

HOW THE TAX CODE'S BURDENS ON
INDIVIDUALS AND FAMILIES DEMONSTRATE
THE NEED FOR COMPREHENSIVE TAX REFORM

HEARING
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
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**How the Tax Code's Burdens on
Individuals and Families Demonstrate
the Need for Comprehensive Tax Reform**

WEDNESDAY, APRIL 13, 2011

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The committee met, pursuant to notice, at 10:02 a.m., in Room 1100, Longworth House Office Building, the Honorable Dave Camp [chairman of the committee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Camp Announces Hearing on How the Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform

April 06, 2011

Congressman Dave Camp (R-MI), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on the special burdens that the Tax Code imposes on individual taxpayers and families and on the need for comprehensive tax reform to address these problems. **The hearing will take place on Wednesday, April 13, 2011, in Room 1100 of the Longworth House Office Building, beginning at 10:00 A.M.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

As mid-April approaches each year, individuals and households across the country face the daunting task of fulfilling the one civic duty that touches more Americans than any other—filing accurate and timely Federal income tax returns. While many criticize the individual income tax system primarily for imposing too large a financial burden on taxpayers in terms of dollars owed to the government, individual taxpayers struggle just as much with the Tax Code's mounting complexity and uncertainty. According to recent testimony from the National Taxpayer Advocate, the complexity of the current tax system is the single most serious problem facing taxpayers today, leading nearly 90 percent of Americans either to pay a professional to prepare their tax returns or to purchase tax preparation software to help them file their own returns. Indeed, over the past 25 years, the Tax Code has increasingly come to feature hidden marginal tax rates and has seen a remarkable proliferation of redundant and confusing tax subsidies that, in many cases, may not be fully achieving their intended objectives. Moreover, in recent years temporary tax rates and other temporary provisions have made it increasingly challenging for families to plan their personal finances.

In announcing this hearing, Chairman Camp said, **"As the deadline for filing individual tax returns approaches, the time for simplifying and stabilizing the Tax Code for individuals and families is also upon us. With so many Americans struggling to meet their tax compliance responsibilities, Congress and the President need to work together to achieve a tax system that is fair, simple, and efficient. While some seem to prefer a 'business-only' approach to tax reform, we owe it to the hard-working taxpayers we represent to ensure that they are not left out of this discussion. This hearing will help the Committee better understand the many problems that plague our tax system as it affects individuals and families across the country."**

FOCUS OF THE HEARING:

The hearing will examine some of the difficulties that individuals and families face in navigating the current Tax Code, including both compliance burdens and challenges faced in making long-term financial decisions when confronted with confusing, overlapping, and frequently temporary tax preferences.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, April 27, 2011**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and **MUST NOT** exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://www.waysandmeans.house.gov/>.

Chairman CAMP. The committee will come to order for a hearing on how the Tax Code's burdens on individuals demonstrate the need for comprehensive tax reform.

We meet today to continue our dialogue about what I hope will result in a bipartisan path forward to reform our federal income tax system. While there has been a lot of valuable discussion about the impediments the Tax Code creates for America's job creators, and we will certainly continue that discussion over the time ahead, today's hearing will focus on the burdens imposed by the current federal income tax system on individual taxpayers and families.

Today's hearing is especially timely since each one of us likely knows a family that is racing to file their taxes before this year's

April 18th deadline. And because of the thousands of amendments to the Tax Code enacted over the past quarter century, this race to the finish has become increasingly challenging over the years.

And since the Tax Reform Act of 1986, the last comprehensive tax reform enacted by the Congress, the code has become a maze of increasingly complex credits, deductions, exclusions and exemptions.

The challenges created by the Tax Code for job creators and families are rooted in a similar place. The Tax Code is too complex, too costly, and takes too much time to comply with. Whether it is the compliance with administrative burdens, or the impact of temporary and expiring tax provisions, today's Tax Code is hampering the ability of individuals and families to plan their finances with reasonable certainty.

With nearly 4,500 changes in the last decade, 579 of them in 2010 alone, the code is too complex. Adding to that complexity is the fact that each Tax Code provision is a little bit like a cell. Each one has its own distinct features, characteristics, and life span. For example, over 200 federal tax provisions are scheduled to expire between 2010 and 2020. Whereas, in 1998, there were only 50 expiring provisions.

And while 20 years ago, it was mostly businesses affected by the temporary nature of tax provisions, now families and individual taxpayers are held captive to the calendar. For example, tax rates on ordinary income and on investments, the amount of the child tax credit, the deductions for state sales taxes and college tuition, just to name a few, are all temporary in nature.

Given the complexity created by the ever-changing Tax Code, it is easy to understand why compliance with it has become too costly for American families. According to the National Taxpayer Advocate, in 2008 alone taxpayers spent \$163 billion complying with the individual and corporate income tax rules—that's billion, with a "b." These costs impede the ability of individuals and families to put together their household budgets.

And since provisions may change from one tax filing season to the next, it is no wonder that almost 9 out of 10 families either hire tax preparers or purchase software in order to calculate their taxes. This is a sad reminder that we now have a code that can only be managed if you happen to be someone who can hire an expert to deal with its challenges.

And not only is the Tax Code too complex and too costly, it takes too much time to comply with. Navigating through the tangled web of the Tax Code has resulted in taxpayers spending over six billion hours annually to comply with the code. Ask any family, and I am sure they will have a long list of better ways they could be spending their time.

Although it will require a lot of hard work on our part to achieve consensus on a solution, I think it is safe to say that we all agree that the current Tax Code is broken. We can do better. The members of the Joint Committee on Taxation had a very positive conversation with two key architects of the Tax Reform Act of 1986 during last week's JCT roundtable discussion: Secretary James Baker and Congressman Dick Gephardt. Their message was clear.

It will take the leadership of this Congress and the White House to get this done.

The American people deserve a Tax Code that is responsible and responsive to their needs. We can do our part by working together to make sure that this one is fairer and simpler for all families. And I look forward to hearing from our witnesses today.

And with that, I yield to Mr. Levin for his opening statement.

Mr. LEVIN. Thank you very much, Mr. Chairman. The announcement for this hearing stated that, "Congress and the President need to work together to achieve a tax system that is fair, simple, and efficient. While some seem to prefer a business-only approach to tax reform, we owe it to the hard-working taxpayers we represent to ensure that they are not left out of this discussion." I very much agree with that.

The kind of tax reform proposed in the Republican budget would reduce taxes for the very highest earners, and increase the burden on working families. These reductions for the highest earners come on top of the nearly \$700 billion in additional tax cuts the Republican budget assumes for taxpayers with income above \$250,000, almost 80 percent of which go to people making more than \$1 million.

As we consider complexity in the individual tax system, we must be sensitive to the reasons provisions were enacted in the first place. Our goal should be to strengthen provisions that help working families send their kids to college, save for retirement, or simply make ends meet.

The Republican budget indicates that the individual and corporate rates will be reduced from 35 to 25 percent, but leaves it up to this committee, the Ways and Means Committee, to fill in the details. To do so in a deficit-neutral manner, some estimate that we would have to eliminate more than \$2.9 trillion worth of tax expenditures over the next decade.

The Child Credit, Earned Income Tax Credit, American Opportunity Tax Credit, and retirement savings accounts are primarily middle and lower income provisions. The need for simplification cannot be used as a rationale for irrational inequity, or for undoing progress that helped foster the growth of the middle class in this country.

So I look forward, Mr. Chairman and colleagues, to continuing this conversation, and hearing today's testimony, and I join in thanking all the witnesses for participating. I yield back.

Chairman CAMP. All right. Thank you very much. We have four witnesses today: Alan Viard, resident scholar of the American Enterprise Institute in Washington, D.C.; Annette Nellen, CPA, director, masters of science in taxation program at San Jose State University in California; Mark Johannessen, a CFP managing director, Harris—SBSB, McLean, Virginia; and Neil Buchanan, associate professor of law, the George Washington University, Washington, D.C. Thank you all for being here.

Under our rules, you each have five minutes. We have your written testimony. You each have five minutes to summarize your statement, whereupon, after the panel completes all of their testimony, we will go to Member questions.

So, Mr. Viard, you may begin. You have five minutes.

**STATEMENT OF ALAN D. VIARD, RESIDENT SCHOLAR,
AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, D.C.**

Mr. VIARD. Chairman Camp, Ranking Member Levin, Members of the Committee, it is an honor to be here today to testify about the Tax Code's burdens on families and individuals. Let me note that the views I express today are my own, and do not represent the views of the American Enterprise Institute, or any other person or organization.

In keeping with the theme of this hearing, I will focus on the complexity affecting individual taxpayers with non-business income. Of course, as the members of this committee are aware, there is also a significant degree of complexity affecting tax returns that contain business income, and that includes not only the corporate income tax returns that C corporations file, but also the individual income tax returns filed by owners of pass-through firms.

But I will not discuss those today. Nor is there time to discuss all of the provisions that add to the complexity of the code. Mr. Chairman, you mentioned the billions of hours that taxpayers spend on their returns. I will have to focus today on three specific areas: the needless complexity of the incentives for saving, education, and families in their current design; the proliferation of income-based phase-outs in the code; and the alternative minimum tax.

And, as I will emphasize throughout my testimony, these problems can be addressed separately from such contentious issues as the appropriate level of revenue, the appropriate degree of progressivity in the Tax Code, or even the appropriate breadth or narrowness of the Tax Code.

I believe that these issues should be addressed as part of comprehensive tax reform, if such reform is adopted, but should also be addressed separately, if comprehensive reform does not occur. And I think it's an opportunity for members of both parties to work together to eliminate this needless complexity.

The first area that I want to examine is the complexity of the current tax incentives for saving, education, and children. As Ranking Member Levin mentioned, these provisions play important purposes in the Internal Revenue Code. But their current design today suffers from needless complexity that actually undermines their efficacy.

These problems have been documented by such sources as the Joint Tax Committee, the National Taxpayer Advocate, and the 2005 President's Advisory Panel on Federal Tax Reform. So I do not detail them here in my oral remarks. And even in my written testimony, I rely primarily upon the findings of those previous studies.

Just to state the matter briefly, the current tax system provides more than 20 tax-preferred savings accounts and plans, multiple tax preferences designed to encourage education, and a wide array of incentives for families and children, including both a credit and a deduction for the children in typical households. The National Taxpayer Advocate, the President's Advisory Panel, and the Joint Tax Committee have all proposed ways to consolidate these incentives, while still allowing them to fulfill their essential purpose,

and also promote greater uniformity of rules across the handful of incentives that might remain.

Let me next turn briefly to income-based phase-outs. There are more than a dozen provisions in the Tax Code that phase-out or phase-down tax credits or exclusions or deductions, as income rises. These are measures that promote progressivity in the code. And, like other measures that promote progressivity, they increase the effective marginal tax rate that taxpayers face. But compared to changes to the explicit rate schedule, income-based phase-outs are generally an inferior way to promote progressivity. They make it more difficult for taxpayers to know the true marginal rate that they face, and they require taxpayers to complete an array of worksheets to apply the income-based phase-out that applies to each provision.

Moreover, there is no rhyme or reason as to how the income-based phase-outs work across different provisions. Some of them are indexed to inflation, some are not, and they treat family status in different ways, and so on.

So, in general, transparency and simplicity can be advanced by eliminating most of the income-based phase-outs, while making appropriate adjustments to the rate schedule to achieve any desired degree of progressivity.

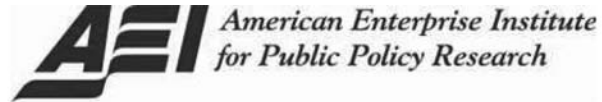
The final problem I want to address is the alternative minimum tax, a parallel tax system that disallows some, but not all, of the tax preferences that can be claimed under the regular income tax. More than four million tax payers are currently subject to the AMT. If the annual patch that Congress passes to address the AMT were to expire, more than 30 million taxpayers would become subject to this parallel tax system.

The AMT represents an attempt to curtail the use of certain tax preferences, but it does so in a capricious and needlessly complex manner. Whatever preferences are desired in the tax system can be provided in the regular tax system. Whichever ones need to be curtailed can be curtailed within the regular tax system without having to put taxpayers through a second tax system with a completely separate set of rules.

In summary, Mr. Chairman, I believe that these are areas that can be addressed on a bipartisan basis, because they do not raise some of the contentious ideological and philosophical issues raised by such things as the level of revenue or the level of progressivity that the tax system has. Certainly this complexity is a problem that the American people face, but it's also an opportunity for members of both parties to work together to give the American people a better tax system.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Viard follows:]



Testimony before the House Committee on Ways and Means on
“The Tax Code’s Burdens on Families and Individuals”

Alan D. Viard
Resident Scholar
American Enterprise Institute
April 13, 2011

The views expressed in this testimony are those of the author alone and do not necessarily represent the views of the American Enterprise Institute.

Chairman Camp, Ranking Member Levin, and members of the Committee, it is an honor to appear before you today to discuss the tax code's burdens on families and individuals. The views expressed here are my own and do not necessarily represent the views of the American Enterprise Institute or any other person or organization.

In my testimony, I focus on the complexity affecting individual taxpayers with non-business income. It should be noted that the tax system also imposes significant complexity with respect to the taxation of business income, whether reported on the corporate income tax returns filed by C corporations or on the individual tax returns filed by owners of pass-through firms (sole proprietorships, partnerships, limited liability companies, and S corporations). Although those issues are important, I do not examine them in this testimony.

Due to time and space limitations, I also cannot discuss all of the numerous provisions that contribute to tax complexity for individuals and families. Instead, I focus on three specific areas; the proliferation of complicated and duplicative tax incentives for saving, education, and families, income-based phase-outs, and the alternative minimum tax. As I explain throughout my testimony and in the conclusion, these problems can be addressed separately from such contentious issues as the appropriate level of revenue or degree of tax progressivity. These issues should be addressed as part of comprehensive tax reform if it is adopted, but should be addressed separately if comprehensive reform does not occur.

Because nearly all of this complexity arises from statutory rather than regulatory provisions, corrective action must come from Congress and the president. Because this issue cuts across ideological lines, it offers an opportunity for members of both parties to work together to promote the public interest in a simpler and more workable tax system.

Needless Complexity of Tax Incentives for Saving, Education, and Children

Over the years, Congress has offered tax incentives for a variety of purposes, including saving, education, and children. Unfortunately, the current design of these incentives needlessly burdens taxpayers and detracts from the efficacy of the incentives. Although the decision whether to offer such incentives and the generosity of any such incentives may be contentious, the needless complexity can be addressed separately from those difficult issues.

The primary problem is the proliferation of tax incentives that serve largely similar purposes, but governed by different and complicated rules. Taxpayers must sort through these incentives, keeping in mind that selection of one incentive may preclude the use of others. Because much attention has been devoted to these problems, I provide only a brief discussion here. More complete analysis may be found in the reports of the Joint Tax Committee and the National Taxpayer Advocate and the other articles that I cite below.

These sources also offer detailed proposals to reduce complexity. The general outlines of the proposals are relatively similar across the different sources, reflecting a consensus that spans

ideological divides. The proposed solutions generally involve consolidation of the incentives into a much smaller set, along with simpler rules that are more uniform across the remaining incentives.

The current tax system provides more than 20 tax-preferred savings accounts and plans, including employer pension plans, traditional IRAs, nondeductible IRAs, nonworking spousal IRAs, Roth IRAs, rollover IRAs, SIMPLE IRAs, 401(k) plans, profit-sharing plans, employee stock ownership plans, money purchase plans, defined benefit plans, Simplified Employee Pensions, SARSEPs, SIMPLE 401(k) plans for small employers, 403(b) tax-sheltered annuity plans for 501(c)(3) organizations and public schools, 457(b) deferred compensation plans for state and local governments, 529 plans, Coverdell education savings accounts, Archer medical savings accounts, and health savings accounts. Each type of account is subject to different contribution limits, eligibility rules, and restrictions on withdrawals. The National Taxpayer Advocate (2004, pp. 423-432) and the Joint Committee on Taxation (2001, pp. 149-228) documented the complexity of tax-preferred savings accounts and plans and offered suggestions for simplification. The National Taxpayer Advocate cited one study in which 30 percent of workers choosing not to participate in 401(k) plans listed complexity as the principal reason. The President's Advisory Panel on Federal Tax Reform (2005, pp. 115-121) offered a simplification proposal that featured only three types of tax-preferred savings accounts and plans.

Similarly, the current tax system offers multiple tax preferences designed to encourage education. Taxpayers may exclude interest on education Savings Bonds and employer-provided educational assistance from taxable income claim, engage in tax-preferred saving through 529 plans or Coverdell education savings accounts, deduct interest expense on student loans, work-related education costs, and qualified tuition, and claim either the American Opportunity credit or the Lifetime Learning credit for tuition and related costs. These provisions have different rules and limitations; for example, the American Opportunity credit, but not the Lifetime Learning credit, is limited to the first four years of post-secondary education. Joint Committee on Taxation (2001, pp. 122-143) and National Taxpayer Advocate (2004, pp. 403-422) documented the proliferation of educational incentives and offered proposals for simplification.

The current tax system also offers a wide array of incentives for families and children. In many cases, taxpayers may claim both an exemption, currently \$3,700, and a credit of \$1,000 for each child. Unmarried taxpayers with one or more children are allowed to claim head-of-household status rather than single status, giving them a more favorable tax rate schedule than that available to childless unmarried taxpayers. Low-income workers with children may claim an earned income tax credit far more generous than that available to childless low-income workers. Here, too, different rules apply to different provisions; for example, the child credit is available only for children 16 or younger, while the other tax breaks are also available for older children. The President's Advisory Panel on Federal Tax Reform (2005, pp. 63-69) proposed the replacement of these provisions with two simplified Family and Work credits. Hassett, Lindsey, and Mathur (2009) and Maag (2010) also discussed ways to simplify and consolidate these provisions.

Income-Based Phase-Outs

Income-based phase-outs are another source of complexity. A number of tax preferences are eliminated or restricted for taxpayers with higher incomes. For example, taxpayers are generally allowed a \$1,000 credit for each child 16 or younger in the household, but the credit is fully available only to unmarried parents with incomes below \$75,000 and married parents with incomes below \$110,000. For each extra \$1,000 (or portion thereof) of income above those thresholds, \$50 of credit per child is phased out. Once income reaches \$95,000 for single parents or \$130,000 for married couples, the credit is completely eliminated.

The table on page 9 provides information for sixteen income-based phase-outs, updated from Brill and Viard (2008). As can be seen, the phase-outs apply at many different income levels and are constructed in a bewildering variety of ways. Some income ranges are inflation-indexed while others are not. The ratio of the income ranges for married couples to the corresponding ranges for single taxpayers is one, two, or intermediate values for different provisions. Some phase-outs distinguish between single taxpayers and heads of household while others do not. The applicable definition of income (not shown in the table) also varies across some of the provisions.

The current tax system also features a few phase-in provisions, under which tax preferences become larger as income rises. For example, the earned income tax credit increases as labor income rises over a certain interval, as does the refundable portion of the child tax credit.

Phase-outs add to the progressivity of the tax system by raising taxes on those with higher incomes through the reduction or elimination of selected tax preferences. Like other measures that promote progressivity, phase-outs also increase the effective marginal tax rates faced by taxpayers. The marginal tax rate is the fraction of additional income that is paid in tax and controls the incentives to earn additional income.

For example, consider a married couple with two children 16 or younger and with income between \$110,000 and \$130,000 and suppose that the couple is in the 25 percent tax bracket. Earning an additional \$1,000 of income directly and visibly results in an additional tax liability of \$250 through the rate schedule. But, because the \$1,000 of additional income also triggers the loss of \$100 of child tax credits, the couple's tax liability actually rises by \$350. The couple's effective marginal tax rate is therefore 35 percent, equal to the official 25 percent marginal tax rate plus 10 additional percentage points from the phase-out of the child tax credit. (Of course, this calculation assumes that the couple is not affected by any other income-based phase-outs. If the couple also claims the District of Columbia homebuyer credit, the exclusion of interest income on Education savings bonds, or the student loan interest deduction, the additional income may also trigger a reduction of those benefits, implying an even higher effective marginal tax rate.)

Striking the appropriate balance between progressivity and incentives is a longstanding and difficult tax policy question. Regardless of what stand is taken on that question, however, income-based phase-outs are generally a flawed way to increase progressivity, because, as discussed below, they reduce the transparency of the tax system and add to its complexity. These problems are avoided if progressivity is instead advanced through direct changes to the tax rate schedule.

Income-based phase-outs reduce the transparency of the tax system because it is difficult for taxpayers to know how much their taxes will rise if they earn additional income. Althsuler and Goldin (2009) documented the significant number of taxpayers who face effective marginal tax rates higher or (due to phase-ins) lower than the official marginal tax rates given by their tax brackets. Phase-outs also cause marginal tax rates to vary capriciously across taxpayers, depending upon which tax breaks they happen to claim. Moreover, income-based phase-outs add to complexity because a separate computation, generally requiring a separate worksheet in the IRS instructions, must be performed for each phase-out that applies to a taxpayer.

There may be good reason for the use of income-based phase-ins and phase-outs in provisions such as the earned income tax credit, which bear a close relationship to the official rate schedule. In principle, phase-outs may also be appropriate if there is a specific reason to provide incentives to promote particular behavior by some, but not all, income groups. In general, though, transparency and simplicity would be advanced by eliminating most income-based phase-outs while altering the tax rate schedule to maintain the desired degree of progressivity. The Joint Committee on Taxation (2001, pp. 79-91) discussed income-based phase-outs and offers proposals to eliminate many of them.

Alternative Minimum Tax

The alternative minimum tax (AMT) is a parallel tax system. Each taxpayer, in each year, must pay either his or her tax liability computed under the regular income tax rules or his or her tax liability computed under the AMT rules, whichever is larger.

Some of the deductions, credits, and exclusions that are allowed under regular tax rules are disallowed under the AMT, causing the AMT to have a broader base than the regular income tax. At the same time, the AMT offers lower tax rates than the regular income tax for many taxpayers, although AMT rates can be higher than regular tax rates for some taxpayers. Current law effectively classifies tax preferences into two categories, those that are available under both the regular tax and the AMT and those that are available only under the regular income tax. The AMT limits the use of the latter preferences, but does so only for taxpayers who claim a sufficiently large amount of those preferences that their liability is higher under the AMT rules than under the regular tax rules.

The AMT disallows the per-person exemptions that taxpayers can claim for themselves and their dependent children under the regular income tax system. It also disallows the regular tax

system's itemized deductions for state and local property taxes and income (or sales) taxes, employee business expenses, and costs of earning investment income and does not allow interest on home equity loans to be deducted. Unlike the regular tax system, the AMT taxes interest income on some private-activity municipal bonds. It also imposes heavier taxes on incentive stock options.

According to the AMT's permanent rules, it also denies a host of tax credits that are allowed under the regular income tax, including the American Opportunity and Lifetime Learning education credits, the credit for child and dependent care expenses, and the credit for the elderly and disabled. As explained below, however, these credits have actually been allowed under the AMT through 2011 under a series of temporary "patches" adopted by Congress.

On the other hand, the AMT resembles the regular tax system in many respects. It follows the regular tax system by excluding gifts, inheritances, imputed rent on owner-occupied homes, interest income on public-activity municipal bonds, personal-injury damage awards, many government transfer payments, and most fringe benefits from taxable income. Both systems provide preferential tax rates for dividends and long-term capital gains. The AMT also generally conforms, sometimes with minor modifications, to the regular tax system's deductions for mortgage interest expense (except on home equity loans), moving expenses, charitable contributions, large theft and casualty losses, large out-of-pocket medical and dental expenses, and gambling losses that offset gambling winnings. The AMT also allows the adoption credit, the earned income tax credit, and the \$1,000 child credit.

