Opening Comments
Senate Finance Committee Hearing
on
"Tax Complexity, Compliance, and Administration:
The Merits of Simplification in Tax Reform"
March 10, 2015

I am Carol Markman, a CPA from Westbury, NY. I am Director of Taxation for EP Caine & Associates, CPA LLC of Bryn Mawr, PA. For over 35 years, I have worked with individuals and small businesses specializing in taxation.

I currently serve on the Tax Executive Committee of the American Institute of Certified Public Accountants and previously served a three-year term as a member of the Internal Revenue Service Advisory Council (IRSAC). I am a Past National President of the National Conference of CPA Practitioners, NCCPAP, the only professional organization focused on representing Certified Public Accountants in Public Practice, and a past chairperson of its Tax Policy Committee. Accompanying me is Stephen Mankowski, CPA, a partner of EP Caine & Associates, CPA LLC of Bryn Mawr, PA and the National Executive Vice President of NCCPAP and the current Chair of the NCCPAP Tax Policy Committee.

Thank you for your invitation to speak at this hearing on the merits of simplification in tax reform. Simplicity is a lofty goal in tax reform that many of us would like to see, however, simplicity frequently leads to unfair and/or unreasonable outcomes. For example, the simplest type of tax is a sales tax but it is the most regressive type of tax since it places the highest proportionate burden on those least able to pay the tax.

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I have chosen to speak about several areas which I believe cry out for simplification paired with fairness and equity:

- Retirement plans
- Education incentives
- Definitions in the tax code, in particular modified adjusted gross income
- Allowable mileage rates
- Different forms of business entities

Retirement plans

There are many different types of retirement plans; 15 are listed on the IRS website. Many taxpayer have more than one type of plan when they reach age 70 ½. This age is important because at 70 ½ taxpayers must begin taking an annual required minimum distribution (RMD) from all of their retirement plans except if they are currently employed by the organization that is the sponsor of the plan or their account is a ROTH Individual Retirement Account (ROTH IRA). The amount that must be withdrawn is based on the account balance at the end of the immediately preceding calendar year, the plan owner's age during the current year and a factor from one of two IRS approved tables depending on the age of the beneficiary.

One area of tax law that is ripe for simplification is the rule requiring a taxpayer to withdraw an RMD from each type of retirement account. Once the Individual Retirement Account (IRA) owner calculates the RMD for each IRA that he or she owns, the IRA owner can withdraw the total amount from one or more of the IRAs. Similarly, a 403(b) contract owner must separately calculate the RMD for each 403(b) contract that he or she owns, but can take the total amount from one or more of the 403(b) contracts.

However, RMDs from other types of retirement plans, such as 401(k) and 457(b) plans, have to be taken separately from each of those types of plan accounts.

This begs the question: Why is it necessary to take an RMD from each type of retirement account? A taxpayer may have a small 457(b) and a large IRA. Perhaps they would like to take the RMD from the entire balance of the small 457(b) and the balance, if any, from the IRA account. Why not permit this? This change creates simplification with no reduction in tax revenue.

Another issue regarding retirement plans is the ten percent penalty for early withdrawal from a plan. There are 12 different exceptions to the additional tax on distributions before age 59 1/2. However, different exceptions apply to different types of retirement accounts. For example, the exception to the imposition of the penalty for qualified retirement distributions made to an alternate payee under a qualified domestic relations order (an order by a judge made to divide a retirement account in connection with a divorce) does not apply to IRAs. Another exception to the penalty is for an IRA distribution made for qualified higher education expenses. This provision does not apply to other types of retirement plans.

It is my recommendation that the penalty exceptions to the additional tax on early distributions from retirement plans be uniform across all types of plans.

Education incentives

There are many incentives in the tax law to encourage post secondary education; some are to encourage taxpayers to save for advanced education, some incentives apply while the student is attending school and there is another for the interest on student loans. Many of the incentives have different income phase outs, different limits on the number of years the benefit is available, the number

of courses the student must take, what type of expenses qualify for the incentive among others.

