cash accounting to $10 million. The AICPA supports the expansion of the number of taxpayers who may use the cash method of accounting, which is simpler in application than the accrual method, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the income. For these same reasons, we are concerned with, and oppose, any new limitations on the use of the cash method for service businesses, including those businesses whose income is taxed directly on their owners' individual returns, such as S corporations and partnerships. Any legislation that would require these businesses to switch to the accrual method upon reaching a gross receipts threshold would unnecessarily discourage growth. A required switch to the accrual method would negatively affect many small businesses in certain industries, including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.

As the AICPA has previously stated,[11] we urge Congress not to further restrict the use of the long-standing cash basis method of accounting for the thousands of U.S. businesses (e.g., sole proprietors, personal service corporations, and pass-through entities) that currently utilize it. We believe that any legislation that would force more businesses to use the accrual method of accounting for tax purposes would increase their administrative burden, discourage business growth in the U.S. economy, and unnecessarily impose financial hardship on cash-strapped small businesses and entrepreneurs.

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[11] AICPA comment letter on the "Continued Availability of Cash Method of Accounting," August 15, 2013, http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.08.15_Comments_on_Continued_Availability_of_Cash_Method_of_Accounting.pdf, AICPA written statement before the House Committee on Ways And Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf, and AICPA written statement before the House Committee on Small Business, Subcommittee on Economic Growth, Tax and Capital Access, dated July 10, 2014, Hearing on "Cash Accounting: A Simpler Method for Small Firms?"; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA%20WRITTEN%20STATEMENT%20July%2010%202014%20to%20House%20Subcte%20on%20Economic%20Growth%20Tax%20and%20Capital%20Access.pdf.

5. Tangible Property Regulations

A challenging tax compliance burden that small businesses had to deal with this year was the new final tangible property regulations (TD 9636). The regulations, which became effective last year, address how businesses should report the acquisition and improvement of tangible property for tax purposes. While we appreciate that Department of the Treasury ("Treasury") clarified some rules and provided several small business favorable provisions, we are concerned that the regulations are burdensome for many small businesses.

The AICPA is pleased that the Small Business Tax Compliance Relief Act of 2015 includes a provision to address small business concerns by increasing the de *minimis* safe harbor threshold for most businesses from $500 to $2,500, and including a reviewed financial statement in the definition of an applicable financial statement (AFS). We agree with this proposal and recommend adjusting the threshold amount on an annual basis for inflation to maintain the fairness and incentive of the intended benefit.

Currently, small businesses must prove that expensing such amounts "clearly reflects income" to deduct amounts higher than the $500 threshold. The clear reflection of income test can be challenging for any taxpayer, especially for small businesses. The test is based on the taxpayer's facts, circumstances, and interpretations of those facts and circumstances by the taxpayer and IRS. Thus, it is arbitrary and often difficult to apply. Large businesses (e.g., taxpayers with an AFS), however, are allowed the higher $5,000 threshold. Subjecting small businesses to the clear reflection of income test at merely $500, adds unnecessary complexity and compliance burdens to small businesses.

6. Tax Return Due Date Simplification

Another challenging compliance issue for small businesses is the current illogical order of due dates for various types of tax returns. Taxpayers and preparers have long struggled with problems created by the inefficient timeline and flow of information. Federal Schedules K-1s are often delivered late, sometimes within days of the due date of taxpayers' personal returns and up to a month after the due date of their business returns. Late schedules make it difficult, if not impossible, to file a timely, accurate return.

We are pleased that the Small Business Tax Compliance Relief Act of 2015 and the recent Senate Finance Committee Business Tax Reform Working Group report contain a provision to address this issue. We also acknowledge one of the members of this Committee, Senator Enzi, for being a champion of this issue and introducing legislation in the prior Congresses.

The AICPA strongly supports the provision in the bill to change the due dates for tax returns of partnerships, S corporations and C corporations because it would:

- Improve the accuracy of tax and information returns by allowing corporations and individuals to file using current data from flow-through returns that have already been filed rather than relying on estimates;
- Better facilitate the flow of information between taxpayers (i.e., corporations, partnerships, and individuals);
- Reduce the need for extended and amended tax returns; and
- Simplify tax administration for the government, taxpayers, and practitioners.