The AMT is an undesirable way to limit the use of tax preferences, because it conditions the availability of particular preferences for a given taxpayer on whether the taxpayer claims a large amount of other AMT-disallowed preferences. There is little justification for allowing a preference under the regular tax system while disallowing it for those taxpayers who fall into a parallel tax system. If Congress decides that a particular preference is undesirable, it should be eliminated under the regular income tax. If Congress decides that a particular preference should be maintained, but at a less generous level, there are many simpler and less capricious ways to cut back on the preference, such as disallowing a fixed percentage of the preference or limiting the allowable dollar amount.

Moreover, the AMT imposes significant complexity on taxpayers who are subject to it by requiring them to engage in two sets of tax computations. The AMT even imposes complexity on some taxpayers who are not subject to it, because they must complete a complicated worksheet to confirm that they are not, in fact, subject to it.

The AMT originally affected only a small set of taxpayers. Lim and Rohaly (2009, p. 12) reported that only 20,000 to 30,000 taxpayers were subject to the AMT in 1970 through 1975 and that the number of affected taxpayers remained below 1 million through 1997. In 2011,

however, the AMT affects roughly 4.6 million taxpayers, according to estimates by the Urban-Brookings Tax Policy Center (2010).

The AMT tends to spread to additional taxpayers as time goes on, because the AMT's permanent rules do not provide for inflation indexation of the credit's exemption amounts while the regular income tax's exemption and bracket amounts are indexed for inflation. As inflation marches on, therefore, tax liability under the AMT rules generally increases relative to tax liability under the regular tax rules, causing the number of taxpayers for whom AMT liability exceeds regular-tax liability to grow. Also, the 2001 and 2003 tax cuts reduced regular income tax liability to a greater extent than AMT liability, further contributing to the spread of the AMT.

The spread of the AMT would be far greater without the annual "patches" adopted by Congress over the past decade. Each year's patch allows the tax credits mentioned above to be claimed under the AMT and increases the AMT exemption amount. If the patch expires at the end of 2011, as currently scheduled, the number of taxpayers affected by the AMT will jump to 34.4 million in 2012, according to estimates by the Urban-Brookings Tax Policy Center (2010). It is highly likely, of course, that Congress will enact another annual patch to avert this massive expansion of the AMT. Nevertheless, the annual patches do not truly fix the problem, because they leave several million taxpayers subject to the AMT and fail to provide any permanent assurance that tens of millions of others will not be swept into the AMT.

Simplicity would be promoted by repealing the AMT. Each of the exclusions, deductions, and credits currently disallowed by the AMT could be disallowed, fully allowed, or partially allowed under the regular income tax system, as Congress deems appropriate for each provision. The rate schedules under the regular income tax could also be adjusted to meet any desired distributional goals. If full AMT repeal is not feasible, substantial simplification could still be achieved by permanently narrowing the scope of the AMT.

Conclusion

There is a strong public interest in having a tax system that permits relatively easy taxpayer compliance. Of course, efforts to properly measure ability to pay or to promote social objectives often require some degree of complexity. But, today's tax system features a large amount of avoidable complexity, forcing many taxpayers to choose among an array of complicated provisions that are intended to advance similar objectives, to apply income-based phase-outs, and to confront a parallel tax system.

Although many tax issues give rise to strong ideological and philosophical disagreement, the issues discussed here are less affected by such controversies. The simplification of needlessly complex tax incentives and the elimination of income-based phase-outs and the AMT can be addressed separately from the issue of how much tax revenue the government should collect or how progressive the tax system should be, because the tax rate schedule can be adjusted to meet any desired revenue and distributional targets.

To a large extent, the issues discussed here can even be discussed separately from the question of whether the income tax should be a broad-based tax with few exclusions, deductions, and credits or a narrow-based tax with many such provisions. Individuals with different ideological and philosophical perspectives may sharply disagree about whether the tax system should offer tax incentives for education, saving, and children and the appropriate generosity of any such incentives. Yet, regardless of how those questions are resolved, it is possible to ensure that such incentives are not needlessly complex and that they are not provided under one, but not the other, of two parallel tax systems. In many, though perhaps not all, cases, it may also be possible to agree that such incentives should not be limited to particular income levels.

Although tax complexity is a vexing problem, it also offers an opportunity for bipartisan action to give the American people a better tax system.

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INCOME-BASED PHASE-OUTS

Provision	Filing Status	Beginning Income Level: 2011	Ending Income Level: 2011	Indexed to Inflation?	First Year
Elderly and disabled credit	Unmarried Married	7500 10000	17500 20000 (1 eligible) 25000 (2 eligible)	No	1954
Dependent care credit		15000	43000	No	1982
Performing artists deduction		16000	16000	No	1987
Earned Income Tax Credit	Unmarried Married	7590 16690 16690 12670 21770 21770	13660 (no children) 36052 (1 child) 40964 (2 or more) 18740 (no children) 41132 (1 child) 46044 (2 or more)	Yes	1975
Social Security benefit exclusion	Unmarried Married	25000 32000	Varies Varies	No	1984
Savers credit	Single Hd of Hshold Married	17000 25500 34000	28250 42375 56500	Yes	2002
Conventional IRA deduction	Unmarried Married	56000 90000	66000 110000	Yes	1987
Lifetime Learning credit	Unmarried Married	51000 102000	61000 122000	Yes	1998
Education Bonds interest exclusion	Unmarried Married	71100 106650	86100 136650	Yes	1990
D.C. homebuyer credit	Unmarried Married	70000 110000	90000 130000	No	1997
Child credit	Unmarried Married	75000 110000	95000 130000	No	1998
Student loan interest deduction	Unmarried Married	60000 120000	75000 150000	Yes	1998
AMT exemption	Unmarried Married	112500 150000	247500 330000	No	1987
American Opportunity credit	Unmarried Married	80000 160000	90000 180000	No	2009
Roth IRA eligibility	Unmarried Married	107000 169000	122000 179000	Yes	1998
Adoption credit		185210	225210	Yes	1997
Education IRA eligibility	Unmarried Married	95000 190000	110000 220000	No	1998

Chairman CAMP. Thank you. Thank you very much.
Ms. Nellen, you have five minutes.

STATEMENT OF ANNETTE NELLEN, CPA, DIRECTOR, MASTERS OF SCIENCE IN TAXATION PROGRAM, SAN JOSE STATE UNIVERSITY, SAN JOSE, CALIFORNIA

Ms. NELLEN. Good morning, Chairman Camp, Ranking Member Levin, and Members of the Committee. My name is Annette Nellen. I am a tax professor at San Jose State University. I am a member of the American Institute of Certified Public Accountants, and the chair of its individual income taxation technical resource panel. Prior to joining San Jose State, I worked at Ernst and Young and the IRS. My testimony today is based on my 20 years of experience working on tax reform and simplification.

Thank you for the opportunity to appear today and provide testimony on the serious complexity problems that burden individuals and families and weaken our tax system.

Our current tax law is often incomprehensible. Its complexity imposes burdens on individuals, in terms of time and out-of-pocket costs, and increases the tax gap. A tax system should follow the principle of simplicity. That is, the tax law should be simple, so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.

As noted in our written testimony, there are several commonly-encountered areas of the tax law that frustrate individuals, generate filing mistakes, and lead to missed opportunities to take full advantage of incentives. I will briefly address a few of these complexities, as well as some possible solutions to illustrate that much complexity can be avoided.

First, there are 14 tax rules that offer some incentive for higher education. While all the rules have a common purpose, the definitions, eligibility, and income phase-outs vary. Further, use of one benefit likely precludes use of another, making it difficult to know which is the best incentive to use. This confusion leads some individuals to forgo the tax benefit all together, and some to claim credits beyond what they are entitled to. The AICPA recommends, at a minimum, consolidating the education provisions, and providing uniform definitions.

Another area in need of simplification is the kiddie tax, which was enacted in 1986 to prevent parents from shifting tax liabilities on investment assets to their children, in order to lower their rates. These rules can apply to children under the age of 18, or full-time students up to age 23. Challenges with the kiddie tax include obtaining the required information and interaction with AMT and capital gains. The AICPA recommends using a separate rate structure for children subject to the kiddie tax.

Another point of confusion stems from use of due dates that are not what an individual would expect. For example, an individual with a foreign financial account who needs to file a special form known as FBAR, must file it by June 30th, an odd due date in the tax system. We recommend October 15th, the extended due date for Form 1040.

Another significant area of complexity affecting a growing number of individuals each year is the AMT. The AICPA recommends that the AMT be repealed. A second tax system is unnecessary. It is burdensome in terms of record-keeping, calculations, and the confusion it causes individuals when, for example, they think their

state taxes are deductible, only to find that they are not, because they are an AMT.

In addition, phase-outs complicate tax calculations and planning. For example, the \$1,000 child credit starts to phase out or reduce once a married couple's income reaches \$110,000. However, income levels and measures of income for the phase-outs vary among incentives, leading to confusion. We understand phase-outs exists to prevent higher-income individuals from reaping full benefit of any favorable tax rules. In effect, though, phase-outs disguise an individual's true marginal tax rate and make it difficult to know if a tax incentive is truly available to you.

The earned income tax credit is another area of complexity. Any reform effort should take into account the difficulties of administering this significant program, and reduce its complexity.

Lastly, much frustration is due to the numerous temporary provisions in our tax law. Many temporary provisions are routinely allowed to expire for a period of time, then are temporarily reinstated. This leads to confusion, frustration, and often, less than ideal use of an individual's financial resources.

For example, when the AMT patch is not in place at the start of a year, many individuals must include AMT in their quarterly estimated tax payments. Or, when the exclusion for employer-provided education expires, employers might stop offering the benefit, or employees may opt out, due to the tax consequences, as they cannot rely on the provisions being retroactively reinstated.

The AICPA looks forward to assisting you in reducing the many compliance and planning burdens that the tax system imposes on individuals and families. Thank you for this opportunity to testify. I look forward to your questions.

[The prepared statement of Ms. Nellen follows:]

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**TESTIMONY BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON HOW THE TAX CODE'S BURDENS ON INDIVIDUALS AND
FAMILIES DEMONSTRATE THE NEED FOR COMPREHENSIVE TAX
REFORM**

APRIL 13, 2011

Good morning Chairman Camp, Ranking Member Levin and Members of the Committee. My name is Annette Nellen. I am a professor in and director of San Jose State University's graduate tax program. I am a CPA, a member of the American Institute of Certified Public Accountants ("AICPA"), a former member of the AICPA Tax Executive Committee and the current chair of the AICPA Individual Income Taxation Technical Resource Panel. I am also an attorney and a member of the Executive Committee of the Tax Section of the California Bar. Prior to joining San Jose State University, I was a tax practitioner with Ernst & Young and worked at the IRS as a revenue agent and lead instructor. My testimony today is based on my 20 years of experience working on tax reform and simplification.

I would like to thank this Committee for the opportunity to appear at today's hearing which focuses on the special burdens that the Internal Revenue Code (Code) imposes on individuals and families.

Current tax law is often incomprehensible. 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. We understand the challenges Congress faces as it tackles the complex issues inherent in drafting tax legislation and appreciate your diligence in trying to do the right thing for taxpayers.

In 2002, the AICPA released a tax policy report – "Guiding Principles for Tax Simplification." Based on the AICPA's prior decades of long work on simplification, we noted the following potential impacts of tax law complexity:

- Lower levels of voluntary compliance
- Inadvertent tax overpayments or deficiencies
- Increased perceptions that the tax system is unfair
- Higher costs for both tax administration and tax compliance
- Poorer quality of tax administration and tax assistance
- Inefficient economic decisions, driven primarily by tax considerations
- Unintended tax "traps" for certain taxpayers

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The AICPA suggests that tax system design and reform follow principles of good tax policy. One significant tax policy is simplicity. The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.

There are a number of areas in the Code affecting individuals where the simplicity principle is not followed. These areas warrant your attention in order to help reduce the complexity individuals and families face in tax compliance and planning. For example, simplification is needed in areas such as education, the Kiddie Tax, mileage rates, due dates on reporting requirements for foreign accounts, alternative minimum tax ("AMT"), phase-outs, and the earned income tax credit ("EITC"). In addition, changing the filing due dates for partnership and trust returns would reduce the compliance burden on many individuals because partners and other pass-through owners and beneficiaries must wait for a Schedule K-1 in order to file their personal income tax return. Finally, the avoidance of temporary provisions would also reduce complexity in the tax law.

I will begin by summarizing a few of the many areas of where simplification is needed.

Harmonize and Simplify Education-Related Tax Provisions

Tax incentives are meant to encourage certain types of economic behavior, but taxpayers will only respond if they are aware of and understand those incentives. Few, if any, taxpayers are both aware of all the education tax incentives and familiar with their details. Fewer still can perform the analysis to determine which incentive is most advantageous to them.

The Code contains at least 14 complex incentives to encourage saving for and spending on education.¹ Requirements, eligibility rules, definitions, and income phase-outs vary from incentive to incentive. For example, eligibility for one of the two education credits depends on numerous factors including the academic year in which the child is in school, the timing of tuition payments, the nature and timing of other eligible expenditures, and

¹ The 14 education tax incentives are (1) non-itemized tuition deduction; (2) non-itemized college loan interest; (3) itemized deduction for work related education; (4) HOPE (American Opportunity Tax) Credit; (5) Lifetime Learning Credit; (6) tax-free treatment of student loans canceled; (7) tax-free student loan repayment assistance; (8) tax exemption for scholarships used for tuition, fees, and books; (9) Coverdell Education Savings Accounts; (10) penalty-free withdrawal from IRAs to pay for education; (11) interest exclusion for savings bonds used to finance college education; (12) Section 529 qualified tuition plans; (13) tax-free education benefits provided by employer plans; and (14) additional dependent exemption for students age 19-23. There is also one disincentive for saving outside these programs: full-time students age 19-23 can be taxed at their parents' marginal tax rate. There are also a few tax incentives outside of the income tax rules, such as the gift tax exclusion for gifts made directly to an educational institution on a beneficiary's behalf.

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the adjusted gross income ("AGI") level of the parents (or possibly the student). Further, in a given year a parent may be entitled to different credits for different children, while in subsequent years credits may be available for one child but not another. Further complicating the statutory scheme, the Code precludes use of the Lifetime or Hope (American Opportunity Tax) Credit if the child also receives tax benefits from a Coverdell Education Savings Account. Although the child can elect out of such benefits, this decision also entails additional analysis. The IRS publication to explain the income tax rules on education incentives (Publication 970) is 86 pages long.

In an effort to harmonize and simplify education-related provisions, the AICPA proposes the following changes:

1. Replace tax incentives (i.e., Hope Credit, American Opportunity Tax Credit, Lifetime Learning Credit and the tuition and fees deduction) intended to help taxpayers meet current higher education expenses with one new or revised credit. Combining features of these incentives into one credit would simplify the tax benefits and remove duplicative provisions relating to higher education expenses.
2. Create a uniform definition of qualified higher education expenses ("QHEE") for all education-related tax provisions. Specifically, QHEE should include tuition, books, fees, supplies and equipment.
3. Coordinate the phase-out amounts for the student loan interest deduction, the educational savings bonds and Coverdell Education Savings Accounts exclusions with the new or revised tax credit intended to help taxpayers meet current higher education expenses. All education-related tax provisions should have the same AGI limitations.

For many taxpayers, analysis and application of the intended incentives are too cumbersome to deal with compared with the benefits received. The U.S. Government Accountability Office ("GAO") estimated that for tax year 2005, 19 percent of eligible tax filers did not claim either a tuition deduction or a tax credit that could have reduced their tax liability by an average of \$219, probably due to the complexity of the tax provisions.² Further, according to GAO research, although the number of taxpayers using the educational tax credits is growing quickly, the complexity of the tax provisions prevents hundreds of thousands of taxpayers from claiming tax benefits to which they are

² U.S. Government Accountability Office, Testimony Before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives, *Higher Education – Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes*, May 1, 2008, GAO-08-717T.

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entitled or which would be most advantageous to them.³ Finally, there is evidence that the regressive nature of the provisions prevents low-income taxpayers from getting the tax benefit that Congress envisioned.⁴

Furthermore, there is evidence from government studies that erroneous application of the Hope Credit contributes to the "Tax Gap." A 2009 U.S. Treasury Inspector General for Tax Administration ("TIGTA") report identified approximately 203,000 taxpayers who claimed the Hope Credit for the same student for the three consecutive years ending in Tax Year (TY) 2006 (TYs 2004, 2005, and 2006).⁵ The TIGTA report explained that the amounts of the credits inappropriately claimed in TY 2006 averaged close to \$1,500 and totaled just over \$300 million.⁶ Further, over 58,000 of these taxpayers claimed the credit for the same student for four consecutive tax years (TYs 2004 through 2007).⁷ The amounts of the credits inappropriately claimed for a fourth year totaled almost \$80 million.⁸ In a separate report, more than 169,000 taxpayers were identified who claimed the Hope Credit for the same student for the three consecutive tax years ending in TY 2007 (TYs 2005, 2006, and 2007).⁹ The amounts of the credits inappropriately claimed averaged close to \$1,400 and totaled just over \$232 million.¹⁰

Simplify the Kiddie Tax

For tax years beginning after May 25, 2007, section 1(g) of the Code taxes a portion of the unearned income of children under the age of 18 or full-time students under the age of 24 at the parents' marginal tax rate. Specifically, the provision applies in cases where: (1) the child's earned income does not exceed one-half of the child's support; (2) either parent of the child is alive at the close of the year; and (3) the child does not file a joint return for the taxable year.

In the case of parents who are not married, the marginal tax rate of the custodial parent is used to determine the tax liability on net unearned income (that is, in 2010 or 2011, the amount above \$950 plus the greater of \$950 or itemized deductions directly connected to

³ *Ibid.*

⁴ *Ibid.*

⁵ Treasury Inspector General for Tax Administration, (2009). *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions*, September 30, 2009, Ref. No. 2009-30-141.

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

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producing unearned income). The marginal tax rate of the individual with the greater taxable income is used in the case of parents filing separately. When the provisions of section 1(g) apply to more than one child in the family, each child's share of the parental tax is apportioned ratably based on the ratio of the child's net unearned income to the total net unearned income of all children.

Under certain limited circumstances, parents can elect to include their children's income on their return. However, the election is not available for parents of a child with any earned income, unearned income in excess of \$9,500, capital gains, withholding or estimated tax payments.

The Kiddie Tax adds such significant complexity to the computation of tax liability that the Internal Revenue Service ("IRS") has issued Publication 929, a 38-page booklet which provides worksheets to assist the taxpayer, or the return preparer, with calculating the child's taxable income and tax liability. Nonetheless, there are several challenges related to the Kiddie Tax:

1. Difficulty in obtaining information about the applicable tax rate: Parents may either refuse to provide the tax rate or, if divorced, one parent may refuse to cooperate with the other in providing the information. Without this information, the tax preparer is required to calculate the child's tax unfairly at the highest rate.
2. Qualified dividends or capital gain distributions: The IRS requires qualified dividends and capital gain distributions to be allocated between the first \$1,900 (in 2010) of unearned income and the portion of the child's unearned income in excess of \$1,900, thus making the computation burdensome.
3. Interrelationship with parents'/siblings' returns: If either the parents or siblings file amended returns, the child must also file an amended return.
4. AMT: The Kiddie Tax provision only considers the regular tax of section 1 and not the AMT of section 55. Therefore, under the current rules, if a parent must pay AMT, the children's income is still taxed at the parent's regular marginal tax rate, while the parent is taxed at the AMT rate without taking into account the child's income or the child's regular tax liability. This provision results in the payment of more tax than if the parent and children's income are both included in the parent's AMT calculation.

The AICPA has recommended repeal of the requirement to link a child's taxable income to his/her parents' and siblings' taxable income. A separate rate schedule could apply to income (other than capital gains) which is subject to the Kiddie Tax. The child's capital gains would be taxed at the capital gains rates. Taxing the child's income at a separate rate (rather than a rate linked to that of family members) would eliminate a significant amount of complexity, while still accomplishing the original intent of the Kiddie Tax.

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Standardize the Mileage Rates for Business, Medical and Charitable Purposes

A standard mileage allowance, generally determined annually, is allowed to taxpayers in determining their expenses related to employment (50 cents per mile beginning January 1, 2010, 51 cents per mile beginning January 1, 2011). Further, a standard mileage allowance, also generally determined annually, is allowed to taxpayers for purposes of medical and moving expense deductions (16.5 cents per mile beginning January 1, 2010, 19 cents per mile beginning January 1, 2011). When necessary, the IRS has the authority to adjust these rates at any time (as it did in mid-year 2008 to reflect the extraordinary rise in gasoline prices). In contrast, the mileage rate allowed for charitable contribution deduction purposes has been permanently set by law at 14 cents a mile. Prior to 1984, the IRS had the authority to set this rate as well.

In the interest of tax simplification, the AICPA has recommended the allowance of two mileage rates: one for business expenses and another for all non-business purposes (charitable, medical and moving expense). The IRS should set the non-business rate at a percentage (at least 50% and as high as 70%) of the business rate, rounded to the nearest half cent. Congress should also allow the IRS to once again set the charitable contribution deduction mileage rate and standardize the rate with the amount allowed for other non-business purposes (i.e., medical and moving expenses). Finally, the IRS should continue to adjust all mileage rates on an annual basis and possibly semi-annually in certain circumstances.

Currently, taxpayers often need to apply at least two and sometimes three different mileage rates on a single return. The AICPA's proposal would reduce these numbers to one and occasionally two rates per return. Linking all mileage rate allowances to a single standard and adjusting those rates at least annually would bring fairness and equity to the process.

Revise the Due Date of the Reporting Requirements for Foreign Accounts

Treasury Regulations 31 CFR sections 103.24 and 103.27 require that if any U.S. person has a financial interest in or signature or other authority over any foreign financial account (including bank, securities or other types of financial accounts in a foreign country) and if the aggregate value of all of the person's financial accounts exceeds \$10,000 at any time during the calendar year, that person must report that relationship for the calendar year by filing Form TD F 90-22.1 on or before June 30 of the succeeding year.

The AICPA has recommended changing the reporting due date from June 30 to October 15. Many, if not most, taxpayers with the financial resources to have offshore investments or business interest are very likely to file for an extension of time to file their

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income tax returns. Complete filing information from foreign sources is rarely available until mid-summer or later. To conserve time and minimize fees, preparers usually wait until all the required return information is available before beginning work on a return. Thus, the amount and details of offshore accounts are often not known until after June 30.

Further, few individuals understand the full scope of the phrase "foreign financial account" or the concept of indirect (constructive) ownership. Thus, individuals are unlikely to tell the preparer of the need to file the report by June 30. To increase voluntary compliance and reduce the cost of oversight, the due date for the report should be changed to October 15.

Repeal Alternative Minimum Tax

The AMT was created to ensure that all taxpayers pay a minimum amount of tax on their economic income. However, the AMT is one of the tax law's most complex components. In fact, the AMT is a separate and distinct tax regime from the "regular" income tax. Code sections 56 and 57 create AMT adjustments and preferences that require taxpayers to make a second, separate computation of their income, expenses, allowable deductions and credits.

Although most sophisticated taxpayers are aware of AMT, many middle-class taxpayers have never heard of AMT and are unaware that it may apply to them. Unfortunately, the number of taxpayers facing potential AMT liability is expanding due to: (1) "bracket creep"; (2) classifying as "tax preferences" the commonly used personal and dependency exemptions, standard deductions, and itemized deductions for taxes paid, some medical costs, and miscellaneous expenses; and (3) the inability to use many tax credits to offset AMT.

