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

April 14, 2015

The Honorable Dean Heller Senate Committee on Finance Tax Reform Working Group on Community Development and Infrastructure 219 Dirksen Senate Office Building Washington, DC 20510	The Honorable Michael Bennet Senate Committee on Finance Tax Reform Working Group on Community Development and Infrastructure 219 Dirksen Senate Office Building Washington, DC 20510

RE: AICPA Suggestions to Tax Reform Working Group on Community Development and Infrastructure

Dear Senator Heller and Senator Bennet:

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.

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 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

We, therefore, appreciate the opportunity to provide input as you begin shaping tax reform policy in the community development and infrastructure tax area.

In the interest of good tax policy and effective tax administration, specifically focusing on the simplification of community development and infrastructure taxation, we respectfully submit our recommendations for permanent tax provisions related to disaster relief.

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

T: 202.737.6600 | F: 202.638.4512 | aicpa.org

The AICPA urges Congress to consider the following ten legislative proposals as permanent tax provisions that are triggered when a taxpayer resides, or has a principal place of business located, in a Federal Emergency Management Agency's (FEMA) "Disaster Declaration"[2] area for which individual "Disaster Assistance"[3] is available:

1. Waive Individual Casualty Loss Limitations;
2. Extend Net Operating Loss Carryback to Five Years;
3. Increase Section 179 Expense Limits;
4. Increase Property Replacement Period to Five Years;
5. Waive the Penalty for Early Retirement Withdrawal;
6. Allow a Housing Exemption for Displaced Individuals;
7. Allow Discharge of Indebtedness;
8. Allow Employee Retention Credit for Affected Employers;
9. Permit the Use of Prior Year's Income to Calculate the Earned Income Tax Credit, Child Tax Credit, and Premium Tax Credit; and
10. Increase the Medical Expense Deduction.

Introduction

The AICPA applauds the Senate Committee on Finance and its Subcommittee on Taxation and Internal Revenue Service (IRS) Oversight for their continued consideration of tax relief for individuals, small businesses, and communities, after a disaster.[4] We are pleased that Congress enacted the Katrina Emergency Tax Relief Act of 2005[5] and we commend the members of Congress for their dedication and hard work, over the years, in developing tax relief bills for disaster victims.[6]

AICPA members, like you and many others in the U.S., are all too familiar with the devastating consequences of disasters, such as Hurricanes Sandy, Hurricane Isaac and the severe storms, fires, floods, landslides, and mudslides in Colorado.[7] Therefore, we continue to stress the need to include, in the Internal Revenue Code (IRC or "Code"), permanent tax provisions that will quickly aid affected taxpayers as they recover from the impacts of natural disasters. Families and communities impacted unexpectedly by disasters are often displaced from their homes, their livelihoods, and their businesses. We believe permanent relief, which is long-overdue, will provide disaster victims with certainty, fairness, and the ability to promptly receive the aid they

[2] Federal Emergency Management Agency's Disaster Declarations are available at: http://www.fema.gov/disasters.
[3] FEMA Disaster Assistance information is included in the Disaster Assistance and Emergency Relief Program for Individuals and Businesses information that is available at: http://www.disasterassistance.gov/.
[4] AICPA written testimony before the Senate Committee on Finance, Subcommittee on Taxation and IRS Oversight, dated November 18, 2014, "Hearing on Tax Relief After a Disaster: How Individuals, Small Business, and Communities Recover," http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Testimony-SFC-Hearing-on-Tax-Relief-After-a-Disaster.pdf.
[5] PL 109-73, "Katrina Emergency Tax Relief Act of 2005," September 23, 2005.
[6] *See* S. 1696, Hurricane Katrina Tax Relief Act of 2005, S. 93, Investment Savings Access After Catastrophes Act of 2013, and S. 2634, National Disaster Tax Relief Act of 2014.
[7] IR-2013-75, "IRS Provides Tax Relief to Victims of Colorado Storms," September 16, 2013.

need after a natural disaster, while reducing the administrative burdens on disaster victims and the IRS.

AICPA Proposal

The AICPA urges Congress to enact tax legislation that permanently provides meaningful and timely relief that is automatically triggered by a declaration of a federal disaster rather than providing for such relief via individual bills following a disaster.

It is important that tax relief provisions are made permanent in order to provide assurance to disaster victims. Although we cannot prevent natural disasters, predict when or where they will arise, or predict the scope of damages that will result, we know disasters occur annually on a regular basis throughout the country. Each year, we witness the far-reaching effects of these events, which frequently extend across state borders and Congressional districts, impacting hundreds of thousands of people. The implementation of permanent disaster relief provisions will afford taxpayers, across the nation, a certainty in the tax benefits they receive. Our current system provides inconsistent tax relief.[8] In the past, Congress has considered each disaster as an isolated event and restricted any special tax relief to such individual event. Unfortunately, this unsystematic process results in similarly-situated taxpayers receiving different tax benefits for comparable losses. It is important that all victims – whether they reside in Nevada, Colorado or some other state, and whether they endured a hurricane, a mudslide or other type of disaster – receive comparable relief.