7. Civil Tax Penalties

We have expressed concerns[12] about the numerous unfair or untargeted penalty provisions in the Internal Revenue Code ("Code") and are pleased that the Small Business Tax Compliance Relief Act of 2015 would address many of them.

Penalties should deter bad conduct without deterring good conduct or punishing small businesses which are acting in good faith. Targeted, proportionate penalties that clearly articulate standards of behavior and that are administered in an even-handed and reasonable manner encourage voluntary compliance with the tax laws. On the other hand, overbroad, vaguely-defined, and disproportionate penalties, particularly those administered as part of a system that automatically imposes penalties or that otherwise fail to provide basic due process safeguards, create an atmosphere of arbitrariness and unfairness that is likely to discourage voluntary compliance.

For example, penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Good tax policy would also suggest that we avoid strict liability provisions that do not grant the IRS discretion to take into consideration the facts and circumstances of a particular business' situation.

The AICPA points out the following specific penalty-related issues with the current system and are pleased that the bill would provide these improvements:

[12] See the "AICPA Tax Penalties Legislative Proposals," submitted to Congress in April 2013: http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-legislative-proposals-penalties-2013.pdf; and the "AICPA Report on Civil Tax Penalties," submitted April 2013: http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-report-civil-tax-penalty-reform-2013.pdf.

a. Trend Toward Strict Liability

We appreciate that the bill would address strict liability issues. The IRS discretion to waive and abate penalties where small businesses demonstrate reasonable cause and good faith is needed most when the tax laws are complex and the potential sanction is harsh. This reason is especially true where the taxpayer's state of mind is central to the conduct that is subject to penalty. Because it is not feasible to anticipate every possible situation to which a penalty might apply, permitting a reasonable cause defense and avoiding fixed-dollar amount penalties helps to ensure that a disproportionately large penalty is not applied to an unforeseen and/or unintended set of facts.

b. An Erosion of Basic Procedural Due Process

Penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Judicial review of an IRS decision to impose a penalty or to deny waiver is an important constitutional check on Executive authority. Statutes that prohibit judicial review of agency penalty determinations undermine voluntary compliance by undercutting taxpayers' faith in the system and eliminating an essential and expected avenue of potential redress.

c. Repeal Technical Termination Rule

We are pleased that the bill contains a provision, similar to prior AICPA recommendations,[13] to repeal section 708(b)(1)(B) regarding the technical termination of a partnership.[14] Under current law, when a partnership is technically terminated, the legal entity continues, but for tax purposes, the partnership is treated as a newly formed entity. The current law requires the partnership to select new accounting methods and periods, restart depreciation lives, and make other adjustments. Furthermore, the final tax return of the "old" partnership is due the

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[13] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[14] AICPA submitted letters and written statements on Option 1 and Option 2 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Business_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf, and Option 2 comments, dated July 30, 2013; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf.

15th day of the fourth month after the month-end in which the partnership underwent a technical termination.[15]

A technical termination most often occurs when, during a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. Because this 12-month timeframe can span a year-end, the partnership may not realize that a 30% change (a minority interest) in one year followed by a 25% change in another year, but within 12 months of the first, has caused the partnership to terminate.

In practice, this earlier required filing of the old partnership's tax return often goes unnoticed because the company is unaware of the accelerated deadline due to the equity transfer. Penalties are often assessed upon the business as a result of the missed deadline. Although ignorance is not an acceptable excuse, this technical termination area is often misunderstood and misapplied. The acceleration of the filing of the tax return, to reset depreciation lives and to select new accounting methods, serves little purpose in terms of abuse prevention and serves more as a trap for the unwary.

d. Late Filing Penalties

Sections 6698 and 6699 impose a penalty of $195 per partner related to late-filed partnership or S corporation returns. The penalty is imposed monthly not to exceed 12 months, unless it is shown that the late filing is due to reasonable cause. 2014 amendments to sections 6698 and 6699 adjust the penalty for inflation beginning after 2014.

The AICPA proposes that a partnership (or S Corporation), comprised of 50 or fewer partners/shareholders, each of whom are natural persons (who are not nonresident aliens), an estate of a deceased partner, a trust established under a will or a trust that becomes irrevocable when the grantor dies, and domestic C corporations, will be considered to have met the reasonable cause test and will not be subject to the penalty imposed by section 6698 or 6699 if:

- The delinquency is not considered willful under section 7423;
- All entity income, deductions and credits are properly allocated to each owner; and

[15] For example, a partnership that technically terminated on April 30 of the current year due to a transfer of 80% of the capital and profits interests in the partnership to be timely filed must file its tax return for that final tax year on or before August 15 of the current year.