Due to the increasing AMT complexity, the AMT's impact on unintended taxpayers, and AMT compliance problems, the AICPA supports repealing the individual AMT. However, we recognize that simply eliminating the AMT would generate a new set of problems given the large loss of tax revenue that would accompany such a move. Consequently, the AICPA urges Congress to consider alternative solutions that would reduce or eliminate most of the complexity and unfair impact of the AMT as currently imposed.

The AICPA has urged Congress to consider the following alternative solutions, which we believe would reduce or eliminate most of the complexity and unfair impact of the AMT as currently imposed:

1. Increase and index for inflation the AMT brackets and exemption amounts, and eliminate phase-outs.

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2. Eliminate the standard deduction and personal and dependency exemptions as adjustments to regular taxable income in calculating AMT.
3. Eliminate miscellaneous itemized deductions as an adjustment to regular income tax so that middle income taxpayers are able to deduct such items as employee business expenses for AMT.
4. Eliminate the AMT medical expense adjustment so that middle income taxpayers are allowed the same amount of medical expenses for both regular tax and AMT.
5. Eliminate state, local, and other taxes as an adjustment.
6. Allow tax credits enacted to promote important public goals – such as the low-income tax credit, tuition tax credits, etc. – to be credited against AMT liabilities.
7. Exempt all taxpayers with regular tax AGIs under \$100,000 from AMT.
8. Have only one AMT tax rate and set that rate to below the third lowest regular tax rate of 25 percent.
9. Require the impact of AMT on future tax legislation, i.e., whether the intended tax benefits of any change are negated by the AMT regime, to be reported with the revenue impact of proposed legislation.
10. Allow a minimum tax credit for *all* AMT, not just AMT attributable to deferral preferences, in order to place the individual AMT on parity with the corporate AMT.
11. Liberalize the capital loss limitation rules when calculating AMT associated with incentive stock option (ISO) transactions (e.g., specifically allow a negative basis adjustment for ISO differences to be ordinary rather than capital loss).
12. Eliminate the definition of “qualified housing interest” and allow all deductible residence interest as a deduction for AMT.
13. Exclude AMT from the estimated tax penalty.

Eliminate or Rationalize Phase-Outs

The Code includes many exclusions, exemptions, deductions, and credits aimed at benefiting low- and middle-income taxpayers. Already complex, these benefits are

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further complicated by phasing out benefits for individuals or families whose incomes exceed certain levels.

Unfortunately, there is no consistency across these phase-outs in how income is measured, the income range over which the phase-out applies, or the method of applying the phase-outs. Phase-outs become hidden tax increases that (1) create irrational marginal income tax rates, (2) make tax returns longer and more complicated, (3) increase errors, (4) are difficult to understand, and (5) impair taxpayer ability to know whether the intended benefits will ultimately be available. Affected taxpayers are understandably frustrated when they discover that they have lost, either wholly or partially, itemized deductions, personal exemptions, or credits.

Simplify the Earned Income Tax Credit

According to the Treasury Inspector General for Tax Administration, the number of taxpayers claiming the EITC grew from 6.2 million in 1975 to 22.4 million in 2006. During this period, amounts claimed rose from \$1.2 billion to \$43.7 billion.¹¹ Since its inception in 1975, the EITC has lifted millions of families above the poverty level, and it is now the largest means-tested, antipoverty program in the United States.

However, the program has experienced a high rate of noncompliance. The IRS estimates that EITC over-claim rates for 2005 were between 23 percent and 28 percent of dollars claimed, or between \$9.6 and \$11.4 billion.¹² On the other hand, eligible taxpayers are not claiming all the benefits to which they are entitled. For example, the National Taxpayer Advocate's 2004 study indicated that after audit reconsideration, 43 percent of taxpayers received additional EITC benefits that had been initially disallowed.¹³

The EITC is complex due to the numerous definitions and special rules, as well as the computation itself. This complexity, coupled with a lack of financial sophistication of many eligible families, present a major challenge for taxpayers, tax practitioners and the IRS. Congress somewhat reduced EITC complexity by adopting a uniform definition of a qualifying child in the *Working Families Tax Relief Act of 2004*.¹⁴ As a result of significant steps the IRS has taken to address many EITC compliance problems, the

¹¹ Treasury Inspector General for Tax Administration, (2008). *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments*, December 31, 2008, Ref. No. 2009-40-024.1.

¹² *Ibid.*

¹³ National Taxpayer Advocate, *2004 Annual Report to Congress, Volume II – Earned Income Tax Credit (EITC) Audit Reconsideration Study*, Publication 2104 (Rev. 12-2004) and National Taxpayer Advocate, *2008 Report to Congress*, vol. 1, p. 8.

¹⁴ H.R. 1308, Pub. L. No. 108-311.

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National Taxpayer Advocate has removed the EITC from its "most serious" list. Nonetheless, any federal tax reform effort should take into account the difficulties of administering this significant program and further reducing its complexity.

Change Tax Return Due Dates Affecting Individuals' Returns

The filing of many individuals' Form 1040 would be more accurate and simpler if Schedules K-1 were received in advance of the due date. The original due date for a partnership Form 1065 is due April 15, the same due date as the Form 1040. While the extended due date for partnership returns was recently moved to September 15 to assist individuals, many Form 1040 extensions could be avoided if taxpayers received their Schedules K-1 prior to April 15.

To rectify these and other administrative problems for both taxpayers and the government, the AICPA has proposed a change to the due dates of partnership, corporate, trust and other returns.

Avoid Temporary Provisions, Especially Last-Minute Provisions

The use of temporary provisions in the tax law creates uncertainty and confusion. While some measures, such as those designed for economic stimulus, are appropriate for temporary and sporadic use, longstanding, continually renewed, temporary tax provisions, including many incentive provisions, have become far too common. In its January 2011 report on expiring tax provisions (affecting individuals and other taxpayers), the Joint Committee on Taxation lists 65 tax provisions that expire in 2011, and 37 in 2012.¹⁵

Many temporary provisions are routinely allowed to expire for a period of time, with subsequent debate and legislative action to extend them for some additional temporary period, thus causing confusion and frustration to many Americans, and often filing complications as well. For example, when the "AMT patch" is not in place at the start of a tax year, many individuals must include AMT in their quarterly estimated tax payments. Or, when the exclusion for employer-provided education has expired, employers might not offer the benefit or employees may opt out due to the tax consequences as they cannot rely on the provision being retroactively reinstated. Or, perhaps a teacher will defer purchasing books and other supplies for their classroom until the above-the-line deduction is extended. From a pure tax policy perspective, it is both inefficient and ineffective to utilize temporary provisions.

¹⁵ Joint Committee on Taxation, *List of Expiring Federal Tax Provisions, 2010-2020* (JCX-2-11), January 21, 2011.

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In reality, the temporary nature of some provisions has not led to rigorous review of the related incentives before their renewal. Further, the temporary nature of the incentives may have served to blunt their effectiveness in motivating taxpayer behavior.

These ever-changing, often expiring, short-term changes to the tax laws make it increasingly difficult for individuals to do any long-term cash-flow or financial planning. These planning challenges are further compounded when tax laws are changed after the year has already begun but are slated to take effect that same tax year. When tax laws, new regulations or Treasury guidance are issued late in the year or at the last minute, individuals do their best to comply with no ability to plan for such last-minute provisions, no matter how well-intentioned.

Uncertainty also breeds complexity. The need to extend expiring provisions (e.g., AMT relief) adds confusion and, in many cases, undermines the policy reasons behind these incentives. The on-again-off-again nature of these provisions, coupled with retroactive tax law changes, necessitate filing amended returns, make long-term planning difficult, and significantly increase complexity.

Future tax changes should be enacted with a presumption of permanency, except in rare situations in which there is an overriding and explicit policy reason for making provisions temporary, such as when a new provision requires evaluation after a trial period.

Tax Policy Guidance

We appreciate your efforts in examining some of the difficulties that individuals and families face in navigating the code, including both compliance burdens and challenges faced in making long-term financial decisions when confronted with confusing, overlapping and frequently temporary tax provisions. We suggest in drafting new tax legislation that you review the AICPA's Tax Policy Concept Statement #2: Guiding Principles for Tax Simplification. In brief, our principles are (1) make simplification a priority; (2) seek simplest approaches; (3) minimize compliance burdens; (4) reduce frequency of tax law change; (5) use consistent concepts and definitions; (6) consider administrative burdens; and (7) avoid limited applicability. We also suggest that you review the AICPA's Tax Policy Concept Statement #1: Guiding Principles for Good Tax Policy to assist you in identifying problems in the Code as well as to test any new proposals against the principles of good tax policy.

* * * * *

The AICPA is the national professional organization of certified public accountants comprised of approximately 370,000 members. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions

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of Americans. Our members provide services to individuals, tax-exempt organizations, small and medium-sized businesses, as well as America's largest businesses.

Thank you, again, for the opportunity to testify. In addition to my testimony, we encourage you review the AICPA's recent publication on alternatives for tax reform, our report on penalty reform, our guiding principles for good tax policy and simplification, our compendium of simplification and technical proposals, and our recent proposal to change the original and extended due dates for several returns, all of which are available online, as follows:

Tax Reform Alternatives for the 21st Century, is available at:
<http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/TaxReformStudies/DownloadableDocuments/Tax%20Reform%20Alternatives%202009.pdf>

Report on Civil Tax Penalties: The Need for Reform, is available at:
http://www.aicpa.org/InterestAreas/Tax/Resources/IRSPpracticeProcedure/Advocacy/DownloadableDocuments/AICPA_report_civiltax_penalty_reform1.pdf

AICPA's Tax Policy Concept Statement #1: Guiding Principles for Good Tax Policy, is available at:
http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Tax_Policy_Concept_Statement_No.1.doc

AICPA's Tax Policy Concept Statement #2: Guiding Principles for Tax Simplification, is available at:
<http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/TPCS%202%20-%20principles%20for%20tax%20simplification.pdf>

AICPA Compendium of Legislative Proposals – Simplification and Technical Proposals, dated November 2010, is available at:
http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/AICPA%20_010_Compndium_of_Legislative_Proposals_-_Simplification_and_Technical.doc

AICPA's Letter to Chairmen Baucus and Levin, and Ranking Members Grassley and Camp dated October 8, 2010 on a proposal to change the original and extended due dates for several returns, is available at:
<http://www.aicpa.org/InterestAreas/Tax/Resources/Partnerships/Advocacy/DownloadableDocuments/Due%20Date%20Letter%20and%20Bill%20-%20Final.pdf>

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We hope you will find this testimony and additional publications useful in your continued work on tax reform for individuals. The AICPA welcomes the opportunity to discuss this information with you informally or in any future public hearing.

Chairman CAMP. Thank you very much.
Mr. Johannessen, you have five minutes.

**STATEMENT OF MARK E. JOHANNESSEN, CFP, MANAGING
DIRECTOR, HARRIS SBSB, MCLEAN, VIRGINIA**

Mr. JOHANNESSEN. Chairman Camp, Ranking Member Levin, and esteemed members of the House Ways and Means Committee, thank you for inviting me here today to speak to you on behalf of the Financial Planning Association. My name is Mark Johannessen. I am a certified financial planner at Harris SBSB, a firm in McLean, Virginia. In addition to being a planner, myself, I served on the Financial Planning Association's board of directors for six years, and served as elected president in 2008.

Much of the difficulty in understanding our tax system arises from the ever-changing provisions of the code. In 1986, the goal of tax reform was to make the code more fair and simple. Since that time, there have been tens of thousands of changes and additions, each with its own set of rules, requirements, and phase-outs. Congress has also added provisions that are designed to encourage certain behaviors. Many of these changes have the support of financial planners, such as tax preferred savings vehicles for medical, education, and retirement needs. Nonetheless, all tax incentives should be regularly reviewed by this committee to ensure they effectively meet Congress's policy goals.

Even with my additional education, training, and experience, I know that only professionals completely dedicated to understanding the principles of the Tax Code are able to complete a tax return for all but the most simple of filings. If the interplay of various provisions confuses trained financial professionals, imagine the plight on the average citizen. Today, the most basic tax provisions are in a constant state of flux. The inability to predict, even in the medium term, the future rates in income, capital gains, and dividends, makes financial planning more challenging and expensive for consumers. All too often I have observed consumers holding off on making important plans while they wait for Congress to act.

I have some specific examples in the time I have remaining. It is well referenced so far, the complexity that AMT, the alternative minimum tax, brings to the average taxpayer, with 30 million folks ultimately possibly being affected if no patch is enacted each year. So I will limit my time to discussing the financial planning issues.

Under current law, the top rates on dividends will nearly triple, from 15 to 43.4 percent in January 2013. The long-term capital gains rate will also increase from 15 to 20 percent. This is already affecting investment decisions, as individuals shift their choices to maximize their after-tax profits. In some cases, we are seeing investors choosing stocks that will produce more capital gain, or perhaps tax-free investments like municipal bonds. And the impact on the capital markets of a permanent Tax Code should not be overlooked.

Starting in 2010, a greater number of taxpayers were allowed to convert their traditional individual retirement accounts, their 401(k)'s and 403(b)'s, to an after-tax Roth account. For most investors, the question that determines whether to undertake this conversion is whether one will be higher or lower income taxes in their retirement. Many people can estimate their likely income bracket, but they must also make a best guess about what the tax rate will be—will be in their retirement.

And then, finally, in 2010, individuals faced another decision of whether to elect to pay the entire tax on their conversion in 2010, or split it over—through 2011 and 2012 returns. Because rates were scheduled to increase, many decided to take the tax hit in 2010. And this caused general confusion, as we approached the end of the year.

Charitable contributions have become one of the provisions of the tax extenders exclusions, where exclusions from income up to \$100,000 can be distributed or transferred directly to a charity. And if we can look at 2010 alone, when the extension didn't occur until December 17th, I believe many, folks had already made their minimum required distributions at that time, and so it somewhat muted the actual impact for charities and for our clients to take advantage of a tax advantage.

Estate planning is another area well addressed, I am sure, by this committee.

So, in closing, in its effort to appeal to constituent concerns, Congress has killed the code with its kindness, loading it up with thousands of special breaks and exemptions. While the goal to encourage certain behaviors is laudable, the sheer magnitude of these special breaks and exemptions has made the income tax system unmanageably complex. I would urge this committee to work together to pass tax reform. Thank you.

[The prepared statement of Mr. Johannessen follows:]

Testimony of

Mark Johannessen, CFP®

on

**How the Tax Code's Burdens on Individuals and Families Demonstrates the Need for
Comprehensive Tax Reform**

Before the

House Committee on Ways and Means

U.S. House of Representatives

April 13, 2011

Chairman Camp, Ranking Member Levin, and esteemed members of the House Ways and Means Committee, thank you for inviting me here today to speak with you on behalf of the Financial Planning Association¹ about the difficulties that American taxpayers face in navigating the current tax code and planning for their financial futures.

My name is Mark Johannessen. I am a CERTIFIED FINANCIAL PLANNER™ and a Managing Director at Harris SBSB, a McLean, Virginia firm which serves a wide range of individuals and families who seek objective advice and guidance in order to make smart financial decisions in four distinct areas: financial planning, portfolio management, tax compliance and fiduciary services. I served on the Financial Planning Association's Board of Directors for 6 years, served as its elected president in 2008, and I am honored to represent them here today.

Financial planners are dedicated to working with consumers on wisely managing their finances so that they can achieve success in their financial goals and navigate challenging financial situations at every stage in life. I am also committed to adhering to the Financial Planning Association's Standard of Care, which ensures that I act with due care and in utmost good faith for my clients, and always put their interests above my own. My experience as a financial planner has also provided me with a unique perspective on our tax code and how the current level of complexity and instability in that code affects taxpayers' financial decisions every day.

Overview

U.S. Supreme Court Justice, Oliver Wendell Holmes, Jr. once said, "Taxes are what we pay for a civilized society." But most Americans are probably more likely to agree with Albert Einstein who noted "the hardest thing in the world is to understand the income tax".

Much of the difficulty in understanding our tax system arises from the ever changing provisions of the code. In 1986, the goal of tax reform was to make the code more fair and simple. Since that time, there have been tens of thousands of changes and additions, each with its own set of rules, requirements, and phase outs. Let me repeat that: **Tens of Thousands** of changes and

¹ The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with approximately 24,000 individual members. FPA members serve 3.5 million client households and directly manage more than \$1.8 trillion in assets. FPA is incorporated in Washington, D.C., where it maintains an advocacy office, with headquarters in Denver, Colorado.

additions to the tax code since 1986. The rates have been changed. New sections have been added and dropped.

Many provisions are now indexed for inflation. While indexing may protect taxpayers from higher taxes caused by inflation, it does result in annual changes to many tax provisions that require the taxpayer to stay up to date. It also creates a divergence from provisions that are static.

Congress has also added provisions that are designed to encourage certain behaviors. Many of these changes have the support of financial planners, such as the tax-preferred savings vehicles for medical, education, and retirement needs. Most financial planners believe the continuation of these particular savings programs is justified. Nonetheless, all tax incentives should be regularly reviewed by the Ways and Means Committee to ensure that they are effectively meeting Congress' policy goals.

Financial planners work with their clients in considering their long-term needs like education, retirement, estate, and risk management issues. By and large, taxpayers will have to meet these needs with after-tax money. So in creating a plan, it is impossible for financial planners to ignore the impact that taxes will have on clients' financial decisions.

Complexity Adds Confusion

As part of my training to become a financial planner, I was required to fulfill an education requirement and pass a 10-hour exam that covered all areas of financial planning, including tax, retirement and estate planning.² Even with my additional education and experience, I know that the tax code is so complex that only professionals completely dedicated to understanding its principals are able to complete a tax return for all but the simplest of filings. My firm employs an in-house Director of Tax and a Manager of Tax who work alongside a team of associates to prepare approximately 300 client returns. In addition, we outsource work to several firms, Certified Public Accountants (CPAs) or Enrolled Agents (EAs). It is not uncommon for financial planning firms to outsource all tax preparation work.

² Topic list for CFP® Certification Examinations:
<http://www.cfp.net/downloads/Financial%20Planning%20Topics%202006.pdf>

If the interplay of various tax provisions confuses trained professionals who specifically focus on understanding complex financial issues, imagine the plight of the average citizen who has only a basic knowledge of our tax code. According to IRS data, about 60 percent of Americans complete their own returns³. Many taxpayers choose to hire a tax preparation professional or purchase tax preparation software at an additional cost rather than worry about making errors or missing out on tax benefits by completing returns unaided.

It is a sad state of affairs when one of the basic duties of our nation's citizenry – to pay for their government – has grown so complex that many cannot complete it without professional assistance.

Too Much of the Tax Code is Temporary

Financial planning, by its very nature, requires dealing with uncertainty. We must consider changing family dynamics, life expectancy, health issues, and investment variability. Our training and the financial planning process provide us with specialized skills to deal with this uncertainty. However, it is not so easy for the average individual whose limited time is likely already fully devoted to their job, family and personal lives.

Part of producing a long-term financial plan for a client requires a consideration of what effect future taxes will have. While the tax code is always being updated and modified, today the most basic provisions are in a constant state of flux. The inability to predict – even in the medium term – the future rates on income, capital gains and dividends make planning more challenging and expensive for consumers. Plans become more complex to accommodate the multiple possibilities. Often they must be scrapped and redrafted as new laws are passed. This comes at additional frustration to the client and does not even address the issue of how an unadvised individual might make decisions in the current environment.

While the current structure may create plenty of busy work for the financial planner, it is energy that could be better spent working with clients on other aspects of their financial lives, such as

³ IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2008); George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity 7 (presented at IRS Research Conference, June 2010).

addressing poor saving behavior, credit counseling, and proper portfolio allocations. It is also time that cannot be spent helping new clients achieve their own financial security.

While taxes are the elephant in the room when it comes to maximizing investment returns, Planners counsel their clients to not allow tax considerations to drive their investment and financial decisions. All too often, though, consumers hold off on making important plans that they worry will be made obsolete, instead hoping that Congress will act first.

As you can see, consumers would benefit from comprehensive tax reform and a simplification of the tax code that provides permanency, stability, and predictability of tax laws.

Specific examples

Dealing Annually with AMT

If one income tax system isn't incomprehensible enough, most people forget that they also must contend with the Alternative Minimum Tax (AMT). Many of the deductions and credits that are allowed under the regular income tax are not allowed under the AMT. Consumers who have been carefully acting under the assumptions of the regular income tax regime can have their plans undone by the AMT.

To highlight the capriciousness of this system, consider a married couple who believed they might be subject to the AMT in 2010 and attempted to adjust their withholdings to match their expected liability. If they had based their decision on the law at the beginning of 2010, they would have overpaid their estimated taxes by over \$7,000⁴.

While the couple will receive a refund, that money has sat unproductive, rather than earning interest, being invested, or making its way into the economy. Had the couple failed to properly withhold, however, they would have run the risk of owing additional penalties and interest. This unfortunate outcome is another reason many taxpayers prefer to deal with taxes in the rearview mirror sometime around April 15. This backward-facing perspective erodes the value of credits

⁴ As based on the difference between the original AMT exemption for married couples in January 2010, of \$45,000, and what was signed into law on December 17, 2010, of \$72,450, assuming a 26% or 28% AMT tax rate.

and deductions meant to induce certain behaviors, as taxpayers wait for the tax preparer to tell them if they got a lucky break.

Investing Choices

Capital gains and dividend rates directly impact the choice of securities investments. If investors expect the rates on dividends and capital gains to remain equal for the foreseeable future, they would likely hold more dividend paying stocks, under the assumption that a dividend paid today is worth more than the promise of a future gain. Economic research has demonstrated that after these rates were equalized, companies did increase the amount of dividends that were paid out.

For seniors, the allocation between capital gain and dividend producing stocks can have significant impact on their after-tax level of spending. IRS Statistics of Income data show that seniors are more likely to have dividend and capital gain income than taxpayers in other age cohorts⁵.

Under current law, the top rates on dividends will nearly triple from 15 percent to 43.4 percent⁶ in January 2013. The long-term capital gains rate will also increase from 15 to 20 percent. This is already affecting investment decisions, as individuals shift their choices to maximize their after-tax profits. In some cases, investors will choose stocks that produce more of a capital gain or tax-free investment like municipal bonds.

Many investors are considering a "harvesting gains" strategy to minimize their exposure to a capital gains increase. Under this strategy, the taxpayer sells the security, taking the gain and paying the tax at today's 15-percent rate. That same or similar security is repurchased, resetting the cost basis higher and reducing exposure to a future capital gains increase. While this strategy is rational and can save taxes, it isn't free of cost.

⁵ <http://www.irs.gov/pub/irs-soi/08in15ag.xls>

⁶ In 2013, the dividend tax rate will revert to the individual's marginal rate. A married taxpayer with AGI in excess of \$250,000 will owe an additional Medicare contribution tax of 3.8 percent.

Small Business

The increase in the dividend rate currently scheduled into law also provides a strong incentive to owners of closely-held C corporations to payout more of their profits as a dividend or bonus in anticipation of higher taxes. This loss of capital results in fewer dollars for the business to grow, pay salaries, or hire employees. The strategy is a rational means of reducing one's exposure to a dividend rate increase. However, the behavior is counterproductive to the business owner if tax rates remain the same. While the payout provides an initial increase in tax revenues, it is only temporary. In the longer term, it slows business and job growth and is ultimately counterproductive for the economy as a whole.

Choice of entity

When starting a new venture, entrepreneurs must decide whether to operate their business as a C corporation or as a pass-through entity, such as an S corporation, limited liability corporation, or partnership. There are non-tax reasons for choosing these options. Some limit liability and protect the owners' other assets from debtors. C corporations might be a better choice for startups that hope to be bought out by a public corporation.