Many of the benefits are per family rather than per student. If a family has more than one child in college at the same time, some colleges actually provide additional aid to the family. However this aid it is not necessarily sufficient enough to offset the combined costs of tuition and other higher education related costs for multiple children in college at the same time. These per-family limits on benefits are very unfair and place additional stress on the family budget.

Some of the benefits are available for a specific number of years but some college programs such as a Bachelor's degree in accounting are required by some states to be five year programs. Also some students are not able to carry enough credits so that they can graduate in the expected number of years because they must work while going to college.

The phase-out of the benefits for high-income taxpayers should be made uniform across all similar incentives and there should be a separate phase-out for taxpayers filing as Head of Household (HOH). Currently the phase-out for taxpayers filing as HOH is the same as for single taxpayers but their family financial circumstances are frequently very different. Many taxpayers filing as HOH are raising their children on their own with little or no other support.

There is a need to coordinate the various education incentives so that the benefits are available to the desired taxpayers with less confusion. Fewer tax provisions with uniform phase-outs, per-family limits, and types of allowable expenses would go a long way to simplifying these provisions. A computer should not be needed to determine which education benefits apply and which ones provide the best tax result for a taxpayer.

Modified Adjusted Gross Income

There are many definitions of Modified Adjusted Gross Income (MAGI) that factor into the preparation of individual income tax returns. MAGI are determined by adding back certain items to the individual's Adjusted Gross Income (AGI).

The difficulty is determining which items of income or deductions are added back. This varies with the provision in the tax code for which MAGI is being calculated. Items such as foreign earned income, foreign-housing allowances, student-loan deductions, IRA contribution deductions, passive losses, adoption expenses, and deductions for higher-education costs are add-backs for some tax provisions but not others. I have identified 17 add-backs and items not taken into account and two subtractions that are needed for one or more MAGI calculations. I have prepared a chart of some of the more common addback and subtractions, which is attached to this testimony.

The calculation of MAGI is a factor in various calculations including, but not limited to, determining education benefits, who is allowed to make certain types of IRA contributions, the special allowance for real estate professionals, whether a taxpayer has to pay higher Medicare Part B and Part D premiums, the Affordable Care Act Premium Tax Credit and the Health Coverage Exemptions, among others.

MAGI is also used to determine how much of a taxpayer's Social Security Benefits are taxable, and whether a taxpayer is eligible for the adoption tax credit, the retirement savings credit, and/or education tax deductions or credits.

The IRS has a relatively simple MAGI calculator on irs.gov, but this calculator can only be used to calculate MAGI for Passive Activity Loss computations with knowledge that it is for this purpose and no other.

These varying definitions greatly add to the complexity of tax return preparation so that it requires a computer to calculate MAGI in many instances. It would aid in simplification if MAGI for similar provisions could be made uniform. For example, why are non-taxable Social Security benefits an item that must be considered for MAGI in order to make a ROTH IRA contribution but not for a Traditional IRA contribution when neither type of IRA contribution is tax deductible?

Allowable mileage rates

There are several allowable mileage rates available to taxpayers for claiming deductions in connection with different types of travel: business mileage, mileage to obtain medical care, mileage when moving for a change in employment, and mileage while performing charitable activities. All except the charity rate are annually set by the IRS. The charity rate was set by the Congress prior to 1984 and has not been changed since that time. Other Federal agencies, such as the General Services Administration (GSA), also set mileage rates.

A comparison of the 2015 IRS rates for tax deductions purposes and the GSA reimbursement rates is interesting:

	IRS	GSA Reimbursement
Business mileage – personal auto	0.575	0.575
Business mileage – government auto	N/A	0.23
Medical care and moving mileage	0.23	N/A
Charity activity mileage	0.14	N/A

It does not make economic sense that the rate for charitable activities has not increased in 30 years. Today, that rate is significantly lower than the rate for moving and medical care. Taxpayers view this difference as unfair since many more people can claim mileage for charity than can claim mileage for medical care.