- Each partner/shareholder fully reported its share of income, deductions and credits of the entity on its timely filed federal income tax return.

e. Failure to Disclose Reportable Transactions

Taxpayers who fail to disclose a reportable transaction are subject to a penalty under section 6707A of the Code. For penalties assessed after 2006, the amount of the penalty is 75% of the decrease in tax shown on the return as a result of the transaction (or the decrease that would have been the result if the transaction had been respected for federal tax purposes). If the transaction is a listed transaction (or substantially similar to a listed transaction), the maximum penalty is $100,000 for individuals and $200,000 for all other taxpayers. In the case of reportable transactions other than listed transactions, the maximum penalty is $10,000 for individuals and $50,000 for all other taxpayers. The minimum penalty is $5,000 for individuals and $10,000 for all other taxpayers.

The section 6707A penalty applies even if there is no tax due with respect to the reportable transaction that has not been disclosed. There is no reasonable cause exception to the penalty. The Commissioner may, however, rescind all or a portion of a penalty, but only in the case of transactions other than listed transactions, where rescinding the penalty would promote efficient tax administration and only after the taxpayer submits a lengthy and burdensome application. In the case of listed transactions, the IRS has no discretion to rescind the penalty. The statute precludes judicial review where the Commission decides not to rescind the penalty.

Under section 6662A, taxpayers who have understatements attributable to certain reportable transactions are subject to a penalty of 20% (if the transaction was disclosed) and 30% (if the transaction was not disclosed). A more stringent reasonable cause exception for a penalty under section 6662A is provided in section 6664, but only where the transaction is adequately disclosed, there is substantial authority for the treatment, and the taxpayer had a reasonable belief that the treatment was more likely than not proper. In the case of a listed transaction, reasonable cause is not available, similar to the penalty under section 6707A.

The AICPA recommends an amendment of section 6707A to allow an exception to the penalty if there was reasonable cause for the failure and the taxpayer acted in good faith for all types of reportable transactions, and to allow for judicial review in cases where reasonable cause was denied. Moreover, we propose an amendment of section 6664 to provide a general reasonable cause exception for all types of reportable transactions, irrespective of whether the transaction was adequately disclosed or the level of assurance.

f. 9100 Relief

Section 9100 relief, which is currently available with regard to some elections, is extremely valuable for taxpayers who miss the opportunity to make certain tax elections. Congress should make section 9100 relief available for all tax elections, whether prescribed by regulation or statute. The AICPA has compiled a list[16] of elections (not all-inclusive) for which section 9100 relief currently is not granted by the IRS as the deadline for claiming such elections is set by statute. Examples of these provisions include section 174(b)(2), the election to amortize certain research and experimental expenditures, and section 280C(c), the election to claim a reduced credit for research activities. We do not believe taxpayers are likely to abuse or exploit hindsight, as the IRS would continue to have discretion as to whether to grant relief for each specific request.

g. Form 5471 Penalty Relief

On January 1, 2009, the IRS began imposing an automatic penalty of $10,000 for each Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, filed with a delinquent Form 1120 series return. When imposing the penalty on corporations in particular, the IRS does not distinguish between: a) large public multinational companies, b) small companies, and c) companies that may only have insignificant overseas operations, or loss companies. This one-size-fits-all approach inadvertently places undue hardship on smaller corporations that do not have the same financial resources as larger corporations. The AICPA has submitted recommendations[17] regarding the IRS administration of the penalty provision applicable to Form 5471. Our recommendations focus on the need for relief from automatic penalties assessed upon the late filing of Form 5471 in order to promote the fair and efficient administration of the international penalty provisions of the Code.

[16] AICPA letter on "Tax Reform Administrative Relief for Various Statutory Elections," submitted January 23, 2015: http://www.aicpa.org/advocacy/tax/downloadabledocuments/aicpa-letter-to-congress-on-9100-relief-1-23-15submitted.pdf.

[17] AICPA submitted comments to the IRS, dated March 26, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-Form-5471-Penalties-3.26.13.pdf.