Comments by U.S. Treasury Secretary Geithner have indicated that the treatment of pass-through entities may be modified in the future⁷. These comments have made many reconsider choosing a pass-through entity in light of this risk and unsettled business owners who are already using that business structure.

Roth IRA conversion planning.

The Tax Increase Prevention Act of 2005 (TIPRA) allowed taxpayers, starting in 2010, to convert their traditional Individual Retirement Account (IRA), 401(k) and 403(b) to an after-tax Roth account. For most investors, the fundamental question that determines whether to undertake the conversion is whether one will pay a higher or lower income tax rate when they retire. Many people can estimate their likely income bracket, but now they must also make a best guess about what the tax rate for that bracket will be.

⁷ <http://www.bloomberg.com/news/2011-02-25/geithner-says-tax-overhaul-must-address-businesses-filing-as-individuals.html>

In 2010, individuals faced an additional hurdle of deciding whether to elect to pay the entire tax on their 2010 tax return or to split it over their 2011 and 2012 returns. Because rates were scheduled to increase for many taxpayers in 2011, many decided to take the hit in 2010. Few people, however, have the cash to pay the taxes out of pocket. Those who paid the tax with part of the proceeds of the conversion permanently reduced the amount of principal that can grow tax free in their account and that they will have for retirement.

Charitable Contributions of Minimum Required Distributions

One of the provisions in "tax extender" legislation has been the provision to allow for the exclusions from income of up to \$100,000 of minimum required distributions that are transferred directly to a charity⁸. The provision had expired at the end of 2009. By the time the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was signed into law on December 17, 2010, many of the required distributions had already been made. This negatively impacted both the individual's planned charitable giving but also the charities themselves.

Estate planning

Under 2010 law, anyone with an estate of more than \$1,000,000 in 2011 would be potentially subject to the estate tax. Many individuals included a provision in the wills for a bypass trusts or similar entity to mitigate their estate taxes. Now, with the exemption at \$5 million, many have incurred the legal cost to draft a bypass trust they don't think they need, given that the exemption is now portable. However, portability is only an option if BOTH members of the couple die in 2011 or 2012, unless of course, Congress makes the provision permanent.

A middle-income family that has steadily saved \$1.5 million over their lifetime may have had to redraft their will several times in the span of a couple years to keep up with changing laws, at a cost of several thousand dollars per each change. While the cost of having an improperly drafted will can come at a very high price, it is not surprising that many clients are taking a "wait and see" approach for Congress to work on legislation that is expected to be more permanent.

Closing

As a result of the complexity and lack of predictability in our tax code, I am increasingly seeing the tail wagging the dog when it comes to taxes and the financial decisions being made by my

⁸ IRC section 408(d)(8)

clients. Rather than plan ahead, the vast majority of taxpayers choose to deal with their taxes through the rearview mirror, sometime shortly before the April 15 deadline.

In its effort to appeal to constituent concerns, Congress has killed the code with its kindness, loading it up with thousands of special breaks and exemptions. While the goal to encourage certain behaviors is laudable, the sheer magnitude of these special breaks and exemptions has made the income tax system unmanageably complex.

This complexity has created a cruel burden on those who can least afford it. Those who are unable to afford the cost of a competent, professional tax preparer or tax preparation software are the most likely to miss out on the multitude of tax benefits that could be a lifesaver for them in these challenging economic times.

Americans would be better served by a tax code that is fair and simple.

Chairman CAMP. Thank you.
Mr. Buchanan, you have five minutes.

**STATEMENT OF NEIL H. BUCHANAN, JD, PH.D., ASSOCIATE
PROFESSOR OF LAW, THE GEORGE WASHINGTON UNIVER-
SITY, WASHINGTON, D.C.**

Mr. BUCHANAN. Chairman Camp and Ranking Member Levin and Members of the Committee, I am an economist and a professor of tax law at the George Washington University. Thank you for giving me the opportunity to address the committee today.

At the risk of stating the obvious, there are many areas of the Internal Revenue Code that could benefit from rationalization and simplification. In areas in which multiple provisions have accumulated over time, such as retirement savings and education incentives, the same incentives and benefits surely could be provided in a simpler fashion.

That being said, I hope through my testimony to warn the committee of some red herrings, issues that need not be addressed as you work to simplify the lives of Americans who honestly try to comply with the tax laws. Clearing away some tempting distractions will, I hope, provide more clarity and time for the committee to focus on genuine tax simplification.

First, the committee should be wary of reducing tax complexity without reducing what we might call overall complexity. A simple way to reduce the complexity of the Tax Code, after all, would simply be to stop running certain benefits through the Tax Code, and instead, run them through some other agency of the government. The mortgage interest deduction, which is about housing, could be turned into a benefit run by the Department of Housing and Urban Development. The Earned Income Tax Credit, which is a benefit to workers, could be run by the Department of Labor. Doing either of those things, however, would do nothing to make the lives of American taxpayers less complicated. If anything, compliance burdens would become even more onerous, as our citizens would now have to deal not just with the IRS, but with newly created administrative arms of other cabinet departments, or mini IRS's, which would also add to federal spending, by the way.

The IRS has the advantage of being a single agency with which citizens interact, and it is the logical agency to provide incentives and benefits, the eligibility for which are conditioned on income levels. In addition, decades of experience have shown that the IRS and its employees possess the expertise, dedication, and experience, notwithstanding years and years of chronic underfunding, to handle the administration of important benefits that we administer currently through the Tax Code.

Second, reducing the number of tax brackets is not an important aspect of simplifying taxes, and it has the undesirable effect of making the Tax Code less progressive. Some analysts have asserted that the existence of multiple brackets is confusing, making it more difficult for taxpayers to figure out how much taxes they owe each year. In fact, all of the work and uncertainty involved in tax compliance is related to what happens before tax rates even become relevant. That is, once a taxpayer has determined his or her taxable income, it takes merely a few seconds—and I repeat, seconds—to look at the relevant table to determine the tax owed. We could have 10 or 20 tax rates without increasing the compliance burden. The taxpayer's uncertainty is in figuring out what to in-

clude, exclude, deduct, credit, and so on, not in dealing with different tax rates.

Third, as a related matter, the existence of so-called phase-outs is not inherently complicated, either. Again, the difficult part of the process is in figuring out whether a person is eligible for a particular provision. The arithmetic involved in the phase-outs is a relatively simple after-thought, and the IRS is perfectly capable of providing simple tables to assist the taxpayer in determining how a phase-out alters the final tax computation.

I should add the qualification that phase-outs can pile up, with a different phase-out for each of several different tax provisions, which does complicate compliance somewhat. I offer an example of how to deal with this problem in my prepared testimony.

In addition, it is important to remember that phase-outs serve two important purposes. First, they are a way to means-test benefits, benefits that, after all, cost the Federal Government money. Second, phase-outs avoid abrupt all-or-nothing changes to tax benefits, with a taxpayer suddenly losing all of a benefit after hitting an income limit or some other arbitrary threshold.

My message today, Mr. Chairman, therefore, amounts to taking three items off the list of possible approaches to tax simplification.

First, taking policies out of the Tax Code and out of the IRS's jurisdiction can make citizens' lives more complicated, rather than less so, as it would simply relocate the complexity that our citizens face, rather than actually reducing complexity.

Second, the number of tax rates is a non-issue, as far as complexity and compliance burdens are concerned.

And third, the existence of phase-outs is nearly a non-issue, and the complexity of phase-outs can be all but eliminated by harmonizing phase-outs across all provisions that Congress chooses to means-test.

The committee's work is daunting, involving important work in eliminating and combining duplicative and sometimes ineffective tax benefits. That work will be difficult enough without becoming distracted by false promises of reduced complexity.

I hope that my testimony will prove useful in directing the committee away from those distractions. Thank you.

[The prepared statement of Mr. Buchanan follows:]

Neil H. Buchanan, JD, Ph.D.
Associate Professor of Law,
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Testimony Before the Committee on Ways and Means
April 13, 2011

Chairman Camp and Ranking Member Levin, and Members of the Committee:

Thank you for giving me the opportunity to address the Committee today. At the outset, at the risk of stating the obvious, I want to acknowledge that there are many areas of the Internal Revenue Code that could benefit from rationalization and simplification. In areas in which multiple provisions have accumulated over time, such as retirement savings and education incentives, the same incentives and benefits surely could be provided in a simpler fashion. That being said, I hope through my testimony to warn the Committee of some red herrings – issues that need **not** be addressed as you work to simplify the lives of Americans who honestly try to comply with the tax laws. Clearing away some tempting distractions will, I hope, provide more clarity – and time – for the Committee to focus on genuine tax simplification.

False Simplification

Assuming that the goal of simplifying the tax code is truly to simplify the lives of citizens, and that the exercise is not merely a cover for the elimination of the housing, education, retirement savings and other incentives that past Congresses have enacted to benefit the American people, the Committee should be wary of reducing “tax complexity” without reducing what we might call “overall complexity.” A simple way to reduce the complexity of the tax code, after all, would simply be to stop running certain benefits through the tax code and, instead, run them through some other agency of the government. The mortgage interest deduction, for example, could be turned into a benefit program run by HUD. The earned-income tax credit, which is a benefit to workers, could be run by the Department of Labor. The medical expense deduction could go through HHS.

Doing any of those things, however, would do nothing to make the lives of American taxpayers less complicated. If anything, compliance burdens would become even more onerous, as our citizens would now have to deal not just with the IRS but with newly-created administrative arms of other cabinet departments, or “mini-IRS’s” – which would also add to federal spending, by the way.

The IRS has the advantage of being a single agency with which citizens interact, and it is the logical agency to provide incentives and benefits the eligibility for which are conditioned on income levels. In addition, decades of experience have shown that the IRS and its employees possess the expertise, dedication, and experience – notwithstanding years and years of chronic under-funding – to handle the administration of important benefits that we administer through the tax code.

Multiple Rate Brackets

Reducing the number of tax brackets is **not** an important aspect of simplifying taxes, and it has the undesirable effect of making the tax code less progressive. Some analysts have asserted that the existence of multiple brackets is confusing, making it more difficult for taxpayers to figure out how much they owe in taxes each year. In fact, all of the work and uncertainty involved in tax compliance is related to what happens **before** tax rates even become relevant.

That is, once a taxpayer has determined his or her “taxable income,” it takes merely a few seconds to look at the relevant table to determine the tax owed. We could have ten or twenty tax rates without increasing the compliance burden. The taxpayer’s uncertainty is in figuring out what to include, exclude, deduct, credit, and so on, not in dealing with different rates. Again, it is the determination of taxable income, not the final step of determining the tax owed, that takes up all of a taxpayer’s time.

Phase-outs

As a related matter, the existence of so-called phase-outs is not inherently complicated, either. Again, the difficult part of the process is in figuring out whether a person is eligible for a particular provision, and what facts must be known before one can even understand the provision in question. The

arithmetic involved in the phase-outs is a relatively simple after-thought, and the IRS is perfectly capable of providing simple tables to assist the taxpayer in determining how a phase-out alters the final tax computation.

I should add the qualification that phase-outs can pile up, with a different phase-out for each of several different tax provisions, which complicates compliance somewhat. Combining separate phase-outs into a consolidated phase-out would, therefore, allow taxpayers to apply a simple adjustment to all of the relevant provisions for which they might otherwise qualify. For example, if we were to set a “universal phase-out” range from, say, \$100,000 to \$250,000 for a single taxpayer, then any single taxpayer earning more than \$250,000 would know that it is not worth the time to work through the various tax benefits. Taxpayers with incomes below \$100,000 would know that they qualify for full benefits, and taxpayers in between would know in advance the fraction of the benefits that they can expect to receive.

More to the point, however, as the Committee sets priorities, its time would be much better spent simplifying tax provisions themselves – who qualifies, what can be deducted, and so on – than on hunting down and eliminating phase-outs.

In addition, it is important to remember that phase-outs serve two important purposes: First, they limit the cost of any tax benefit, by reducing the benefits received by people who can afford to live without the deduction. They are, therefore, a way to means-test benefits – benefits that, after all, cost the federal government money. Second, phase-outs avoid abrupt, all-or-nothing changes to tax benefits, with a taxpayer suddenly losing all of a benefit after hitting an income limit or some other arbitrary threshold. Without phase-outs, taxpayers can face especially harsh tax consequences as they suddenly lose a benefit that they would otherwise have received.

My message today, Mr. Chairman, therefore amounts to taking three items off of the list of possible approaches to tax simplification. First, taking policies out of the tax code – and out of the IRS’s jurisdiction – can make citizens’ lives **more** complicated, rather than less so, as it would simply relocate the complexity that our citizens face, rather than actually reducing it. Second, the number of tax rates is a non-issue, as far as complexity and compliance burdens are concerned. And third, the existence of phase-outs is

nearly a non-issue, and the complexity of phase-outs can be all but eliminated by harmonizing phase-outs across all provisions that Congress chooses to means-test.

The Committee's work is daunting, involving important work in eliminating and combining duplicative and sometimes ineffective tax benefits. That work will be difficult enough without becoming distracted by false promises of reduced complexity. I hope that my testimony will prove useful in directing the Committee away from those distractions.

Thank you.

NOTE: These comments represent my own thoughts on the issues presented. They in no way are meant to represent the views of my employer or any other organization with which I might be affiliated.

Chairman CAMP. All right. Thank you. Thank you all very much.

The President's Economic Recovery Advisory Board issued a report in August of 2010, also known as the Volcker Report. And in that they also underscore how complex our Tax Code is, and even

say that the cost of compliance is about 1 percent of GDP annually and that those costs are actually more than 12 times the IRS budget, really about \$.10 on every dollar of income tax that is collected.

I am interested in one particular area right now. Mr. Viard, in your testimony you note there are over 20 tax preferred savings accounts and plans in the code. And the Volcker Report also talks about those, as well. And I just wanted to talk with you a little bit more about them.

From a tax administration standpoint, what is the impact of having so many different savings accounts and plans, in terms of IRS oversight and taxpayers' ability to really assess those and use those plans?

Mr. VIARD. Well, thank you, Mr. Chairman. I think that the proliferation of accounts creates complexity at several different levels. The IRS has to promulgate regulations governing each of these accounts, and the rules are different, with respect to the income limits and the contribution limits, as to how much can be put into the account, and also the rules for withdrawal, what types of withdrawals incur penalties, and such not.

But I think the biggest grounds for concern arises at the individual taxpayer level. It is very difficult for taxpayers to choose between these accounts. And one of the interesting findings that I mention in my written testimony which comes from the National Taxpayer Advocate's 2004 report, is that 30 percent of taxpayers who were eligible for a 401(k) and chose not to participate in it cited the complexity as one of the reasons for not participating.

So, I think one of the real grounds for concern is that the social purposes that are intended to be achieved by these provisions is undermined if the provisions are too complicated for taxpayers to take advantage of them. And, as you mentioned, Mr. Chairman, this problem has been documented, you know, numerous times by the Volker panel, the National Taxpayer Advocate, the Joint Tax Committee, the President's Advisory Panel. So it is a long-standing problem. And I think we know the general approach that can be taken to simplify these accounts, in terms of consolidating them, and making the rules more uniform.

Chairman CAMP. Mr. Viard and Professor Nellen, you both, in your testimony, point out that we have multiple tax breaks for higher education, and that there are inconsistent rules and criteria for these tax breaks, and that they cause complexity. Does the current design of these incentives, the complexity of them, and the fact that many of them expire frequently reduce their effectiveness? And I guess I would like to hear from both of you your thoughts on that.

Ms. NELLEN. Yes, I would say it is the confusion that the taxpayers would have as to what is available to them. The IRS instructions actually explaining these 14 provisions is an 86-page publication which is just daunting.

They also—these incentives try to do a few different things. Some of them are actually designed to encourage you to save for higher education. And others are going to be used when you are currently incurring costs of higher education. They could be consolidated into do you want to have just one credit, or should it be a

deduction. Some of the provisions can be used together, some of them cannot.

And I know there has been studies by the GAO and TIGTA that there are people that are overlooking these provisions, I think probably just being overwhelmed by them. If a person is not getting assistance from a paid preparer knowledgeable in these, they are probably going to be overlooked. Your comment earlier about a good number of individuals also use software, the software actually might not be pointing out, "Gee, maybe you should be saving for education," or, "Maybe you have, you know, a choice here and you should be planning next year to try and use this particular incentive." So, I think being left to an 86-page publication is just overwhelming.

In addition, many of these individuals would also be dealing with trying to get other forms of financial aid through what might be offered at the university, through state or Federal Governments. So it's just adding to the overall complexity, because a Tax Code is one place they can get some educational support. But there are other places, as well.

Chairman CAMP. All right, thank you.

Ms. NELLEN. Thank you.

Chairman CAMP. Mr. Viard.

Mr. VIARD. I would really echo those comments, and particularly underscore the point about the limited role of preparers and software. You know, once the year is complete, and I have taken advantage of whatever provisions I may have availed myself of, of course a preparer or a software can help me compute my tax liability correctly, and to file the return properly. But it is much more challenging for the taxpayer to know what to do during the year, which options are available, which ones can be used without sacrificing the opportunity to use others, and which one will actually be most effective for the taxpayer's particular situation.

Even if a preparer or software does offer advice on this, the advice may be—may change from year to year, depending upon changes in the taxpayer's circumstances, and of course, the legislative changes that you have mentioned, Mr. Chairman. So, I think the simple proliferation of these has surely undermined their effectiveness in achieving Congress's goal of promoting education.

Chairman CAMP. All right. Thank you. Mr. Levin may inquire.

Mr. LEVIN. Well, thank you very much for your testimony.

You know, Ms. Nellen, I think your reference to education is a good example. Clearly, we need simplification. But it cannot be at a cost of meeting needed purposes. There is a reason for a credit so people will save, and for a grant for those people who cannot afford it. And sometimes they are confused, and maybe that is one of the reasons why H.R. 1 reduced Pell Grants by \$6.5 billion. We can have credits to stimulate savings. I don't think that means we eliminate grants for people whose kids need help to go to college. I think we need to emphasize simplification, and remember what its purpose is.

I think also—let me just ask you. Do you know the percentage of taxpayers who use either 1040EZ or 1040A? Do you have any idea?

Ms. NELLEN. Actually, I just looked at that last night. It's about 60 percent, I think, use 1040. I think it's 28 percent use 1040A and 12 percent use the 1040EZ from data based—from the IRS—on 2009.

Mr. LEVIN. Yes, our data shows that about 41 percent use the EZ or A, while 59 percent use 1040. Do you know the percentage of those who file the 1040 and use the standard deduction?

Ms. NELLEN. Yes, actually, approximately two-thirds of individuals claim the standard deduction, rather than itemize.

Mr. LEVIN. So, it is clear. The vast majority of taxpayers use one of the more simplified forms, or they use 1040 and use the standard deduction, right?

Ms. NELLEN. Right.

Mr. LEVIN. All right. I think we are all agreed about the AMT and the need to simplify it.

Let me just say a word about the phase-outs quickly, because I looked at your chart, Mr. Viard, and welcome your testimony. It was perhaps more modulated than some people expected. But it is interesting to look at this. The majority of the phase-outs passed in the later 1990s when the now-majority was in control. It may well be that phase-outs are often used for budget purposes, to make sure that the cost is kept down, no?

Mr. VIARD. Well, I think you are right, Mr. Ranking Member, that that is one of the motivations that underlie the use of income-based phase-outs. But, of course, it is always possible to avoid the use of the phase-out and then to make an adjustment to the rate schedule instead, to keep both revenue and distribution roughly unchanged.

I mean, I think the relevant issue in each instance is: Do we have a reason, on policy grounds, why particular income groups should be denied the incentive for this particular type of behavior? If there is no reason to deny the incentive to a particular income group, then I think a phase-out is unwarranted.

And if there is a concern, then, that a particular group, be it a high-income group or any other, is receiving a larger tax reduction than would otherwise seem appropriate, then, of course, an adjustment to the rate schedule can address that in a manner that is more transparent and that still allows this group to benefit from the incentive for the behavior that Congress has decided to encourage.

Mr. LEVIN. Mr. Johannessen, you end up by saying Congress has killed the code with kindness. Let me just say we have a problem with simplification, with complexity.

I just think we need to be careful in our rhetoric. A couple of weeks ago someone said in testimony, "Government is a disease." And you do not say quite the same thing. I am not sure we have killed the code with kindness. That would seem to mean that the kindness was somewhat irrelevant. I do not think you mean that.

A lot of the provisions in our Tax Code—take the mortgage interest deduction for example. Without it, the state of Michigan where, that Mr. Camp and I come from, and I think where most of us come from, would not have the middle class that it does today. Employer-based health insurance would never have been created on a broad basis in this country without the exclusion. My time is up.

Mr. CAMP. Time has expired. Mr. Herger is recognized.

Mr. HERGER. Thank you, Mr. Chairman. I would like to thank our witnesses for your testimony.

When so many middle class families have to hire professional help just to figure out what they owe in taxes, it is clear that something is wrong. And I hope this committee can work in a bipartisan way to clear away some of this unnecessary complexity.

Mr. Viard, I would like to explore the issue you raised about the phase-out of tax deductions and credits leading to high marginal rates. According to the Tax Foundation, when you add up the income tax, the payroll tax, the phase-out of the earned income tax credit, a family of five making \$48,000 a year faces an effective marginal tax rate of 42 percent. In other words, \$.42 of each additional dollar they earn goes to paying federal taxes. It is my understanding that once the new health insurance exchange subsidies take effect, some low to middle income families could face a total marginal rate of well over 50 percent. And that is without taking into account state and local taxes, or non-tax benefits like food stamps that are tied to income.

Mr. Viard, what is the economic impact of these high marginal rates?

Mr. VIARD. Well, thank you, Congressman. You have pinpointed an important problem that arises, or can arise from the use of income-based phase-outs. Because the marginal tax rates are not being explicitly and openly adopted in the Internal Revenue Code, it becomes possible, I think, for them to be set at levels that are higher than would ever be agreed to if they were presented explicitly on the table. If we were to say, "Do you want a 42 percent marginal tax rate," I think that members of this committee and Members of Congress would think long and hard as to the advantages and disadvantages of that. But with the use of income-based phase-outs, these marginal tax rates are often difficult to detect, and they vary across different households, depending upon their circumstances and which tax breaks they are claiming.

In general, marginal tax rates have the potential to discourage the earning of income—that is to say to discourage work, to discourage saving, to discourage doing things in taxable form, instead of in tax-exempt form.

One thing that we do not understand well is how important the phase-outs are in affecting behavior. Precisely because they are complicated, some people have suggested that people may not be aware of them, and that, therefore, their behavioral impact may be smaller than from explicit marginal tax rates. I am wary of that argument. Although I agree that most taxpayers do not understand precisely the rate they face, which is a problem of transparency, the proliferation of these income-based phase-outs, I think, contributes to the attitude that any attempt to earn additional income may trigger undesired tax consequences. So it creates an area of uncertainty that I think has its own set of disincentive effects.

Mr. HERGER. Would that same reasoning also apply to the phase-outs you have described at the higher end of the income tax scale?

Mr. VIARD. Yes. I think that at every income level, you would anticipate some disincentive effects, and the amount of those ef-

fects depends upon which choices are available to the taxpayers in question. At high income levels, there may actually be greater scope for disincentive effects, because those taxpayers may have a variety of techniques available to them whereby they can reduce their taxable income. And the phase-outs may prompt them to take steps to take advantage of those strategies and lower their taxable income.

Mr. HERGER. Thank you. That is very discouraging. It is very discouraging to those who would like to work their way up the income level to better themselves.