Timely relief for disaster victims is also an important factor. Providing tax relief in a timely manner could relieve victims from the long periods of uncertainty and concern regarding what tax relief they will receive and when they will receive it, and allow these families and communities to more swiftly recover, rebuild, and return to their homes and businesses. The AICPA recommends Congress enact legislation that would take effect immediately when a triggering event occurs. Specifically, we propose that this trigger occurs when a taxpayer resides, or has a principal place of business located, in a FEMA "Disaster Declaration" area for which individual "Disaster Assistance" is available. In developing this recommendation, the AICPA reviewed previously enacted and proposed legislation, such as the Katrina Emergency Tax Relief Act of 2005,[9] the Hurricane Sandy Tax Relief Acts of 2012[10] and 2013,[11] and the Investment Savings Access After Catastrophes Act of 2013,[12] which was proposed in response to Hurricane Isaac.

[8] See IRS new release webpage for a list of "Tax Relief in Disaster Situations" at: http://www.irs.gov/uac/Tax-Relief-in-Disaster-Situations.

[9] H.R. 3768, "Katrina Emergency Tax Relief Act of 2005" is available at: http://thomas.loc.gov/cgi-bin/bdquery/z?d109:hr3768:.

[10] H.R. 6683, "Hurricane Sandy Tax Relief Act of 2012" is available at: http://thomas.loc.gov/cgi-bin/bdquery/z?d112:hr6683:.

[11] H.R. 2137, "Hurricane Sandy Tax Relief Act of 2013" is available at: http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.2137:.

[12] S. 93, "Investment Savings Access After Catastrophes Act of 2013" is available at: http://thomas.loc.gov/cgi-bin/query/z?c113:S.93:.

We ask Congress to consider the following ten legislative proposals as permanent tax provisions, which if enacted, would take effect upon the occurrence of the above mentioned federal disaster declaration trigger by FEMA:

1) Waive Individual Casualty Loss Limitations

   Waive the casualty loss floor of 10% of adjusted gross income (AGI) (section 165(h)(i))[13] and the $100 per loss floor (section 165(h)(2)) for losses attributable to a disaster event. The purpose of this provision is to extend adequate relief to the affected taxpayers under section 165(h)(i).

2) Extend Net Operating Loss Carryback to Five Years

   Allow a five-year carryback period for net operating losses (NOLs) attributable to a disaster event under section 172(b)(2). By allowing a five-year carryback period for NOLs attributable to a disaster event, impacted taxpayers will have the benefit of an extended carryback (increase of three years) from the normal NOL carryback period of two years.

3) Increase Section 179 Expense Limits

   Increase section 179 expensing limits under section 179(b)(1) in either the year of the disaster event or the following year by the lesser of a specified amount ($100,000) or the cost of "qualified property," as described in section 179(e)(1). "Qualified property" replaces or rehabilitates property damaged by the "disaster event." This provision is intended to provide immediate tax relief to business owners for unanticipated capital expenditures caused by the disaster event.

4) Increase Property Replacement Period to Five Years

   Allow a five-year replacement period (increased from two) under section 1033(a)(2)(B) for property damaged or destroyed by a disaster event. For certain disasters that have occurred, a five-year replacement period is already in place. This provision simply makes five years the standard replacement period. Also, allow this revision to the replacement period to cover trade/business property, real property, and/or principal residences that are involuntarily converted during a disaster event.

5) Waive the Penalty for Early Retirement Withdrawal

[13] All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated there under, unless otherwise specified.

Impose no tax on qualified disaster victims who withdraw up to a specified amount ($100,000) from a qualified plan or individual retirement account (IRA) and repay that amount within five years. Any amount not repaid within five years of the date of withdrawal is taxable income during that fifth year unless a taxpayer chooses to report the amount as income and pay the tax in any earlier year. Any income recognized under this section would not be subject to the 10% early withdrawal penalty under section 72(t) for distributions up to a specified amount ($100,000). Such favored distributions were previously allowed under section 1400Q(a) for "hurricane" disasters; however, this provision would include all federally declared "disaster events," including but not limited to hurricanes. One purpose of this provision is to allow affected taxpayers to access their own funds immediately while waiting for government assistance and insurance reimbursements that are not immediately forthcoming.