Different forms of business entities

The various forms of business ownership, which include partnerships, limited liability companies (LLC), limited liability partnerships (LLP) and corporations, are governed by state laws, rules and regulations. The principal forms of business operations for tax purposes are sole proprietorships, partnerships, S corporations and C corporations. LLCs and LLPs can elect to be taxed as a partnership, S corporation or a C corporation. LLCs are a hybrid type of business that combines features of a corporation with the operational flexibility available to partnerships. LLCs did not come into existence until 1977.

Sole proprietorships, partnerships, S corporations and C corporations are all taxed differently. Sole proprietorships can have only one owner (unless the second owner is the owner's spouse) and are the simplest form of flow-though entity. The net income from a sole proprietorship is taxed at individual rates and subject to self-employment tax. Retirement plan contributions for a sole proprietor are not deductible in the calculation of the owner's self-employment tax.

Partnerships and S corporations are also flow-through entities where the net income is taxed to the partners or the shareholders, whether or not there are funds available to make distributions of the profits.

Partners are not permitted to receive their compensation as wages. Partnership compensation is in the form of guaranteed payments or distributions from the

partnership and all partnership income is taxable at individual rates and subject to self-employment tax. Retirement plan contributions for the partners are not deductible in determining self-employment tax.

S corporation shareholders can receive compensation from the corporation in the form of wages. Retirement plan contributions for the shareholders are deductible by the corporation and reduce the FICA tax on the shareholder's wages.

Another challenge is that many businesses that began as corporations want to convert to LLCs but cannot do so because of the adverse tax consequences as a result of such a conversion. Flow-through entities account for nearly 95 percent of all business entities in 2008 according to a 2011 report issued by Ernst & Young.

In the interest of simplicity and fairness, there should be one type of flow-through entity where the owners enjoy the same benefits.

One area that can be simplified - at no cost - concerns the rules regarding the deduction for self-employed health insurance by S corporation shareholders with more than two percent ownership. Currently the S corporation is required include the health insurance premiums in wages. The premiums paid by the corporation are reported on the taxpayer's K-1 from the S Corporation. The taxpayer can deduct the health insurance premiums as an adjustment to arrive at Adjusted Gross Income. The net affect is that more wages are reported on the W-2 but the taxpayer gets a full deduction for the health care premiums, with no change in taxable income.

The simplified procedure would be for the S corporation to pay and deduct the health care premiums and no deduction on the shareholder's individual income tax return. There would be no impact on the taxable income of the taxpayer and no change in the shareholder's taxes.

Thank you for the opportunity to present this testimony.

Respectfully submitted,

Carol Markman, CPA

Definitions of Modified Adjusted Gross Income

		Medicare Premiums Increased for High income	Traditional IRA	ROTH IRA	Education credits American Opportunity Coverdale IRA Lifetime Learning	Student loan interest	Tuition & Fees deduction	Education savings Bonds	Form 8582 Passive activities	Form 8962 Premium tax credit	Form 8965 ACA penalty
Addbacks to Adjusted Gross Income											
	Deduction for IRA contribution		X	X					X		
	Deduction pension plan contribution								X		
	Deduction for deductible part of self-employment tax								X		
	Passive income or losses								X		
	Real estate losses allowed to professionals								X		
	Exclusion for income from US savings bonds used for education		X	X				X	X		
	Exclusion for adoption expenses								X		
	Student loan interest deduction		X	X		X		X	X		
	Overall losses from PTP								X		
	Taxable Social Security								X		
	Tuition and fees deduction		X	X		X	X	X	X		
	Domestic production activities deduction		X	X		X	X	X			
	Excludible employer-provided adoption benefits		X	X				X			
	Non taxable Social security benefits			X						X	
	Tax exempt interest	X								X	X
	Exclusion for foreign earned income & housing allowances		X	X	X	X	X	X		X	X
	Income from Puerto Rico & American Samoa				X	X	X	X			
Subtractions from Adjusted Gross Income											
	Income resulting from the conversion of an IRA (other than a Roth IRA) to a Roth IRA			X							
	Rollover from a qualified retirement plan to a Roth IRA			X							

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