So, what I would like to ask both you and Professor Nellen is this. Would it be possible for us to reform the Tax Code in a way that achieves two goals at once: simplifying the tax system and making it easier to understand, while also eliminating these hidden marginal tax rates that have such a negative impact on the incentive to work?

Ms. NELLEN. I think some simplification certainly is possible. For example, on these phase-outs, there are a few areas of complexity. One is that most of them start at a different dollar amount. But also, what that dollar amount is is not always defined the same way. Some of them are based on what your adjusted gross income, or AGI, is. Some are based on what is your modified adjusted gross income.

The definition of modified adjusted gross income can actually vary from incentive to incentive as to what that calculation is, just making it more difficult, for example, for a practitioner to explain to a client, "This is how this is going to affect you." Instead they will just say, "I need to go double-check what the calculation is and run the numbers." So, some simplification could occur, just by standardizing the deduction as to how do you define what your income level would be. And it probably should just be maybe adjusted gross income, a dollar amount that is clearly right on the tax return, to then base the phase-outs.

Some of the incentives, perhaps—

Chairman CAMP. I am sorry, his time has expired.

Mr. HERGER. And thank you. It sounds very, very complicated to me. Thank you.

Chairman CAMP. Mr. McDermott is recognized.

Mr. LEVIN. Jim.

Mr. MCDERMOTT. Okay. Thank you, Mr. Chairman. I noticed from the sparsity of the audience that the tax lawyers must be sitting in their office watching this, rather than being forced to come up here and look at this.

And I—as I look at the complexity of the Tax Code, it seems to me that those folks who have money have plenty of people figuring it out for them. They don't have any trouble figuring it out. And I am sure that they—most of the complexity in the code is derived around the issue of how to get me out from under some of it. So, I do not worry about the people at the top of the Tax Code very much, because I figure they will be taken care of quite well.

So, my question to you is which of the tax provisions affect the middle class and below would you try and uncomplexify?

[No response.]

Mr. MCDERMOTT. First, if you had one. I mean I assume this hearing is on the level, and it is really about making it better for the middle class in the country, rather than for the people in the top one percent or one-tenth of one percent.

So, for the middle class, which one would you try and decomplexify?

Mr. VIARD. Well, Congressman, I think that the area that seems the most promising, in terms of simplification, is to address the savings and the education and the family incentives. As Ranking Member Levin mentioned, these provisions are significant to the middle class. And I think it is the middle class households that are affected by the complexity that I and the other witnesses have described.

So I think that would be a promising area to begin, in order to provide simplicity for middle class taxpayers.

Mr. MCDERMOTT. And give me your solution. I mean we are gathering ideas here. This is a hearing. So I would like to hear your ideas about how you would decomplexify it.

Mr. VIARD. Well, to take the savings accounts, for example, the basic approach that I think holds the most promise is one that has been outlined in various forms by a number of people before me, and that involves simply consolidating the 20 different types of accounts.

We fundamentally want to encourage saving through employer-based plans. We want to encourage saving by individuals for retirement. And we want to encourage saving by individuals for a range of other purposes, such as health and education. Those three purposes can probably be achieved by offering three different types of tax preferred savings accounts—

Mr. MCDERMOTT. You mean replace?

Mr. VIARD [continuing]. Instead of 20.

Mr. MCDERMOTT. Replace three with three new ones?

Mr. VIARD. No, I'm sorry, replace the 20-some accounts that currently—

Mr. MCDERMOTT. Ah, with three.

Mr. VIARD [continuing]. Serve those 3 purposes with 3 accounts. And then try to make the rules as uniform as possible across them. The President's Advisory Panel on Federal Tax Reform outlined a reform along these lines. And options have been discussed by other groups, as well, that are very similar.

Mr. MCDERMOTT. Why—explain to me why this committee—I mean nobody sits on this committee to think of how you can make the plans more complex. So, why did 20 plans get developed? Explain to me that process.

Mr. VIARD. I am not certain about the answer to that, Congressman. The accounts have arisen over the years. I think there has been a tendency at each point to address some specific problem in isolation from the accounts that already existed. I think the same process has occurred, for example, on the education incentives.

What I think this hearing offers is the opportunity to sit back and say, "Regardless of how we got here, let us take a look at these 20 different accounts, and see if they actually serve 20 different objectives." And I think the answer is pretty clear that they do not. And we now have a range of organizations of diverse ideological

backgrounds, and those that are not ideological, saying there are opportunities to simplify these, to step back and say, "Yes, let us not be shackled by the history of how these have developed," but instead, try to find ones that will most effectively and simply achieve the purposes that Congress has set forth.

Mr. MCDERMOTT. Mr. Buchanan, do you have any comments? Dr. Buchanan?

Mr. BUCHANAN. Yes. Thank you, Mr. McDermott. I agree with most of what Mr. Viard just said. I do think that the Congress has enacted a lot of responses to individual concerns. If we think that people are not saving enough for health emergencies, for example we create health savings accounts, and similar benefits.

I do think that it makes sense to stop and shovel out the stables every now and then, because there is a lot of accumulated mess. It is appropriate to go back and combine various benefits into thematic groups, or take the different groups and combine them into one type of tax credit. If we believe that saving needs to be increased for retirement, then we should have one and only one retirement savings incentive.

Chairman CAMP. All right. Thank you. Mr. Johnson is recognized.

Mr. JOHNSON. Thank you, Mr. Chairman. I think the word is "simplify." I understand that word better than I do that other one they are using over there. Don't you all?

Ms. Nellen, I appreciate your comments regarding the standard mileage rates. You rightly said in your testimony, "The IRS can increase these rates as it did last in 2008, when gas prices surged to \$4." I paid \$4 yesterday, so it is there. As you may know, last month I called on the IRS to increase the mileage rates due to higher travel costs brought on by surging gas prices.

This headline by CNN Money has it right: "Gas prices in the firing range of an all-time high."

So, for the sake of those who use these rates, particularly our nations' small businesses, I would hope that the IRS does the right thing and provides relief from the near-record gas prices by increasing the mileage deduction. And I hope you would agree with me on that one.

But let me ask you a question. Since about 90 percent of the budget cost of earned income tax credit is in the form of outlays, rather than credits for actual tax liability, it appears the provision effectively is a credit against payroll tax, rather than income tax. Would you agree that a simpler way to deliver this tax benefit would be to reduce payroll tax liability in the first instance, rather than requiring taxpayers to engage in this circular flow of tax credits within the government?

Ms. NELLEN. Thank you, Congressman. On the earned income tax credit, you are correct, that that is really refunding all or some portion, or maybe even beyond what the Social Security is.

Actually, I had provided a paper on that topic to Joint Committee when they did the simplification study back in 2001. I and others had suggested that perhaps, if they could just not have to give the money in the first place, because they are giving it through their payroll withholding, but to stop that payroll withholding, so they would actually also have it on a weekly regular basis, that could

simplify what the earned income tax credit is intended to do, and that would cause a few complexities for employers.

But I think that could be worked out. And there is probably some other improvements to the earned income tax credit that could simplify that. But if you could, just stop, you know, taking their money, only to give it back to them at the end of the year. That, hopefully, could simplify the process.

Mr. JOHNSON. Yes. There is a whole bunch of things like that, isn't there? I mean—

Ms. NELLEN. Well, earned income tax credit is a good example of that, because it is, in essence, refunding the Social Security—

Mr. JOHNSON. We need her to help us simplify the Tax Code. What do you think? Thank you for your comments. Mr. Chairman, I yield back.

Ms. NELLEN. Thank you.

Chairman CAMP. All right. Thank you. Mr. Neal is recognized.

Mr. NEAL. Thank you, Mr. Chairman. Professor Nellen, I understand that you are testifying today on behalf of AICPA. And I have to say that your statement in support of repeal of alternative minimum tax is music to my ears. I have staked a career here on that issue.

I first filed a bill years ago that would, at that time, have repealed AMT when it only cost a few billion dollars. Now it has overtaken the regular income tax collections. Some of us have argued that the decision in 2001 not to deal with AMT saved the overall cost of the Bush tax cuts, and that the drafters did so knowingly. In fact, in 2001 a Treasury Department economist warned, "Indexation of AMT parameters, however, would not completely eliminate the sizeable increase in the percentage of AMT taxpayers through 2010 because of the post-2001 growth in Tax Reform Act provisions."

Even with indexation, the percentage—indexation. Even with the percentage of taxpayers subject to AMT would increase by more than 200 percent between 2000 and 2010. So, while the lack of indexation has always been a contributor to the AMT problem, massive cuts in the regular tax were a major contributor, as well.

You have suggested that all new tax bills require the impact of AMT to be revealed [sic]. Can you explain how this provision would work, and why AICPA believes it is important?

Ms. NELLEN. Thank you, Congressman. When there are new provisions added—the child credit would be an example of that that was added, I think, roughly 10 years ago. And when you are going to give individuals what then was a \$500 credit—now it is a \$1,000 credit, temporarily up to \$1,000—that would then generate the question, "Well, now your regular tax has gone down even lower. Is that going to make you more likely to pay AMT?"

If that is the case, then I think it needs to be evaluated. Do you want to put in the child credit in the first place? Because that is actually then causing the AMT to do what it should do. If your tax goes below a perceived minimum, you are going to owe the AMT.

Mr. NEAL. Okay. The growth in Tax Reform Act at that time neither fostered significant growth or tax reform, largely because there was no scrutiny of what the provision in the long term

meant. And today, AMT, as I have already indicated, now is the Tax Code, in so many ways.

Mr. Viard, you were nodding your head, so I am going to give you a crack at this, as well.

Mr. VIARD. Well, Congressman, first let me applaud you for your work in trying to repeal the AMT, which I think is the ultimate solution to this problem. But I do agree with this proposal to have the AMT impact of new provisions looked at. And I think it is particularly important, because it almost helps emphasize why the AMT is a flawed provision to begin with.

If a new tax break is being offered, and a decision is being made not to allow it under the AMT, whether it be to reduce the revenue loss or whatever other purpose might be served, I think that it is appropriate for members of this body and for members of the public to ask themselves, "Why is the provision not being allowed under the AMT?"

If it is intended to serve an important public objective, then should it not be available to all taxpayers, not just those who are subject to one of two parallel tax systems?

And if it does not serve a valid purpose, if it is abusive in some sense, if it is a loophole that we want to curtail, then why is the provision being adopted in the first place?

So I think that this suggestion offers a good way to focus that question, and hopefully lead to the answer that we really want this provision to either be available under both systems or none. And then, following that logic, I think, would lead one to conclude that the ultimate solution is to simply repeal the AMT, as you have proposed.

Mr. NEAL. Mr. Johannessen, you are also nodding in the affirmative.

Mr. JOHANNESSEN. I am nodding to the affirmative because I reflected back on the somewhat lack of transparency that the AMT code has allowed public policy makers to hide behind. While speaking and saying, "We are lowering taxes on one front," it is actually increasing on the other.

So, yes, I am agreeing with exactly what they are suggesting here.

Mr. NEAL. Do any of you know what the cost of the 2001 bill would have been, if covered through 2010 with AMT?

Mr. VIARD. I believe that there would be roughly a \$600 billion or greater cost for the AMT relief. It may be larger than that. It is certainly a significant item.

Mr. NEAL. Yes. Thank you very much. And, Mr. Buchanan, lastly, our Republican friends have expressed a willingness to use the vote on the debt ceiling as leverage to advance some policy goals. In your opinion, as an economist, would the economic benefit of moving a 25 percent top rate for individuals be worth flirting with default on the debt?

Chairman CAMP. And time has expired, so just answer quickly, please.

Mr. BUCHANAN. Nothing would be worth threatening the creditworthiness of the United States.

Mr. NEAL. All right, thank you.

Chairman CAMP. Mr. Nunes is recognized.

Mr. NUNES. Thank you, Mr. Chairman. I actually want to pick up where Mr. Neal left off. And maybe we will start with you, Mr. Viard.

In terms of the top rate—this can go to all of you throughout the five-minute period that I have if we were to simplify most of the code—so, in other words, as you said, go from 20 different types of savings accounts down to 3, and take a lot of the inequities out of the code as much as we possibly can—and I don't know what this Congress can do, and I do not know what the Senate would agree to, and I do not know what the President would sign, so this is basically hypothetical, but if you could simplify the code, what should the top marginal rate be, and how would you structure the code, if you could?

Mr. VIARD. Well, Congressman, I think it is actually important to draw a distinction between simplification and base-broadening. The type of simplification that we are discussing here today I think would not necessarily lead to significant reductions, or necessarily to any reduction in the statutory rates.

For example, if you did simplify the 20 tax preferred savings accounts into 3, that does not necessarily mean that they would be less generous.

Mr. NUNES. Right.

Mr. VIARD. That would be a decision that Congress would have to make, and particularly the members of this committee. So you could decide to have 3 accounts instead of 20, to make it easier for middle class and other households to use them. But if they have the same revenue loss, then you actually do not achieve rate reduction.

Rate reduction, instead, requires a much more significant fundamental set of policy choices associated with base-broadening, things that probably, you know, go far beyond what we have been discussing in our testimony.

Someone would have to make decisions, for example, does one curtail the tax preference for home mortgage interest? Do you curtail the preference for employer-provided health insurance? Do you curtail or eliminate the state and local tax deduction?

Mr. NUNES. What do you think, Mr. Viard? I mean you have worked on these tax issues a long time. I have worked with you on a couple different tax issues over the years. What road do you think the Congress should go down? Do you think we should broaden the base and really simplify the code?

Mr. VIARD. I do believe that the base should be broadened, Mr. Congressman, although I think that even a base—even an income tax with a broader base is inferior to consumption taxation.

But personally, I do see areas for broadening the base, in terms of eliminating the state and local tax deduction, restructuring the preferences for employer-provided health insurance and home ownership in ways that are more effective in providing basic health insurance, and allowing people to become home owners, rather than encouraging the spread of expensive homes and expensive health insurance policies. And I think if you adopt those type of measures, you can lower rates, certainly by several percentage points.

Again, though, I do want to stress those reflect fundamental policy debates that clearly are unrelated, at least at first glance, to the simplification that we are discussing here today.

Mr. NUNES. Ms. Nellen.

Ms. NELLEN. Yes, I do agree with that. You know, generally though, a broader base and lower rates does also help the tax law meet additional principles of good tax policy. Things would be more transparent. If you are removing certain provisions, that makes it more clear, you know—well, the tax law won't affect your decision-making as much as—it should not be affecting your decision-making. Make it more neutral.

So I think there should be consideration, as happened in the 1986 act, of lowering the rates and broadening the base. That is one way to get simplification. But as Mr. Viard says, there are ways to get simplification. So far as what the ideal marginal tax rate should be is certainly an important policy debate and should be considered. Distributional effects, as well, among the different income categories.

Mr. NUNES. Thank you. Mr. Johannessen.

Mr. JOHANNESSEN. I can tell you that last year was the first year in my 20 years of working with clients actually say what I have often heard in economic theory, which says as we approach a higher and higher tax bracket at the top, that people will be disincentivized for additional units of work.

And so, probably four or five different clients came to me last year and said, "How can I, next year, reduce my income, either by working less or by not creating, something that otherwise I might be creating?"

And so, I don't know what the idea rate is. I do know that, as we approach 39.6 this year, it began to get people's interest pretty significantly.

Mr. NUNES. Thank you. Mr. Buchanan.

Mr. BUCHANAN. When we discuss base broadening and rate reduction, that is usually done in the context of wanting to be revenue neutral. And I am a bit confused by that discussion in the context of the broader context here. Because, as I understand it, part of the concern overall—especially later this afternoon, apparently—is going to be about reducing long-run deficits. And so I am not sure whether or not the—

Mr. NUNES. So you would prefer the code to stay complex, rates to stay where they are at, and not broaden the base?

Chairman CAMP. All right.

Mr. BUCHANAN. No, absolutely not. What I would prefer is that we broaden the base, and think about how that would affect revenues, and therefore, the long-run deficit picture.

Chairman CAMP. All right, thank you.

Mr. NUNES. I yield back. Thank you, Mr. Chairman.

Chairman CAMP. Mr. Becerra is recognized.

Mr. BECERRA. Thank you, Mr. Chairman. Thank you for your testimony.

Let me see if I could ask you all to help me do something. Mr. Viard, give me a number between one to three. Just give me a number between one to three.

Mr. VIARD. Two.

Mr. BECERRA. Two? Ms. Nellen, give me a number between 1 and—is it Nellen? Ms. Nellen, a number between 1 and 800.

Ms. NELLEN. Seven hundred.

Mr. BECERRA. Seven hundred. Now, Mr. Johannessen, a number—just give me a top or bottom.

Mr. JOHANNESSEN. Top.

Mr. BECERRA. Top? Okay. Let us see. Here is a Tax Code. Number 2, 700, and top. So top is here, we are looking at Section 1361 of the Tax Code, “Effect of Election on Corporation.” I suspect this particular section dealing with corporations won’t affect most individual tax filers. And I suspect we could go through this routine about 1,000 times and most of this random selection of a provision in the Tax Code would not affect most tax filers.

In fact, if you take a look at the forms that are available to tax filers, the 1040EZ, the 1040A, and the 1040 itself, most tax filers can file using the simple tax form, the 1040EZ, or the 1040A. The 1040EZ, if I am looking at it properly—and I have it right here—it has 13 items to be filled out. That is it, 13 items.

Now, the 1040, of course, is the one used by folks who have higher incomes. That has a lot of additions, a lot of supplemental filings with it. But the 1040EZ, which the IRS, in its instructions to tax filers, says to them, “You can use this 1040EZ form if your taxable income is below 100,000”—and, by the way, 87 percent of the 143 million-plus American tax filers earned less than \$100,000—is “your filing status is single, or if you are married and file jointly, if you are under the age of 65 and not blind”—that is a pretty easy one to determine—“you are not claiming any dependents, and your interest income is \$1,500 or less,” with today’s interest rates, you are probably having to earn pretty good interest to collect \$1,500 in interest, some probably \$50,000 in a savings account of some sort, or some kind of something that gains you an income, an interest income.

So, probably not a lot of folks who are at \$100,000 or below, 87 percent of filers, who really have to go beyond the 1040EZ with 13 questions, or perhaps the 1040A. The reality is that the more than 2,300 pages in the Tax Code aren’t for people who earn \$100,000 or less. It is for those who make more who need to use the 1040, because they have lots of different ways to reduce their tax burden, to the point where Warren Buffett has said that he likely pays a lower income tax rate than do the assistance and secretaries that work for Warren Buffett.

And, as the Bloomberg Business Week article of April 7th said, the top 400 income tax returns—so the 400 wealthiest Americans, by income—while their rates, their statutory rates, might be in the 30 percent, their effective rate, what they ultimately paid after they used all of these tax shelters and so forth, was just under 17 percent. That is higher than a lot of those middle income families that would file the EZ, 1040EZ, form. In fact, those 400 percent richest Americans pay at a lower rate than the next set of wealthy Americans, who pay probably about 23 percent. So the richer you get, the lower your taxes.

And the poor average worker, who makes—who gets a paycheck every week or every month, doesn’t have to worry about trying to

sneak through some of the Tax Code, because his or her money is automatically taken out of the paycheck.

And so, as we talk about complexity, I think we have to remember something. The complexity is created not by the average American making \$100,000 or less, it is created by all those folks who make much more money who want to keep as much of their money with them as they can. And the reason you have 2,300 pages is not so that you can help the average stiff who works every day 9:00 to 5:00, it is to help the guy who doesn't use the 1040EZ who is trying to shelter as much as he can.

And so, I hope that as you keep coming to testify before us, you will help us make sure we navigate this so we do not hurt the middle class as some try to protect the wealthiest Americans, who are doing very well on their own.

Chairman CAMP. All right.

Mr. BECERRA. Thanks very much.

Chairman CAMP. Thank you. Mr. Tiberi is recognized.

Mr. TIBERI. Thank you, Mr. Chairman. Mr. Viard? I kind of want to say "Oh," based upon your bio and your days at Ohio State. But you were there after I graduated.

You may have seen yesterday an Ernst & Young report come out. Are you familiar with that at all? It was a report regarding our Tax Code.

Mr. VIARD. I don't think I saw that report, Mr.—

Mr. TIBERI. All right. Well, it had to do with the corporate Tax Code and pass-through entities. About a month ago we had a hearing here with respect to pass-through entities. And today, the President is going to tell us something. He has talked before about doing corporate tax reform. And some in the Administration have talked about doing only corporate tax reform.

In your view, looking at our Tax Code today, if we did only corporate tax reform, and did not deal more comprehensively across the board, would that create inequities, in your opinion, more inequities than we have today?

Mr. VIARD. I think that would depend on how that reform was done. I certainly think that dealing only with the corporate income tax, you know, would be only a partial solution to the problems that affect our tax system today. There are clearly reforms that are needed for individual taxpayers of the type we have been discussing here, as well as some that we have not been discussing. As I said at the beginning of my testimony, I was not going to discuss the problems faced by individual owners of pass-through firms. But, in fact, those regimes are needlessly complex.

I think it was interesting that the tax provision that Congressman Becerra chose at random was a provision pertaining to S corporations. And it is clear that we have some very complicated regimes governing pass-through entities. We have a partnership regime, we have an S corporation regime, each of which is complex in itself, and each of which differs from the others.

And I think that it is absolutely right, as Congressman Becerra pointed out, that the individuals directly affected by this are high-income individuals, in many cases. And so, I do not know that we need to feel compassion that they are struggling with this complexity.

But what I think all of us need to worry about is whether, as, you know, citizens and as members of an economy, whether the efforts of those individuals should be devoted to dealing with intricate tax provisions, or instead, should be devoted to business purposes, to the hiring of new workers, to the creation of new products that are demanded by consumers.

Mr. TIBERI. That is where I was——

Mr. VIARD. And I hope that simplification——

Mr. TIBERI. And that is where I was heading, actually, because the report that came out yesterday showed that a majority of business job creators and business owners were pass-through entities, including S corps, and that if we raise the top rates on them, at the same time we were reducing corporate rates, we would actually impact a number of job creators in a negative way. And not only the complexity issue that has been talked about today, but also raising the rate, would have an impact on our economy.

And so, Mr. Johannessen—did I say that right? For someone who gets his name mispronounced every day, I am sensitive to the way you pronounce your name. You said something in response to Representative Nunes I would like you to say again, with respect to something you have heard this year from some of your clients with respect to the Tax Code. Can you repeat that again?

Mr. JOHANNESSEN. I believe what I said was that for the first time in my 20 or so years, that folks actually were asking what they could do to minimize their earnings potential because they wanted to try and avoid being pushed into the 39.6 percent tax bracket.

Mr. TIBERI. That is the biggest headline that should come out of this hearing today. My mom and dad came to America, as I have said before, for a better life. And in America, it was endless potential. And when you have people, job creators, entrepreneurs, people who are trying to better themselves, take the Tax Code and go to one of their advisors and say, “How can I work less so I don’t get penalized by my government,” that is an incredible statement.

Representing the AICPA, Ms. Nellen, have you or any of your members heard that, or do you see a problem within our Tax Code that creates this thought process?

Ms. NELLEN. Congressman, I have not personally heard that. I have heard stories of that. I do think, in looking at the rates, I think it is—going to hear more of that, because there are some additional rates coming into effect, Medicare tax coming into play at 3.8 percent on certain investment income. I think some might question, “Well, what exactly is my marginal rate?” And I think, just seeing additional taxes does perhaps also raise the question Mr. Johannessen is hearing from his clients.

Chairman CAMP. All right. Thank you.

Mr. TIBERI. Thank you. I yield back.

Chairman CAMP. Mr. Pascrell is recognized.