8. Other Small Business Tax Compliance Issues

There are several other small business tax compliance burden proposals that we support and are pleased that are addressed in the Small Business Tax Compliance Relief Act of 2015, including:

- Removing computer equipment from the definition of "listed property";
- Providing that the executive compensation section 409A rules apply only to public companies;
- Eliminating the top-heavy rules (for retirement plans); and
- Providing full deductibility of health insurance.

a. Listed Property

We are pleased that the Small Business Tax Compliance Relief Act of 2015 would remove "computer or peripheral equipment" from the definition of "listed property" in order to simplify and modernize the traditional tax treatment of computers and laptops. We agree that classifying computers and similar property as "listed property" under section 280F is clearly outdated in a business environment where employees are increasingly becoming expected to work outside of traditional business hours. Various forms of technology, including laptops, tablets and cell phones, are all converging to serve similar purposes. The costs for the internet and service plans are now frequently sold in "bundles" and shared between multiple devices and it has become arguably impossible to segregate the cost of service between a cell phone, tablet, and laptop. The AICPA believes legislative change to update the treatment of mobile devices is the needed simplification, similar to section 2043 of the Small Business Jobs Act of 2010, where cell phones were removed from the definition of listed property for taxable years beginning after December 31, 2009.

b. Executive Compensation

The AICPA supports the Small Business Tax Compliance Relief Act of 2015 provision which provides that the section 409A requirements apply only to public companies. Section 409A, which applies to compensation earned in one year but paid in a future year, was enacted to protect shareholders and other taxpayers from executives guarding their own financial interests without concern for the financial interests of the organization, its shareholders or other creditors.

The rules apply to a broad array of compensation arrangements, including many business arrangements that are not thought of as deferred compensation. Nonpublic companies often want arrangements with employees to allow for sharing equity or providing capital

accumulation for long-term employees, and the nonpublic business owner should not be constrained by rules designed to protect absentee shareholders.

Many nonpublic entities have found themselves with noncompliant plans that cannot be corrected under the existing administrative correction programs. The cost of a noncompliant 409A plan is excessive given the unintended violations. In addition to accrual base income recognition, the additional 20% penalty tax applies to the recipient, often a person unknowingly affected by the violations. Private companies should not be required to pay for the specialized tax guidance needed to ensure that a compensatory arrangement is 409A compliant. The cost of imposing 409A requirements on nonpublic companies is far in excess of any benefit derived.

c. Elimination of Top-Heavy Rules (for Retirement Plans)

Small businesses are especially burdened by the overwhelming number of rules inherent in adopting and operating a qualified retirement plan. Therefore, we are pleased that the bill repeals the top-heavy rules, which limit 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% minimum contribution is often made for safe harbor 401(k) plans. Without the top-heavy rules, more small businesses would adopt plans to benefit their employees.

d. Provide Full Deductibility of Health Insurance

We are pleased that the bill would provide full deductibility of health insurance costs for self-employed individuals. Similar to a proposal in the AICPA Tax Legislative Compendium, the bill would equalize the tax treatment with respect to the deduction for health insurance costs in determining income subject to Old Age, Survivors, and Disability Insurance (OASDI) and health insurance (HI) taxes as was allowed temporarily under the Small Business Jobs Act of 2010.

Deductions allowable in determining a particular tax should remain consistent amongst taxpayers subject to such tax. Employees subject to OASDI and HI taxes are allowed a deduction for health insurance costs in determining their net income subject to these taxes while self-employed individuals subject to these same taxes are not allowed a deduction in determining their net income subject to these taxes.

The provision in the bill would provide that deductions allowed in determining income subject to OASDI and HI taxes remain consistent amongst taxpayers regardless of whether they are employees or self-employed individuals.

CONCLUDING REMARKS

The AICPA understands the challenges that Congress faces as it tackles the complex issues inherent in drafting tax legislation, and note that both small businesses and their tax practitioners are interested in, and need, tax simplification. We have consistently supported simplification efforts because we are convinced such actions will significantly reduce small businesses' compliance costs and encourage voluntary compliance through an understanding of the rules. We look forward to working with the 114th Congress, this Committee, and the tax-writing committees as Congress continues to addresses tax reform.

Again, Mr. Chairman, thank you for the opportunity to testify. I would be happy to answer any questions.