6) <u>Allow a Housing Exemption for Displaced Individuals</u>

Allow a partial or full exemption (as defined under section 151(d)) to individuals who provide at least 60 days of temporary rent-free housing to a person dislocated by a disaster event. Taxpayers may claim this exemption only once for each such persons and shall claim the exemption for the tax year which contains the latter of the 60^{th} day or the day that the temporary housing period ends. The exemption amount is calculated as the number of rent-free days (up to 365) provided divided by 365 and multiplied by the personal exemption allowed a single taxpayer during the applicable year. The maximum number of individuals for which a taxpayer may claim this exemption is four individuals per disaster event. Furthermore, no phase-out under section 151(d)(3) would apply to this exemption.

7) <u>Allow Discharge of Indebtedness</u>

Allow disaster victims to exclude from taxable income, under section 108, cancellation of debt income for non-business debts provided that the cancellation occurs within one year of the beginning date of the disaster event. The discharging entity must certify that the discharge is a direct result of loss, property damage, or other factors caused exclusively by the disaster event. Currently, the Code provides only limited exclusions for discharge of indebtedness income. This recommendation would allow for a much needed provision that recognizes that if individuals affected by a disaster are unable to repay their outstanding loans, they are also likely unable to pay tax on the phantom income.

8) <u>Allow Employee Retention Credit for Affected Employers</u>

Allow a credit under section 38 of 40% of qualified wages (up to $6,000 in qualified wages per employee) for specified disaster-damaged businesses. Qualified wages (as defined for Work Opportunity Credit purposes under section 51(a)) are wages paid to employees who are unable to work because their employer's business was rendered inoperable due to damage from the disaster event. The Code would provide that qualified wages for an employee are calculated based on their regular wages, not including overtime, for the lesser of the period the business is rendered inoperable or 16 weeks. Specified disaster-damaged businesses must have the affected place of business located within the declared disaster area, employ less than 200 full-time equivalent employees, and may only claim the credit for employees who were employed at the affected place of business for at least 30 days prior to the disaster event.

9) Permit the Use of Prior Year's Income to Calculate the Earned Income Tax Credit, Child Tax Credit, and Premium Tax Credit

   Allow affected taxpayers in the disaster area to use either their current year or previous year's income amounts for purposes of calculating the Earned Income Tax Credit (section 32), the Child Tax Credit (section 24) and the Premium Tax Credit (section 36B). With this suggested provision, the affected taxpayer would have the opportunity to use a more beneficial income year, thus allowing the affected taxpayer the opportunity to benefit from various credits that might not have been available to the taxpayer because of the fluctuation of income caused by the disaster.

10) Increase the Medical Expense Deduction

   Eliminate the medical deduction floor percentage (as defined under section 213(a), generally 10% of AGI, and 7.5% for taxpayers over 65) for an individual who incurs deductible medical expenses directly related to an injury caused by the disaster event. This reduction is available only for the directly-related expenses incurred for up to two tax years (the year of the event and the subsequent year). The purpose of this provision is to provide potential relief from the deduction limitations for taxpayers incurring unexpected disaster related medical expenses.

Conclusion

The AICPA acknowledges the prompt response and aid that Congress often provides to individual, self-employed and business taxpayers impacted by natural disasters each year. However, the implementation of timely and permanent disaster relief provisions as foundational aid will allow disaster victims to have certainty, fairness, consistency, and the ability to promptly receive the relief they need after a natural disaster. Additionally, a set of standard disaster tax relief provisions will minimize the administrative burdens on the victims as well as the IRS. Therefore, we urge Congress to enact tax legislation that is timely, permanent, and triggered by a federal disaster declaration.

* * * * *

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. Compliance burdens for individual taxpayers are too heavy, both in terms of time required and out-of-pocket cost. Likewise, complexity increases the "Tax Gap" and may impair the efficiency of tax administration.[14] While there are costs associated with simplification reforms, it is also important to recognize the elimination of significant compliance burdens by such reforms.

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 (801) 523-1051 or tlewis@sisna.com; or you may contact Amy Wang, AICPA Senior Technical Manager, at (202) 434-9264, or awang@aicpa.org.

Sincerely,

Troy K. Lewis, CPA
Chair, Tax Executive Committee

Enclosure

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
Members of the Senate Committee on Finance

[14] AICPA written testimony before the House Committee on Ways And Means, Hearing on "How the Tax Code's Burdens on Individuals and Families demonstrate the need for Comprehensive Tax Reform," dated April 13, 2011; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/FINAL_TESTIMONY_FOR_NELLEN_April_13,_2011.pdf.

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

April 14, 2015

Addendum

<u>AICPA is a Resource on Tax Reform</u>

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.

<u>AICPA Positions on Tax Reform Issues</u>

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.

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.

* * * * *

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 business, as well as America's largest businesses.

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 (801) 523-1051, or tlewis@sisna.com; you may contact Jeffrey Porter, Chair of the Tax Reform Task Force, at (304) 522-2553 or jporter@portercpa.com; or Melissa Labant, AICPA Director of Tax Advocacy, at (202) 434-9234, or mlabant@aicpa.org.