Mr. PASCRELL. Thank you. Mr. Buchanan, good morning.

Mr. BUCHANAN. Good morning.

Mr. PASCRELL. There is nothing more notoriously and pointlessly complex than doing your taxes twice. And you know my friend Mr. Neal has referred to the, you know—in my own district, tens of thousands of people, we—New Jersey ranks number one in

AMT filings. There is a reason for that. And my own district, which is a moderate income to low income, it ranks within the 50th in the entire nation in AMT's filed.

So, there have been numerous attempts, numerous attempts, to index the AMT, to patch it. There have been numerous attempts to repeal it. It is almost biblical. The common theme was that all of these policies were going to be paid for. So, the President's 2012 budget paid for the AMT patch for three years by eliminating tax breaks for specific oil companies and millionaires—very specific, rather than what we usually do on both sides of the aisle, eliminating loopholes, which can mean anything under the sun.

So, the Republican budget, Mr. Ryan's budget, bootstraps the \$1.5 trillion AMT repeal to the extension of the millionaire tax breaks. I find that to be most interesting. At a total cost of \$4.2 trillion, according to the Tax Policy Center. That budget also looks to lower the top rate to 25 percent.

Mr. Buchanan, an AMT repeal was included in the 4.2 trillion tax break in the Ryan budget. Very specific. How much more would it cost to lower the top individual rate and top corporate rate to 25 percent? You have any idea?

Mr. BUCHANAN. It would be in the trillions.

Mr. PASCRELL. Well, the answer is \$2.9 trillion over 10 years, in addition to the 4.2 trillion already in the Ryan budget. That is quite a bit of money, isn't it, Mr. Buchanan?

Mr. BUCHANAN. Yes, sir.

Mr. PASCRELL. For a budget that is supposed to get us to the Promised Land.

Mr. BUCHANAN. Yes, sir.

Mr. PASCRELL. It is not getting us to the Promised Land.

What are the options of paying for this rate reduction? What tax credits or deductions will have to be eliminated? All of them.

The President's debt commission has a top rate of 25 percent. But it eliminated all tax expenditures, did it not?

Mr. BUCHANAN. Yes.

Mr. PASCRELL. Okay. If we eliminated many of the complex tax preferences, such as the earned income tax credit, a favorite of President Reagan, or child tax credit, or the mortgage interest deduction, while extending the Bush tax cuts for top earners to pay for a rate reduction, wouldn't lower and middle income individuals have a higher tax liability in the end, Mr. Buchanan?

Mr. BUCHANAN. Yes, sir.

Mr. PASCRELL. Or else where would the money come from, Mr. Buchanan?

Mr. BUCHANAN. I could not tell you. As far as I can tell from these plans, it boils down to saying, that one way to simplify is to raise the net tax burden on those making less than 200,000 a year.

Mr. PASCRELL. Of course it has to come from some place.

Mr. BUCHANAN. Yes.

Mr. PASCRELL. Or else we will do what we did for eight years, not pay for anything.

Mr. BUCHANAN. As I understand it, and my earlier response to Mr. Nunes was based on this when we are talking about eliminating these various preferences, we are broadening the base. But, as you describe, this is in a context where we are broadening the

base in order to make up money that is being lost in terms of the rate reduction and the elimination of the AMT.

Mr. PASCRELL. Thank you so much, Mr. Buchanan.

Chairman CAMP. All right.

Mr. PASCRELL. And I yield back, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Davis is recognized.

Mr. DAVIS. Thank you, Mr. Chairman. I would like to follow up on Mr. Herger's question for Dr. Viard and Ms. Nellen about how phase-outs might actually discourage work and earnings. I serve as the chairman of the Human Resources Subcommittee. We are looking at some of the arcane and complex interlocking relationships between the silos of the various programs that create some real challenges, I think, for the folks who want to get out of poverty, or want to get off of assistance and build themselves a future.

And we know the Tax Code has many provisions for low-income families. As Ms. Nellen's testimony indicates, however, there is no consistent structure to ensure that the tax provisions work together more harmoniously or holistically. You know, meanwhile, parents who qualify for those tax benefits may, in addition, receive food stamps, welfare, Medicaid, and other benefits that also vary, based on income.

Given all that, it has got to be bewildering for parents to try to figure out if working and earning more will actually make them better off. With all these program interactions, it seems that some families with very moderate incomes can actually face an effective tax rate of more than 100 percent, meaning that they are made worse off if they work and earn more, which is counterintuitive to what the goal is, to begin with.

My question is this. Have any of you reviewed how phase-outs for tax and non-tax benefits discourage work, since earning more may cause someone to lose both tax benefits and other benefits as well? And should we be looking at this more holistically, so low-income and modest-income parents can actually end up better off from working and earning more?

Ms. NELLEN. Congressman, that is a good question. I think it is important to think about when the taxpayer would also even be aware that they have actually lost the deduction. A lot of times that might not happen until they are filing their return. As they are proceeding through the year, they might be thinking, "Oh, there is a particular incentive, I am going to qualify for that," and might not find out—you know, for example, even getting a year-end bonus might be enough to kick them out of that, and they didn't know that earlier on in the year. So that is one problem with the phase-outs. It is not something you always plan for.

Now, some individuals, high income, know that they are beyond all the phase-out levels, they don't even think about getting those. But I think people that—in the levels where you are intending to get those benefits, it is just the uncertainty because of that phase-out.

And sometimes they do not know that unless it has happened once. Then they are more likely to pay attention to it, and either, you know, just count on, "I am not going to get that particular incentive"—I am not sure it will—it is probably too complicated to say, "I am not going to earn more money," because they might lose

one incentive, but not another one, because the phase-out levels are all different.

Mr. DAVIS. Mr. Viard, you would like to comment?

Mr. VIARD. Yes, Congressman. I think you are right about needing to take a holistic approach to this. And it is very complicated, because just as we have a proliferation of phase-outs on the tax side, we also have a proliferation on the spending side.

There are numerous different anti-poverty programs. You mentioned some of them: the food stamps, public housing, temporary assistance to needy families, and so on. And any given household could, at least in principle, be eligible for a number of them. And some of the same complexity problems and marginal rate problems arise there, as well.

I think that if we did try to consolidate, you know, along both sides of the system, that we at least could make more informed and transparent choices about the marginal tax rates.

The one note of caution I do want to put into the discussion, though, is this. It is difficult to avoid high marginal tax rates in these low-income programs, because you really face a difficult trade-off. If you choose to have low marginal tax rates, you either need to reduce the benefits that are paid to the households with the very lowest incomes, or you need to have the benefits continue into higher income ranges at a greater cost.

And so, one of the forces that has driven policy-making towards these high marginal tax rates is the desire, on the one hand, to provide adequate benefits to those at the very bottom, but on the other hand, to have those benefits phase out before the programs become too costly. So it is a very difficult trade-off—

Mr. DAVIS. Wouldn't it, then, make more sense to step to a third-way choice on that question, and actually look at the process itself? One thing I have noticed dealing with integrated systems that have very little information error, is there is no system in the whole of government to be able to roll up, for example, a recipient of benefits to see what they get across the board.

And so, I suspect you could get away from that. I mean, just from a CPA's perspective, would it be helpful if we had statutory language that would allow data to be matched and shared across agencies and programs? Because we don't now, and I think that is one of the reasons we have 10 percent improper payments with our entitlement programs at the moment.

Ms. NELLEN. Well, certainly so far as transparency, having the data would be more useful to help answer these particular questions. And it is just in different locations, when does it come together into one format? But transparency would say, "Let's bring all that together, and analyze what is actually there, and where people are getting their particular benefits."

Mr. DAVIS. It's going to be one of the questions we are going to have in the coming months as we talk about entitlement reforms. Thank you, Mr. Chairman.

Ms. NELLEN. Thank you.

Chairman CAMP. Thank you. Mr. Stark is recognized.

Mr. STARK. Thank you, Mr. Chairman. I have to make this comment, with due regard for the expertise of the other witnesses. But I have some notes here from my staff—I won't tell you which one—

that says that Mr. Viard is the one heavy hitter from the GOP witness list. Congratulations. That is a high compliment from the Democratic side.

Mr. VIARD. Well, thank you, Mr. Congressman, but I do not claim any expertise greater than my fellow witnesses here.

Mr. STARK. Okay. I guess that what we want to hear from all of you is how we could simplify, as Mr. McDermott has suggested, the code for the majority of the taxpayers, which I guess is in the 90 percent, who use the simplified forms. There is discussions of not taking money out of their paycheck every month. But I guess I would ask the witnesses.

Wasn't that initiated because so many people ended up at the end of the year not setting any money aside, then they had a tax liability, and then they were in the soup? I mean they just didn't have the money to pay their tax? Was that not the basis of the payroll withholding? Go ahead.

Ms. NELLEN. Congressman, the reference actually was to the earned income tax credit, not to regular tax payments. Those should be done through withholding, to ensure that they are done.

But so far as an earned income tax credit, if what happens is that the person from paycheck to paycheck—

Mr. STARK. Right.

Ms. NELLEN [continuing]. Is paying FICA tax, only to get that returned at the end of the year through a somewhat complicated process, is there a way they could not have that FICA tax withheld in the first place.

Mr. STARK. Well, I want to thank the panel for their contributions. And as I say, it is going to be a difficult question for this committee, to figure out how we can simplify the tax return without, say, doing away with the interest—home owner's interest deduction, things like that, which politically would be a fire storm that none of the politicians could weather. Thank you for your contributions today.

Mr. Neal, would you have further questions? I would be glad to yield the balance of my time.

Mr. NEAL. I am okay. Thank you.

Mr. STARK. Thank you. I yield back, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Buchanan is recognized.

Mr. BUCHANAN OF FLORIDA. Yes. Thank you, Mr. Chairman, for holding this important hearing today. And I want to thank all our witnesses up front.

There is a lot of discussion on C corps and having the highest rates in the world. I guess Japan lowered its rates, so that leaves us the highest rate, and I have heard the President and many members on this committee talk about lowering corporate rates so we can be more competitive here and abroad.

But can you lower corporate rates—I pose this to all the witnesses—without not dealing with all these pass-through entities? I am someone who has been in business for 30 years. But in the 1980s everybody had a sub-S, and then everybody moved to—at least a lot of the entities that I had were LLC's, which are all pass-through entities.

Do you see any scenario, based on your expertise, where they would lower corporate rates, but not at the same time lower rates

for pass-through entities? Because a lot of those folks are the job providers.

And, Mr. Buchanan, I will start with you, first.

Mr. BUCHANAN. Compliments on your name, Mr. Buchanan.

Mr. BUCHANAN OF FLORIDA. Thank you.

Mr. BUCHANAN. Yes. I do agree that there is a lot of slippage between the different types of business entities. And, therefore, changing the C corp rules is going to create incentives for people either to move into or out of being a C corp, and instead, becoming a pass-through entity.

The permeability isn't perfect, of course, because at this point there are people who argue that C corps have no reason to exist under the existing incentives for pass-through entities, and yet C corps do continue to exist. But I certainly agree with you, Mr. Buchanan, that the business tax reform would need to be thought of as an integrated whole.

Mr. BUCHANAN OF FLORIDA. Yes, and if you just take that one step further, when you are looking at trying to raise rates on the rich, basically a lot of those are job providers. So, if you are looking to lower rates on C corp, and then you have to deal with pass-through entities, that goes right down to the individuals. So that is the point.

Mr. Johannessen.

Mr. JOHANNESSEN. You know, I would rather cede my time to my colleagues here on the panel.

Mr. BUCHANAN OF FLORIDA. Okay.

Mr. JOHANNESSEN. They probably have more expertise in that area.

Mr. BUCHANAN OF FLORIDA. Yes. Ms. Nellen.

Ms. NELLEN. One thing. The rates, actually, as to which is higher, the individuals or the corporations, has changed over time. And people do react to that. Prior to the 1986 act, the rate on individuals was higher than corporations. That switched after the 1986 act, which actually then brought about an increase in the number of pass-through entities, particularly S corporations and partnerships. And I would guess flipping that again would cause, again, some change in behavior.

So, we have a record of showing that when one side or the other—

Mr. BUCHANAN OF FLORIDA. But how could you, in a competitive world like we all live in, have two people competing in the same industry—a C corp, in theory, could do a lot less in revenues and a pass-through entity could do a lot more. And if the C corp was paying a lot less in taxes than the S corp or the LLC, how does that work in our competitive environment, in terms of doing business? To follow your logic—

Ms. NELLEN. Well, I think some pass-through entities perhaps would move to the corporate forum. But you also have, with C corps, that they are still subject to double taxation, which is another issue that really needs to be addressed, along with the consideration of lowering the rates.

Mr. BUCHANAN OF FLORIDA. Mr. Viard, did you want to comment on that?

Mr. VIARD. Yes.

Mr. BUCHANAN OF FLORIDA. Just the idea of lowering C corp rates here and abroad—

Mr. VIARD. Well, I think—

Mr. Buchanan of Florida.—and dealing with everything else—my opinion is you have got to deal with them all. But go ahead.

Mr. VIARD. Well, I think, Congressman, yes, this question highlights, again, some of the complexities that have crept into the Internal Revenue Code in ways that maybe were not intended. I think that, in general, C corporations are taxed more heavily than pass-through entities, because there are two levels of tax. Yet there are circumstances in which C corporations can actually be used as, you know, tax avoidance devices, particularly if earnings are not being distributed and gains are not being realized.

So, what this ultimately tell us is that we do want—ideally, at least—a holistic solution, something that will try to unify the treatment of different business enterprises, and allow the choice of business form to be made without reference to tax considerations. So the different firms, as you say, in the same industry or in different industries can actually compete on a level playing field, be subject to a single level of tax that is really uniform across different types of entities.

Mr. BUCHANAN OF FLORIDA. And one other quick question, as I have got a few minutes, or a minute left, or whatever it is, the IRS says the average person takes 21 hours to fill out their return. In fact, I was reading something where the USA editorial page had commented that, for the new iPad, they get one page of instruction and the 1040 form has 172 pages of instruction.

What would be one or two things that, in terms of tax simplification, would you suggest or do? And we will start on the other end. Mr. Viard?

Mr. VIARD. Well, again, I think the thing that most cries out is really trying to consolidate these different incentives for savings and education and children, which really, you know, do not have a rhyme or reason to them at this point. Crept up over the years, and you have multiple accounts and incentives that are serving only one or two purposes. And—

Mr. BUCHANAN OF FLORIDA. Ms. Nellen, what would you—

Chairman CAMP. I am sorry, the time has expired. Mr. Paulsen is recognized.

Mr. PAULSEN. Thank you, Mr. Chairman. I also want to thank all of you for being here today as a part of this hearing. I find it very interesting.

I will start with Mr. Johannessen, if I could. As a part of the work you do, you obviously advise clients, and we have so many provisions that are set to expire in 2012, which we have heard about, many of those you referenced: dividends, capital gains, and these issues that do affect decisions that go into the future. And a lot of these are in flux right now.

How do you advise your clients just knowing that there is the frequency of the changes that are out there, and the provisions that expire? How do you go about actually advising your clients short-term, long-term?

Mr. JOHANNESSEN. Right. Planners, by our nature, are used to changes in people's plans. We live in that world of uncertainty.

But from a longer-term perspective, the way that we are building our plans today, which—you know, many times we are looking at folks' retirement, or their estate—is by taking the code as we know it exists today, the top tax brackets, and kind of planning out into the future, as legislated. And we have a software that helps us, do that in that environment.

In the short term, it requires a lot of looking at numbers, reviewing numbers, trying to make best guess of the direction of where the congress and, the economy is going. And so, it requires a lot of time and energy. Last year, in particular, with Roth, and as we were heading towards a new tax bracket, whether we would have folks convert or not, you know, that was a significant back-and-forth dialogue.

Mr. PAULSEN. So it seems like it is pretty clear that, given the sense that you have all talked about, that individual taxpayers are frustrated with the complexity in the forms they fill out, whether it is the phase-out provisions or anything else, as a profession you are also navigating the waters and having complex calculations and staff, and everyone trying to advise your client. So it is part of that whole complex situation, right, as a part of—

Mr. JOHANNESSEN. Yes. You know, I think what most intrigued me about this testimony today is the idea of a more permanent structure than the one that has been in flux. When you look at the wave of folks moving towards retirement, just the Baby Boomers alone, and to have some sense of how to plan. Someone mentioned earlier the 21 hours to prepare the average tax return. That is more time than most people do on their financial planning. But then again, most spend time on their family vacation than they do on their financial planning.

And so, to be able to have a more permanent structure, where people can peg towards what their retirement lifestyle needs to be with taxes built in, is hugely important, with the sheer number of people working towards retirement, this will be an issue for, not only seniors today, but the Baby Boomers as they move through the pipeline.

Mr. PAULSEN. And, Ms. Nellen, maybe you have a different relationship with your clients. But do they face similar issues? I mean demographics are a fact, and we cannot change demographics. Can you comment on that?

Ms. NELLEN. Yes, Congressman. I think part of it with practitioners is just being able to explain to their clients as to what the rules are today, what they might be tomorrow, or in—you know, two years out, three years out, and the uncertainty of being able to plan in that context. It does make it quite difficult, having to caveat answers about, "Should I invest this way or that way? When should I sell my business, this year? Next year?" A lot of caveats have to be put in place, and I think the client—and I'm not sure what that means.

But I agree. Permanency would certainly help. Less choice, where they do not have to choose between, you know, 14 different provisions, but it was very clear if I do this I will get this particular education incentive, or get this retirement saving, whatever it might be. Added certainty, I think less choice or options would be helpful.

Mr. PAULSEN. Okay. And Professor Nellen, I know you recently wrote an article for the AICPA that I think was called, "Rethinking the Income Tax Calculation." There is a lot of talk about tax expenditures right now in the context of overall tax reform, and broadening the base, and eliminating a lot of these tax expenditures.

But, you know, and you discuss this as a part of what you wrote, there is a complicated interaction of the rules that affect income tax calculations, and there is the question of what ultimately is a tax expenditure. Can you just explain that interaction a little bit, as this conversation, I think, is going to occur, obviously, and this committee is a part of tax reform. Do you have any suggestions on how we can move forward, keeping in mind some of the issues?

Ms. NELLEN. Well, we hear a lot about this \$1.1 trillion of tax expenditures out there. I am not sure everybody knows exactly what a tax expenditure is. Generally that does not include the standard deduction or personal exemption. Those are viewed as part of a standard income tax system.

So far as I think other misconceptions out there, I think there is a lot of thought that corporations get most of those incentives, where actually, the bulk of those dollars is actually for individuals.

Also, when we hear \$1.1 trillion of tax expenditures, that is actually income tax. Some of those would actually generate, I guess, additional payroll tax, too. If, for example, certain employer-provided exclusions were to be considered all or partly taxed, it would also generate some payroll tax.

But I think, to talk about tax expenditures, it would be helpful if there was a broader understanding of what those are, so the public would understand what that is getting at, who uses those tax expenditures, and how do they affect what the tax rate is.

Mr. PAULSEN. All right, thank you.

Chairman CAMP. Thank you. Mr. Marchant is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman. I represent a largely suburban district, very professional, upper middle class. And I would tell you the largest reason why these professionals have to seek assistance with their tax return is the alternative minimum tax. The largest deduction most of my constituents have are their property taxes and their house payment. So, I don't think we can have any meaningful discussion about simplifying the Tax Code without having a discussion about the AMT, especially in my district.

Mr. VIARD—is that how you say it? Is there a way to calculate the amount of money that is gained by virtue of the alternative minimum tax? Is there a baseline where you can say if there were no alternative minimum tax, here is the amount of money that was collected, but because we are collecting the alternative minimum tax on top of it, it represents what percentage of the total tax collected?

Mr. VIARD. It is certainly possible to compute that number, Congressman. And, in fact, the Urban-Brookings Tax Policy Center, which is probably the most authoritative source of data about the AMT and about many other tax topics, has computed that.

I do not have that number with me, offhand. But one interesting fact is that we have reached a point where it is actually cheaper

to repeal the regular income tax than to repeal the AMT. Now, the bulk of the revenue that is being collected each year would be raised under either of these tax systems. And only a modest portion is the increment that arises from having two of the systems, as opposed to one. But nevertheless, at this point, in that particular sense of the term, you know, the AMT has become the "bigger tax system."

Mr. MARCHANT. Is there a largest deduction across the nation for AMT payers, the single largest deduction that they lose?

Mr. VIARD. They lose the state and local tax deduction in its entirety. So it is the property taxes, as you mentioned, and also either the income or the sales tax, which itemizers have a choice to deduct. They also lose their personal exemptions.

And that is kind of an interesting fact, because Professor Nellen mentioned there is—you know, we do not normally think of the personal exemption as being a tax expenditure. We think of it as being part of the normal tax system. And yet it is not part of the alternative minimum tax. The AMT treats the per-person exemption, the \$3,700 for the taxpayer and the spouse and the dependents, as if it were a tax preference, and eliminates that under the AMT.

Mr. MARCHANT. Is that the most common thing that they lose?

Mr. VIARD. Those two are the biggest single items.

Mr. MARCHANT. Mr. Johannessen, I found your testimony to be especially good, because when you go to your specific examples of dealing with the AMT, I think that is what hits most of the families in my district. They think they are planning all year long on what tax they may owe. And then most times they have paid—in my district—most times they have paid in too much.

And so, they are getting big checks back, but they are curtailing their spending during the year. The government is keeping more of the money than they actually need, but taxpayers are curtailing their spending out of precaution. And it is my contention that if that money was available in the economy to be spent, that we would have an acceleration of the economy. Thank you, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Rangel is recognized.

Mr. RANGEL. Thank you, Mr. Chairman, and welcome all of you. Thank you for sharing your views with us today.

During the President Reagan and President the-first-Bush administration there was a dramatic reduction in taxes. Some people believe that it—that reduction in revenue was responsible substantially for the increase in our deficit. Others have taken the position that any reduction in taxes pays for itself and, in fact, creates jobs and increases revenue.

How many of you believe that the reduction in taxes that had been enacted was responsible in part for the tremendous deficit that we are suffering now?

So, the two in the middle, your belief that tax cuts pay for themselves and grow the economy, and create jobs?

Mr. JOHANNESSEN. No, sir. Actually—

Mr. RANGEL. Now, let me—ladies first. Ms. Nellen.

[Laughter.]

Ms. NELLEN. Thank you, Congressman.

Mr. RANGEL. Besides, she is smiling, so I don't think she will believe your answer.

Ms. NELLEN. I am not sure what the answer is. I think there are many factors that come into play that would affect that. I will leave that to the economists, to know if it actually——

Mr. RANGEL. Why didn't you put up your hand?

Ms. NELLEN [continuing]. Is increasing——

Mr. RANGEL. Let me reframe the question just for you. There is reason to believe that dramatically reducing taxes not only pays for itself, but increases revenue. If you are confused, argue the point of how it is going to create revenue, since you are a tax expert, and you do not do like we do, hope for the best, or put a spin on something. It is just hard for people to believe from the math that you can dramatically reduce taxes and then tell the IRS, "You are in for a boom year."

Ms. NELLEN. Right.

Mr. RANGEL. Right what?

Ms. NELLEN. You reduce the rates, reduce everything, that would be hard to believe that would increase revenues. Actually——

Mr. RANGEL. Let me just——

Ms. NELLEN [continuing]. It gets measured here as a tax cut——

Mr. RANGEL. I guess I am going to have to rely on you to defend this theory, Mr. Johannessen.

Mr. JOHANNESSEN. You——

Mr. RANGEL. The other three—I mean the other two——

Mr. JOHANNESSEN. Right.

Mr. RANGEL. You are.

Mr. JOHANNESSEN. The reason I didn't raise my hand is because it seemed like during some of those times that you referenced in your time line there we also raised expenses while cutting taxes. And any financial planner would suggest to you that a client is more likely to have a successful outcome when the revenue coming in is greater than the expenses going out of any family budget.

And so, there have been times in your time line where we were bringing in less revenue, bringing the base down, and raising our——

Mr. RANGEL. How many times have you been accused of having a two-handed argument? Of course if you reduce spending it reduces the deficit. But I am only dealing with what has been said categorically. Reduction of rates brings in a increase of revenue. You say, "Heck no, not unless you reduce spending."

In other words, it takes both, I would assume, because we are going to be presented with a budget that reduces revenue and reduces spending.

Mr. JOHANNESSEN. I——

Mr. RANGEL. And I think that shatters the myth that it pays for itself. It does not pay for itself, unless you do something else, reduction and spending.

Mr. JOHANNESSEN. Correct. One of—it would make me not popular necessarily with my clients is that I would actually advocate for modest increase in tax rates, tax revenue.

Mr. RANGEL. You would do that as an American that is concerned about your country. To hell with the client. If you just know that you don't want a disaster—who disagrees with Mr. Johannessen that—what? No, Mr. Buchanan is with us. Thank you, Chairman. No, I don't need the help.

Mr. VIARD. Congressman, can I ask a question?

Mr. RANGEL. Yes.

Mr. VIARD. You are absolutely right, Congressman, that tax cuts—

Mr. RANGEL. Let me—

Mr. VIARD [continuing]. Normally do not pay for themselves—

Mr. RANGEL. He threw me off. I just want to ask the question. During the time for our country, Republican and Democrat—so you suggest that to reduce the deficit we should reduce the spending and increase the revenue with a tax increase. Is there anyone that disagrees with that?

[No response.]

Mr. RANGEL. Okay. Now, I am so sorry, Mr. Viard. Your thoughts were?

Mr. VIARD. Well, I—you are absolutely right, Congressman, that the typical tax cut does not pay for itself. I do think it is important to realize that if there is a marginal rate reduction in the tax cut, that you normally do get an increase in economic activity, and that there is some revenue feedback from that.

But the revenue feedback is not large enough to offset the direct revenue loss. And, therefore, you do have a net reduction in revenue from the tax rate cut, even though it is not as large of a revenue loss as it would be if there had been no behavioral response.

Chairman CAMP. All right, thank you.

Mr. RANGEL. What is it—

Chairman CAMP. Time has expired. Mr. Berg is recognized.

Mr. BERG. Well, thank you, Mr. Chairman. I would like to actually weigh in on that debate. In North Dakota we have reduced the income tax. We did that last year. We reduced the corporate income tax. We reduced the tobacco tax. And all of those have brought in more revenue.

So, you know, again, I think the focus of this debate here today is how do we simplify our taxes, and how do we move to that place where it is easier for people to pay their taxes and simplify.

I enjoyed Mr. Buchanan's statement that every now and then you have got to clean out the barn, as I would call it in North Dakota. And for people that have done that, there is a lot of build-up there. And that is, quite frankly, what we did two years ago in North Dakota.

We had two tax forms, one that you could take a lot of deductions on—we had about two percent of the filers on there—and then we had a streamlined one that basically said, "No deductions; here is what your gross income is, here is what your state tax is." We lowered the overall rate and did away with the long form, if you call it. And again, I think that is what we are talking about nationally here, too: How do we again go back to cleaning out the barn, get to, if you will, a short simple form, knowing that, as time progresses, different policy changes come in for deductions and different things. So, you know, I really like that.

The other thing that is such a challenge is just the uncertainty. The uncertainty out there, it is impossible for small business to have confidence in our economy, so they are sitting on their hands. They are not hiring. Everyone out there is worried about this deficit spending, knowing it is going to impact the taxes that they pay and that it is going to be a barrier to that growth.

And so, I guess I would just kind of simplify this. Mr. Johannessen, how difficult is it when all these rules are changing as you are advising your clients?

Mr. JOHANNESSEN. You know, we do that all the time, so for us it is not difficult. For the average citizen, though, I think it is very complex. Studies would tell you that probably two percent of the population actually use a certified financial planner.

But we work in it all the time. And it is a matter of trying to scenario-plan and look down the road. The issues that our clients face certainly are not life and death. They are trying to help our clients make smart financial decisions. And so, it is complex. There is a number of different areas that each year you have to look through.

One of the concerns, that I have kind of on the larger picture is the potential impact on these variable rates on the capital markets. Whether it is in last fall's fall-off of returns in municipal bonds, as some portion of the public left municipal bonds as a result of the changing Tax Code, and how folks can game the system with regards to capital gains, and what investments they are either getting into or getting out of, right at the time that there is an inflection point with capital gains rates or ordinary income rates. I think that needs to be a part of the discussion, a couple of the things that we are thinking about every day.

Mr. BERG. Well, that is an excellent point. Sometimes we forget about the impact of deficit spending on what the long-term markets are going to do, and what impact it will have, even apart from Tax Code. So thank you. I yield back.

Chairman CAMP. Mr. Roskam is recognized.

Mr. ROSKAM. Thank you. Mr. Buchanan, in your testimony you made an argument that said that the phase-outs do not increase complexity. Can you walk us through your thinking on that? It is in conflict to what other experts say. It seems intuitively difficult to track. What is it, in your experience, that animates the hope that, literally, phase-outs do not exacerbate the problem with complexity?

Mr. BUCHANAN. My argument was that Mr. Viard's list of phase-outs is a concern, because that are 20 different phase-outs with 20 different starting points and ending points and phase-out rates. That is complicated.

The concept of having a means-tested phase-out is not inherently complicated, because 99 percent of the actual, in terms of doing tax planning and figuring out which benefits or tax provisions apply comes before you would ever even think of a phase-out, or think of the tax rate that may or may not be phased out.

Mr. ROSKAM. Okay. I am sure you said it well and clearly, and everybody here got it except for me.

Mr. BUCHANAN. Okay.

Mr. ROSKAM. So the first part of your reply was that something was complicated, as it relates to phase-outs, and then you transitioned into "but it is not." Where was the nexus?

Mr. BUCHANAN. The nexus is if you have 20 different phase-outs with 20 different sets of rules for each of those phase-outs, that is complicated. We could have one phase-out that says, "Here is a range of tax provisions that are phased out," but it begins at the same income level for all of them, and it ends at the same income level for all of them. Let us say that the ending point of the phase-out was \$250,000 a year, if I made more than \$250,000 a year, would that I am not going to be eligible for any of those provisions, so—

Mr. ROSKAM. I understand. So they all phase-out. That is your argument?

Mr. BUCHANAN. Yes.

Mr. ROSKAM. Okay. Wouldn't it be better if there weren't any phase-out, though?

Mr. BUCHANAN. No, I do not agree with that. I think that the importance of—

Mr. ROSKAM. Well, it is less complex. What you are accepting is a level of complexity, and you are making the argument that it is better to endure the complexity, because of some other greater good. You are not arguing that it is less complex, though.

Mr. BUCHANAN. Actually, what I am saying is that the phase-out complexity is so minuscule as to not be an important part of the simplicity debate.

Mr. ROSKAM. Okay. Thank you. Can I just ask the other three panelists to take a step back and look at a bigger picture?

And I think it is interesting. There is nobody on the panel, there is nobody on this side of the microphones that is arguing for the status quo, right? There is no constituency that says, "Wow, is our Tax Code fabulous." Nobody is saying that.

Take a step back, the other three, and give us some top lines on fundamental goals, or jurisdictions around the world that have attributes that you think are worth admiring and replicating and trying to draw from. That is commonly called a softball.

[Laughter.]

Ms. NELLEN. Congressman, that is a good question. I think it is worth taking a look at.

One comparison point would just be how many provisions are in the particular income tax, as far as deductions, credits, exclusions. Do they all need to be there? I would venture to say that our system probably has far more than most would.

Also, we have a situation where, as we noted in testimony, so far as education incentives, there is 14 different ones there. So when one is added, often we are not removing another one, we are just saying, "Here is one more way you might be able to qualify for something."

I think it might be that—I don't know if other countries do this, but I would guess they might think, "Well, if we are going to add one, maybe we should be thinking that that is replacing another one."

But I would say certainly be looking at just what is feasible, so far as understanding and explaining to individuals.

Also, just one comment. So far as complexity, we should think of it not only in compliance, but also in tax planning is there complexity there. And certainly phase-outs do cause complexity in both those categories.

Mr. JOHANNESSEN. Congressman, this is more my opinion than the position of the Financial Planning Association, but as I think about the underground economy that exists in our country, and recognizing that a consumptive—or consumption tax is somewhat regressive and maybe not popular, I do believe that some level of consumption tax, in order to gain access to those monies that are kind of living in that underground economy that certainly are not even a part of any of these discussions that we are having today and being filed on a tax return, is perhaps a way to—or would be an important part or element of the discussions.

Chairman CAMP. All right. Thank you. Time has expired. Ms. Black is recognized.

Mrs. BLACK. Thank you, Mr. Chairman. And my question goes to the fact that there have been some members on this committee that have asserted that the Tax Code is not complicated for those that they say are just average working middle class Americans. And one colleague even pulled the code out to try to show his point that the Tax Code is really there for those who have a larger income or maybe even a business where they are making a larger income.

And I wanted to go to you, Ms. Nellen, because I noted in your testimony you did talk about the complexity, and how difficult it might be for just an average working American. And I want to make that point, as I was sitting here thinking about one of the average working Americans in my district. That may be a family of five with three kids, combined salary of \$75,000 a year. We have child care tax credits, we may have one of them that is getting ready to go to school, so we want to know about the education credit. We might also be saving a little bit, and we have to make sure that we are applying that properly to whatever our tax liabilities are. Perhaps a savings plan for retirement might be a part of that.

I am going to give one case that just happened to me—and this is a real-life situation. I was in my district, in a rural part of my district, and I went to a restaurant, a very small restaurant, and just going around, shaking hands, saying hello to folks, saying, “How are things going? Can you tell me what’s happening in your life? How is it?”

And one young gentleman who was, I would say, maybe his early thirties, says, “You know, I just got a promotion in my job,” and I said, “That’s great.” And he goes, “Well, you know, it would be great, except that now I am in another tax bracket. I am working harder, and I am bringing home very little more than what I was bringing home before.”

And so, Ms. Nellen, can you help me? Is, what I am saying to you, actuality, where people who are just average, everyday working people are having difficulty in understanding how to make out their forms and what their tax liabilities are?

Ms. NELLEN. Yes. Congresswoman Black, I agree. I think the complexity is well beyond those who are high-income and can afford people to help explain it. That doesn’t mean it should be toler-

ated, just because they can afford to take care of it, but a lot of the complexity is in the provisions which—many of which are designed for low-income. For example, there is a saver's credit which is designed for low-income individuals. It is fairly complicated to get through, so far as what you need to do to obtain it.

The earned income tax credit certainly is only designed for low-income wage earners. So far as the provisions regarding education, retirement plans, other saving vehicle that could be there, different ways that they might—you know, whether it is funding medical insurance, whatever it might be, I think does raise a significant amount of complexity that is hitting people who are making certainly under, you know, \$80,000.

And I think another part of the complexity is that, again, if they are going to use software, or they are going to someone who is just going to prepare their return without asking, "Well, gee, you know, are you saving for college," those questions are not always getting asked if they are just having their return done for, you know, some low, low fee. They would really need more than that, or they wade through, you know, pages and pages of IRS documents.

So, I appreciate your raising that. The complexity is, I think, very heavy for middle and low-income tax—

Mrs. BLACK. Thank you. And I know my time is brief here, and I want to just jump up to the next category of someone I actually was visiting with this past week before I got on the plane to come here. He owns a business, and it is not a huge business, but he does make an income of \$250,000 a year, he told me. He said, "But, Diane, you know what? If there are benefits out there in that code that really could help me, I can't find them. And I am paying my fair share, and I am paying what I think, you know, as hard as I am working, is a big share."

And so, there is also a complexity, from what I am hearing from my small business owners who make that income of about \$250,000, saying, "There may be tax breaks in all of these books that are here, but frankly, I don't know, and the people I am paying are not really able to find me these significant breaks, where what we are hearing in the media is that I am somebody who is really getting these big, huge breaks, and I am not paying anything."

And then the last thing that I do want to ask each of you, define for me—I keep hearing this over and over again—"wealthy," that the wealthy should pay more. Can you give me a definition of what you would consider wealthy?

And, Mr. Buchanan, I would like to start with you.

Mr. BUCHANAN. Obviously, there is no clean-cut cut-off to define the word "wealth." A person can be relatively wealthy or relatively not wealthy. But, frankly, I think that when you reach the point that you—

Chairman CAMP. If you could just quickly answer. Is there a dollar figure?

Mrs. BLACK. Yes, what is "wealthy?" Give me a number.

Chairman CAMP. Because time has expired, and we want to get through the four answers, and then we will move on.

Mrs. BLACK. Please.

Mr. BUCHANAN. I think the \$250,000 a year cut-off is sensible.

Mrs. BLACK. Is wealthy. Okay.

Chairman CAMP. All right.

Mrs. BLACK. Mr. Johannessen.

Mr. JOHANNESSEN. I think a similar number, \$250,000, is probably reasonable.

Mrs. BLACK. Okay.

Ms. NELLEN. It sounds fine.

Mr. VIARD. And I don't think there is any single answer. I think, obviously, somebody who makes \$250,000 is wealthier than somebody who makes \$100,000, who is wealthier than somebody who makes \$50,000.

Mrs. BLACK. But when we talk about the millionaires who are getting the breaks, we, I think, confuse wealthy with those that we see on television, like the GE's. So, thank you.

Chairman CAMP. None of you characterized how that income was earned, which I thought was interesting. So, Mr. Schock, it is your time.

Mr. SCHOCK. Yes, I was just going to say, first of all, thank you all for being here. Most of the good questions I was going to ask have been asked, I think, three times already.

But since Ms. Black asked such a great question, and I was actually quite taken aback by your answers, I guess my question is this. Assuming you all recognize that the lion's share of small businesses file as either sub-chapter S or limited partnerships, and pay that as personal income tax, isn't it dangerous to assume that somebody who makes "more than \$250,000" is "rich," and that hiking a tax on filers of over \$250,000 would put an undue burden on precisely those small businesses who have created 7 out of the 10 jobs in the last 2 years?

Mr. JOHANNESSEN. I would generally agree with that, but there are opportunities within small business to help defer some of those—the tax liability if the business owner decides to take the stance and help his or her employees set up a savings program for their retirement.

So, though I generally agree with you that it could be a risk, there are also ways for them—and I would love to have the opportunity to talk to Ms. Black about her constituents who have that question. But there are opportunities for them to ultimately reduce the income for that business owner.

Mr. SCHOCK. You mean if they give it to their employees?

Mr. JOHANNESSEN. To themselves and to their employees.

Mr. SCHOCK. Well, let me ask a different question. Is anybody up here advocating increasing the corporate tax, the current rate for corporations?

Ms. NELLEN. No.

Mr. SCHOCK. No one. Okay. So, I guess I am a little dumbfounded that we would actually suggest increasing the tax on filers of over \$250,000 if the lion's share of those filers are actually small business owners.

And if we don't think it is a smart thing to increase the tax on corporations, why is it a good thing to increase the tax, or a justifiable increase in tax, on the largest share of small business owners in America? Why is it okay for GE and for IBM not to pay a higher tax, but it is not okay for the local grocery store or the car dealer?

Mr. VIARD. Well, Congressman, I definitely share your concern about how an increase in the—at these high income levels would affect the owners of pass-through firms. Of course, some of those pass-through firms are small, some of them are large. But all of them are certainly part of the investment that takes place in the economy that sustains employment opportunities and wages.

I do think that should be separated from the question of whether someone who makes \$250,000 is rich. I think someone who makes that income level is rich, and that is true, whether they own a pass-through business or not. But the fact that they are rich does not necessarily mean that we should increase the marginal tax rate that applies to them. You know, at a minimum, we need to be aware of the impediment that that creates, in terms of incentives to invest in pass-through firms.

Mr. SCHOCK. Anyone else?

Mr. BUCHANAN. Mr. Schock, I think it is important to remember two things about this.

First of all, \$250,000 a year for the owner of a small business is not their revenue, it is their income. So we are not talking about somebody who takes in \$250,000 and then has to pay it out to employees' salaries, and that kind of thing. We are saying, net of all their business expenses, what is their income? At the end of the year, after you add up what you have made from the firm, it is \$250,000.

Second of all, if you raise the rate——

Mr. SCHOCK. But let me just understand you. That is the money they then use to reinvest in their business.

Mr. BUCHANAN. Right. But what——

Mr. SCHOCK. And the corporations that I did not hear you saying you were advocating higher taxes on—I am assuming we don't want to raise taxes on them because to take money away from a corporation's pot of money with which they reinvest. So why is it okay to take more money away from a small business owner, but not a big business owner?

Mr. BUCHANAN. Well, in part, because C corporations have the two-part tax that we talked about before. So you are not actually comparing the same things.

Mr. SCHOCK. They are not both the same pot of money that is used to reinvest in the entity?

Mr. BUCHANAN. No, the point is that, for a C corporation, they pay the corporate income tax, and then they can——

Mr. SCHOCK. No, I understand. I understand. Okay.

Mr. BUCHANAN. Okay.

Mr. SCHOCK. Finally—I am almost out of time—I am interested in the lowest wage earners in America. Mr. Viard, maybe perhaps you could address this.

I have got a lot of poor folks in my home town. And when I talk to them a lot about the incentives to go out and work, get a higher-paying job, some families who are trying to get two jobs, for example, the way I understand it now is there are some disincentives for folks in the lower end of the income scale when they hit a certain threshold. Could you maybe speak to that——

Chairman CAMP. Just a quick answer and then we will move on, because time has expired.

Mr. VIARD. Yes, there are very high marginal tax rates applicable to some of these households, because they lose a number of tax-related benefits and also, in some cases, benefits from spending programs.

Chairman CAMP. All right. Thank you. Ms. Jenkins is recognized.

Ms. JENKINS. Thank you, Mr. Chair. Thank you for having this hearing. And thank you, each, for your contribution today.

Much of the focus in the headlines and inside Washington has been focused on tax reform to make our corporations more competitive, internationally. However, we should also focus on helping American families prosper. Could each of you just briefly discuss first of all, how the Tax Code impacts or distorts the daily decisions that families make, and, secondly, how simplifying the individual Tax Code could help individuals and families be more successful and help them make rational choices and remove some of the economic distortions which hamstrings their financial security?

We will start with the heavy hitter.

Mr. VIARD. Okay. The—I mean I think there is a number of impacts that the tax system has on people. There is the almost unavoidable work disincentive, of course.

But the provisions that we have been discussing today I think have more far-reaching and adverse effects, because it means that when households are engaging in decisions like trying to prepare for—to send their kids to college, or in trying to save for retirement, that they are just forced to deal with an additional layer of complexity that does not need to be there, that they really have to think about the Tax Code, front and center, if they want to make, you know, the best decisions that they can for themselves concerning how to go about, you know, what ought to be much simpler activities.

Ms. JENKINS. Thank you. Ms. Nellen?

Ms. NELLEN. Thank you, Congresswoman. The—I think clarity would actually help. For example, if there is a desire in the tax law to encourage people to save for their retirement, perhaps there should be, you know, one particular way of doing that, so it is very clear, “Oh, if I put this \$1,000 into this account, I am going to have it just earn interest tax free, or perhaps I am going to get a deduction for some portion of that.”

I think today they are looking at, “I would like to save for retirement. I am not sure if I am going to have positive or negative tax implications of doing it particular ways.” So I think just the added clarity would be a big benefit to, actually, all taxpayers.

Ms. JENKINS. Okay.

Mr. JOHANNESSEN. Congresswoman, I would like to see a day some day when that more than two or three percent of the public actually think about this stuff on a daily basis. I would like to get there. And this being financial literacy month, would love to help educate folks and create incentives for them to actually think about this and do their planning.

But, unfortunately that is not the way it is today. Folks think about this stuff on or about April 15th, and then quickly forget about it after they have either stroked the check or are now in some kind of payment mode.

So, I would hope that we can get to a point where we do that, but it is—we are not there yet.

Mr. BUCHANAN. In addition to what Ms. Nellen mentioned, in terms of planning for retirement, planning for health care spending, planning for a college education, I think that perhaps one of the greatest effects on what we would call everyday Americans is this sense that they do not really know what is going on.

An earlier comment indicated that people thought, "There are provisions out there that I could be benefitting from, but darn it, I cannot find them." And I think one of the costs of complexity is a sort of "morale cost," an important burden on the citizens of this country. Essentially, the more pages that are there in the Code, and the less time I have to read them, the more I have a sense that I am somehow getting left behind.

Ms. JENKINS. Okay. Thank you all. I yield back.

Chairman CAMP. Thank you. Dr. Price is recognized.

Mr. PRICE. Thank you, Mr. Chairman. I appreciate you sticking around. I want to thank the panel.

And I want to try to touch on one item that has been talked about, which is this notion that if you decrease tax rates, you do not increase revenue. The three cases that are cited most frequently are President Kennedy's tax reductions, President Reagan's tax reductions, and President Bush 43's tax reductions.

Do any of you disagree that the reductions were followed by an increase in revenue to the Federal Government for each of those three Administrations?

Mr. VIARD. Well, I don't believe, Congressman, that they caused revenues—

Mr. PRICE. That is not the question, because it is a very complex situation.

The question is, the tax reductions occurred. Did the Federal Government see an increase in revenue? Anybody disagree with that?

[No response.]

Mr. PRICE. Great.

Mr. VIARD. If I can clarify, Congressman, you mean the revenue was higher—

Mr. PRICE. Higher after the tax reductions than before.

Mr. VIARD [continuing]. Some subsequent—in nominal terms, I think—

Mr. PRICE. Yes.

Mr. VIARD [continuing]. That certainly was true, sure.

Mr. PRICE. Okay. And then we can argue about—or we can discuss—why, indeed, that occurred. But there was an increase in revenue to the Federal Government following tax reductions by each of those Administrations: Kennedy, and Reagan, and Bush.

We are talking about the burden of the taxes. I have not heard anybody talk about the progressive nature of our tax system. The top 1 percent pay about 40 percent of the taxes—of income earners, the top 10 percent about 70 percent, the top 50 percent about 97 percent of the taxes. Is—do any of you believe that that progressive nature is harmful in any way to our economic system, or to our society?

Mr. VIARD. There is always a trade-off, Congressman, between the degree of progressivity and the impact on incentives. As the tax system becomes more progressive, it features higher marginal rates for those who are at the high end of the spectrum. And that does create disincentives for work. Under an income tax system, as opposed to a consumption tax system, it also creates disincentives for saving and investment, which is a very critical distortion.

And as you have said, Congressman, the individual income tax today is quite progressive. I should note that the numbers you give are the for the individual income tax——

Mr. PRICE. Yes.

Mr. VIARD [continuing]. Not for the tax system, as a whole.

Mr. PRICE. Right.

Mr. VIARD. And the overall tax system is somewhat less progressive than the individual income tax in isolation.

But I think that there are a lot of misconceptions. People think that the high-income groups are not paying taxes. And obviously, we can debate. Should they pay more? Should they pay less? But we need to face the reality that they are paying substantial taxes now, they are facing significant marginal tax rates. There are disincentive effects.

And we also need to realize, I think, that as we try to close our fiscal gap, that increasing taxes only for the top two or three percent will not close that gap.

Mr. PRICE. Yes.

Mr. VIARD. Obviously, if we are willing to accept the disincentive effects, that could be part of the response that we adopt.

Mr. PRICE. Thank you.

Mr. VIARD. But certainly not the whole thing.

Mr. PRICE. Does anybody on the panel disagree with the statement that Mr. Viard made, and that is that if you increase the tax rates there is a disincentive to saving, and a disincentive to investment?

Mr. BUCHANAN. I don't disagree categorically, but I think that the evidence on the degree of response is ambiguous, at best. And the best evidence indicates that the responses are quite small.

Mr. PRICE. I think that is debatable. We have been talking a lot about the burden regarding the income tax system for individuals and for families.

I am of the belief that our tax system currently punishes all the things that we say that we want. We want hard work, we want success, we want entrepreneurship, we want risk-taking, we want savings. All of those things that we say that we want, yes, we punish them with our current tax system.

Wouldn't it be simpler and a less burden to society if we did away with the income tax system, and went to a consumption tax system? Wouldn't that be much simpler and a lesser burden—understanding that you take into account those at the lower end of the economic spectrum with the prebate and the like?

Mr. VIARD. Well, Congressman, I believe that consumption taxation is superior to income taxation. I would like to see the income tax system, both individual and corporate, completely replaced by a progressive consumption tax. It would eliminate the disincentives for saving and investment. The work disincentive, of course, would

still exist, but the disincentives for saving and investment would be eliminated. And a significant degree of the complexity of the current tax system could also be removed.

It would not be, you know, a panacea to create a completely simple system, but there are a number of complexities relating to income measurement and to depreciation and such not that would simply be swept away in their entirety by using consumption as the tax base.

Mr. PRICE. Anybody else want to weigh in on the consumption tax? Ms. Nellen?

Ms. NELLEN. I think a former question regarding what do other countries do, I think countries tend to have both an income tax and a consumption tax, in the form of a VAT.

The focus of this hearing being on simplification, I do want to just point out that any tax could be complicated. And I think on a consumption tax, when you talk about, "Well, gee, we are going to exempt this, this, and this," then you get to defining those exemptions, you have got a fairly complex provision.

Or, if you want to say, "We want to encourage people to buy this, so we are going to have a lower rate on that particular item," so any tax could be complicated. I wouldn't—

Mr. PRICE. My time is running—but I do want to say for the record that an income tax and a consumption tax is the worst of both worlds, which I strongly oppose. Thank you.

Chairman CAMP. All right, thank you. Time has expired.

I want to thank all four witnesses for your testimony and for your willingness to answer questions today, and helping inform the committee. This hearing is now adjourned.

[Whereupon, at 12:21 p.m., the committee was adjourned.]

QUESTIONS FOR THE RECORD

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Congress of the United States
House of Representatives

April 19, 2011

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON HEALTH
COMMITTEE ON THE BUDGET

Neil Buchannan,
Professor George Washington University School of Law
Democratic Witness

Re: Committee on Ways and Means; The Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform

Dear Mr. Buchannan:

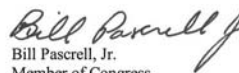
In doing background research for this hearing, I kept asking myself, "what are every day families in my district saving for in life?" The answer that I kept coming back to was "education."

As I delved into the way the IRC assisted families with educational savings, I found that there are a significant number of accounts available. Each account had its own contribution limits, income caps and qualifying expenses. There are: 529, Coverdale, individual deduction for higher Educational, exclusion for employer provided education benefits, the American Opportunity tax credit and a life time learning credit.

The families using these accounts, by definition, have many important obligations in their lives. And to me, it seems that the current system is overly complicated and overlapping, and therefore limits the accessibility of these accounts to individuals they are supposed to help.

So as we move forward with discussions about tax reform, in your opinion, would it not be better to consolidate all of these benefits into one simple tax incentive? How do you think these accounts should look like? And finally, how could they be constructed to make sure whatever account, or accounts, that are created, are accessible to middle income America?

Thank you for your response.


Bill Pascrell, Jr.
Member of Congress





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August 19, 2011

Bill Pascrell, Jr.
Member of Congress
Washington, D.C.

Re: Committee on Ways and Means; The Tax Code's Burdens on Individuals
and Families Demonstrate the Need for Comprehensive Tax Reform

Dear Mr. Pascrell:

I write this letter in response to your Question for the Record, which you posed in a letter dated April 19, 2011.

I share your conviction that the core concern of American families as they save for the future is the education of their children. Other concerns, such as a secure retirement and access to medical care, are also matters of increasing uncertainty for all but the wealthiest Americans, as you well know. Still, there is nothing more important for our country and for future generations than to guarantee that all young Americans have fair access to a sound, high quality education.

If we fail to provide such an education to all Americans, all of our other problems will only become more difficult to solve. The emergence of the United States as a great power in the 20th Century was driven in large part by our commitment to universal pre-college education, and by our development of an unrivaled system of higher education. Even before the onset of our current economic difficulties, we have failed to maintain the system that our parents and grandparents bequeathed to us. If we continue on this path, we will surely see America fade as an economic power. Fortunately, there is still time to avoid that fate.

In your letter, you point out the current Internal Revenue Code includes a number of programs that past Congresses have created to, at least, stem the tide of reduced expenditures on education. These programs reflect the shift in the responsibility of providing education from society as a whole – even though we all gain when Americans are better educated – onto the people who make individual decisions about whether to advance their educations.

It is important to remember that we could still reverse course, shifting the responsibility

for funding education back to the states and the federal government and restoring the funding necessary to allow our schools, colleges, and universities to provide education at affordable prices to all. The tax programs that currently exist are a distant second-best, compared to a system in which the federal government assists the states in making the investments necessary to return our educational system to greatness. Still, in the current political environment, half a loaf is better than none. If it is currently not possible to expand direct funding for public education (at the primary, secondary, or post-secondary levels), then the least the government can do is to assist people through the tax code.

Your letter notes that the current set of tax incentives available to fund education is “overly complicated and overlapping.” I completely agree. It is, therefore, a good idea to discuss ways to combine and simplify those programs. I would recommend revamping our approach to providing education incentives by combining all of the current provisions into one simple program. Although no current program is perfect, a starting point would be the so-called 529 Plans, which allow tax-free distributions from savings accounts to pay for qualified tuition and other education-related expenses.

Your letter also asks how to make these accounts accessible to middle-income Americans. This problem bedevils all savings-related accounts, as middle-income Americans are finding it ever more difficult to set aside any money at all for savings. Household budgets are simply so tight that many people cannot find the money to put into even the most generous tax-favored savings accounts. The strain on household budgets is, moreover, only becoming more intense as the economy continues to struggle.

This suggests that even expanded 529-like plans would need to include an income-based formula to supplement any saving that a household is able to set aside. For example, if a middle-income household were able to set aside \$1000 in a year for higher education – which is not an easy target to reach, for many Americans – the government could match that contribution, either dollar-for-dollar, or on a sliding scale. Lower-income savers could receive higher matching contributions, which could be phased out as incomes rise.

I have been working on some ideas to create this kind of tax-based education incentive program, and I have been in contact with your staff to discuss some of these issues. I would be happy to work with you and your staff to develop legislation that would meet the goals that we both share. For the purposes of this letter, however, I will simply emphasize that it is important to develop a simplified program that is responsive to differences in people’s incomes, to allow the resulting program to be both cost-effective and to help those who most need help.

To summarize my views on your central question, I would say that our legislative priorities should be as follows: (1) Expand direct funding to public education at all levels, (2) If we cannot make education affordable again through direct funding, then we should use the tax code to reduce the net cost of education, and (3) If we are going to use the tax code to reduce education costs, we must supplement middle-income families’ education savings with matching funds from the government.

There is, however, a further problem hiding behind the issues that I have discussed above. One surprising development in American education is the increasing cost of public K-12 education. While most Americans think of public schools as “free” (that is, carrying no specific costs beyond the taxes that people pay each year to support their schools), the fact is that public education has become an increasingly fee-based enterprise.

A May 25, 2011 article in *The Wall Street Journal* (“Public Schools Charge Kids for Basics, Frills”) describes the array of fees that have become part of the landscape of American primary and secondary public education. As the article points out, even though teachers’ salaries have failed to keep up with inflation, school districts across the country are facing increasing costs and decreasing support from taxes and state funding. The new fees can add up to thousands of dollars per family. Notably, while some of the fees are charged for arguably “non-essential” educational services, such as extracurricular activities (although I urge you to reject the view that such activities are not an essential part of educating our children), many school districts are now charging fees simply for students even to enroll in school, and for such basics as copier paper, and even imposing “graduation fees.”

The emergence of these expenses for pre-college education, of course, makes it that much harder for middle-income families to save to send their children to college. No matter what we do to 529 plans, or any other aspect of our current set of programs to help people pay for higher education, the increased costs of public pre-college education are reducing people’s ability to pay for college.

This suggests that Congress’s highest priority should be to support parents whose children are not yet in college. Doing so will not only help families today, but it will increase the likelihood that they will be able to afford college later. We should, therefore, consider expanding flexible savings accounts, to allow parents to use tax-free funds to pay for these education expenses that have been increasingly shifted onto parents. Again, the first-best choice would be to give direct support to states and school districts, making it unnecessary for schools to resort to these harmful fees. If we cannot directly increase funding for education, however, we can at least allow parents to use pre-tax dollars to pay for their children’s pre-college expenses. (Also, I would urge you to think seriously about a structure to subsidize these costs for people of more modest means. Without a subsidy, even an FSA-style approach only reduces the net costs for a middle-income family by 25 percent.)

If you have any further questions, please do not hesitate to contact me.

Sincerely,



Professor Neil H. Buchanan

SUBMISSIONS FOR THE RECORD

Hearing on How the Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform

Submitted by Jay Wiedwald, Volunteer Tax Preparer – April 20, 2011

I am writing from the perspective of a tax preparer who has volunteered the last ten years for the AARP's Tax-Aide program. The clients I serve are primarily lower-income, often minority or immigrant and cover a wide age spectrum.

The testimony presented at the April 13, 2011 hearing focused on the complexities of the tax code for those with higher incomes. But a full one-third of tax returns are filed by taxpayers whose Adjusted Gross Income is less than \$50,000. This is the community that I am familiar with, and the one that the following comments focus on.

SUMMARY:

1. Stop making tax legislation changes that force a person who otherwise wouldn't need to file a tax return to prepare and file one.
2. Eliminate credits having minimal value, either individually or to the nation as a whole.
3. Consider changes that would simplify or even eliminate the impact of filing status and dependency on tax liability/benefits
4. Consider the attitudinal effect on tax filers who "pay" negative taxes over an extended period.
5. Consider offering refunds in the form of monthly payments.

DISCUSSION:

1. Stop making tax legislation changes that force a person who otherwise wouldn't need to file a tax return to prepare and file one. Each of the last five years Congress has instituted short-term legislation that meant a person had to file a tax return in order to get a benefit. Congress's viewpoint is that the IRS is an efficient distribution channel to get funds to the public. But for those who would not otherwise file a tax return, it is extremely inefficient.

These changes impacted tens of millions of Americans who have small or no taxable income and no withholding, and thus were not required nor would normally have a reason to file. This has caused confusion and stress to many, especially seniors who had been advised many years ago that if there were no major changes in their income there was probably no reason for them to ever have to file a tax return again.

2. Eliminate credits having minimal value, either individually or to the nation as a whole.

While politically attractive, there are credits and adjustments that are relatively meaningless in terms of dollars and clutter the tax return. I would specifically target the Educator Expenses adjustment, the Retirement Savings Credit and the Credit for the Elderly, and strongly urge that no new ones that serve only to appeal to a voting bloc but have negligible tangible benefit be instituted.

As examples (all based on tax year 2008 returns):

- While the Educator Expenses adjustment was used by 3.7 million filers, the average tax benefit was under \$40
- The Retirement Savings Credit is non-refundable and since it is available only to lower-income filers it is virtually impossible for a filer to get the maximum benefit. In 2008 nearly 6 million filers claimed it, but the average benefit was only \$163.

- The Credit for the Elderly was worth an average of \$133 to a grand total of 75,000 people (0.05% of all tax filers).

3. Consider changes that would simplify or even eliminate the impact of filing status and dependency on tax liability/benefits. One of the first steps in preparing a tax return is determining filing status and dependency. The tax code originated in an era when divorce and childbearing outside of marriage were uncommon, and has evolved in response to changing times. The evolution has not been an easy one, and has led to extremely complex rules for determining the correct, or in some cases, the optimum filing status and dependency claims (and the credits that go with them). Members of low-income communities are particularly prone to complex filing status and dependency situations; and are severely impacted since these factors have a disproportionate effect on tax liability and credits at lower income levels. About five years ago a simplification of the tax code in this area helped somewhat, but once again only a major tax code overhaul will have any significant effect in alleviating this burden.

4. Consider the attitudinal effect on tax filers who “pay” negative taxes over a extended period. A former US president has been quoted as saying, “Taxes should hurt.” I wouldn’t go quite that far, but every citizen should have a sense of ownership in the US, specifically in how taxpayer money is spent. For a large segment of the population (about 20,000,000 families) this isn’t the case as tax credits result in refunds beyond any tax withheld. Perhaps something as simple as requiring that any tax that is due before refundable credits be paid to the IRS before the refundable credits are paid out. This would add to the IRS’ burden, and burden some tax filers as well, but they would have a better sense of, and pay closer attention to how government spends their money.

Further, low-income filers have few tools for tax planning, but face uncertainties similar to high-earners, and on a proportionate basis have much more at stake. Phase-in and phase-out of child-related credits create gigantic marginal tax rate variations. This leads to large and unpredictable year-to-year variations in tax refunds and ultimately as an incentive against working harder to increase earnings.

5. Consider offering refunds in the form of monthly payments. It is not uncommon for a low-income family that had no tax withheld from wages to be entitled to a tax refund equal to seven months of take-home pay! Currently, this is paid as a lump sum a few weeks after the tax return is filed. It can be quite a burden on a family to manage this large amount, and there are often neighborhood “vultures” willing to help them dispose of it. Perhaps Congress could offer monthly payments (with a sweetener of interest at an attractive rate) as an alternative. This would add a bit of burden to the IRS, but with electronic transfers the cost could be small. This would also result in families that are currently unbanked opening bank accounts, possibly leading to long-term stabilization of their finances.

Imagine the value just in terms of financial security to a family that now has two regular incomes; one from their job and another for as much as 50% additional from their tax refund.

Thank you for the opportunity to contribute to this important discussion.

Submitted on April 20, 2011 by:

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Statement for the Record
U.S. House Ways and Means Committee
“How the Tax Code’s Burdens on Individuals and Families
Demonstrate the Need for Comprehensive Tax Reform”
April 13, 2011

Chairman Camp, Ranking Democratic Member Levin, and Members of the Committee, I appreciate the opportunity to share my concerns about the death tax.

I am one of many small business owners throughout America whose heirs will likely be forced to sell the business in order to pay the estate tax. The irony is that as an entrepreneur and small business owner, I am the very person that every member of congress claims to protect. My story demonstrates how the estate tax harms small businesses and thereby weakens the American economy.

My company, Grande Harvest Wines, is a retail merchant of fine wine and spirits with stores located in New York and Connecticut. The main store of Grande Harvest Wines is located in Grand Central Station, New York City. I have also opened a restaurant in Connecticut. My "wealth" – as far as the IRS will be concerned at the time of my death – is in my building space, my inventory, (shelves upon shelves of wines and spirits, food, and cooking utensils) and in my equipment and machinery. All of the company's cash assets are reinvested in the company in order to maintain inventory.

Due to the complexity of the state alcoholic beverage laws, I maintain multiple corporate entities. This means that my already limited capital is spread throughout my business in such a way as to make it near impossible to quickly raise large amounts of cash. My sons will have no easy way to pay my estate tax liability when I die and will likely need to sell assets in order to raise cash. Doing so will very likely render the business unprofitable and force its complete sale.

I am doing everything I can to avoid the sale of my business due to estate tax liabilities. I have purchased multiple life insurance policies, but these come at the cost of expensive premiums. I would rather reinvestment that money in the business and thereby create new jobs. The truly distressing fact is that even after misallocating hundreds of thousands of dollars on life-insurance premiums, the policies may yet fail to cover my estate tax liabilities.

Except for the estate tax, I see no reason why the company will not continue to grow and expand under my sons' leadership. Three of my sons are already learning the complicated business of importing and retailing wine from around the world. In time they will take over for me, assuming we have found a way to deal with the death tax.

I find it strange that Congress has not yet addressed a tax which falls so harshly on small business owners. This tax burdens the very people who are creating jobs and sustaining our economy.

I have worked hard my entire life, paid my share in taxes, served my country in Vietnam, and generously contributed to my local community. I have created more than twenty jobs and I provide my employees with generous benefits (including health coverage). It is nothing less than an outrage that my sons may lose the family business because of the death tax - the most unfair and un-American tax ever instituted!

I urge the Members of the House Ways and Means Committee to support passage of H.R. 1259, the Death Tax Repeal Permanency Act, or other legislation to permanently abolish the federal estate tax.



Peter Nelson
President of Marc Nelson Oil Products
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Statement for the Record
U.S. House Ways and Means Committee
“How the Tax Code’s Burdens on Individuals and Families
Demonstrate the Need for Comprehensive Tax Reform”
April 13, 2011

Chairman Camp, Ranking Democratic Member Levin and Members of the Committee, I appreciate the opportunity to share my concerns about the death tax.

In 1936 at the height of the Great Depression, my grandfather, Melford M. Nelson, founded M.M. Nelson Oil Co., now known as Marc Nelson Oil Products.

As the first commissioned fuel and lubricants distributor in Oregon, Melford plunged his life and savings into the then one-man operation. Today the company, now headquartered in Salem, employs more than 30 people and serves customers throughout Oregon and Southwest Washington.

Most of our company's growth occurred after my father joined the business in 1962. My father and grandfather worked side by side, building the business the old-fashioned way: living frugally, saving money, investing profits back into the business and focusing on the needs of Oregon residents.

Instead of living the high life, they sacrificed. As it turns out, the very same hard work that made Marc Nelson Oil Products successful now places the business's future at the mercy of the Internal Revenue Service.

When my father, now in his seventies, dies the IRS will "reward" his hard work by taking 35 percent of all his personal and business assets above \$5 million. The valuation of his assets will include our company's inventory, machinery, property, and vehicles. Since the company alone is easily valued in excess of \$10 million, the estate tax liability likely will come close to \$2 million.

Like many family-owned companies in Oregon and elsewhere, Marc Nelson Oil Products is not awash in cash. In fact, we are rather cash-strapped. Coming up with an extra \$1 or \$2 million for the government - to pay a tax for the privilege of existing - won't be easy.

In fact, it might be impossible. That's why we are being forced to spend hundreds of thousands of dollars on tax planning in the hope that we can keep the business alive after my dad passes.

That's hundreds of thousands of dollars we're no longer able to reinvest in the company, to grow it and create new jobs, which is what we would rather do with the money.

If the tax planning is successful, Nelson Oil Products will stay in our family - although it will be weakened, and probably smaller, than it could have been without the estate tax. If planning is not successful, assets will have to be sold and employees laid off. Worst-case scenario: We will be forced to sell the company, jeopardizing the livelihoods of all of our employees.

As it turns out, we're not alone. Some 24 million Americans own family businesses and farms. Like us, many of these families each year spend valuable capital paying estate

taxes or paying accountants and lawyers to find ways to minimize the tax. This is money that could be better spent growing the company and creating jobs.

There is a very simple solution that would cost the government nothing and, in fact, enrich both government coffers and individual pocketbooks: repeal the estate tax.

In a report for the American Family Business Foundation, the former director of the Congressional Budget Office, Douglas Holtz-Eakin, calculated that eliminating the death tax could create as many as 1.5 million jobs - at no cost to the government. That's because the tax raises less money each year than the government loses because the tax slows business growth.

Roughly 20,000 of the 1.5 million jobs would be here in Oregon, according to the Cascade Policy Institute.

The harmful estate tax historically brings in less than 1 percent of total federal revenue. Without the tax, small businesses would grow, and federal, state and local governments would receive more revenue, rather than less. In fact, economist Stephen Entin, a former Treasury official, estimates that repealing the estate tax would increase federal tax revenues by roughly \$89 billion over the next ten years.

The Ways and Means Committee has an opportunity to reduce the burden of the tax code on family businesses by supporting legislation to permanently repeal the estate tax. On behalf of my small business, thousands like it, and the jobs we represent, I respectfully ask that you support permanent death tax repeal. Thank you for your consideration.



Eugene Sukup
Chairman
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Statement for the Record
U.S. House Ways and Means Committee
“How the Tax Code’s Burdens on Individuals and Families
Demonstrate the Need for Comprehensive Tax Reform”
April 13, 2011

Chairman Camp, Ranking Democratic Member Levin, and Members of the Committee, I appreciate the opportunity to share the following op-ed with the committee, which explains why my family business, Sukup manufacturing, is threatened by the Federal Estate Tax.



Estate tax: a sad song for family businesses

Issue Date: August 5, 2009

By Eugene Sukup

The recent deaths of Farrah Fawcett, Michael Jackson, Billy Mays and Ed McMahon have many Americans thinking about mortality. If you're a business owner of a certain age, as I am, it's something you think about daily.



Unlike television personalities and performing artists, most business owners labor in relative obscurity. Our legacy, when we pass, is what we've built and perhaps invented—in my case, agricultural equipment most Americans have never heard of—and the hundreds and perhaps thousands of people who depend on us for jobs.

We're unlike television personalities and recording artists in another important respect as well: When we die, the government may lay claim to half or more of our business. Not directly, but through tax policy.

The main asset of recording artists is their "catalogue." The main asset of television and film stars may be residual rights to their movies or shows. The government can't grab these things because they're protected by copyright law and very difficult to value, since no hard assets are involved—such as buildings and equipment—and future value depends on future demand. As Elvis Presley Enterprises has shown, stars can be worth more after they die than while they were living. Or they might not be. Who's to know what the future will bring?

If you're the founder of a business you do know what the future will bring: The government will require the valuation of your business after you die and will require your heirs—in nine months or less—to pay a stiff tax on the value of those assets. And you know, because you have seen it happen repeatedly to friends and acquaintances, that your heirs, to satisfy the taxman, may be forced to break up, sell or liquidate the business you painstakingly built.

The politicians call this the "estate tax" and tell us it's necessary for the public good. As I told the Senate Finance Committee a year-and-a-half ago, I started Sukup Manufacturing Co. in 1963 and patented my first invention more than four decades ago. Today, our company boasts more than 70 U.S. patents (for drying, handling and storing corn and other grains) and is the single largest employer in Franklin County, Iowa, a rural county 90 miles north of Des Moines. Altogether we have 350 employees [now over 500] at our manufacturing facility in Sheffield, Iowa, and at our distribution centers in Arkansas, Illinois, Missouri, Nebraska, Ohio and South Dakota.

My sons are both active in the business. But they know that when my wife, Mary, and I pass, the estate tax will be so severe—estimated at \$15 million to \$20 million at today's tax rate—the business may have to be sold.

If our employees are fortunate a U.S. investor or competitor will buy Sukup Manufacturing and leave the company alone, to continue doing what it does very well.

But we've seen recent trends. When companies like ours are sold they are typically purchased by overseas firms. The technology is exported to overseas factories where workers are paid a fraction of what our workers are paid. The U.S. facility is shut down. Workers get pink slips. Communities die.

If Sukup Manufacturing is fortunate enough to survive our deaths, the government will claim an additional 45 percent [currently 35 percent through December 31, 2012] when our sons die (more, if Congress raises the tax rate, or allows it to increase automatically to 55 percent, as it will in 2011 under current law) [the rate is now scheduled to return to 55 percent on January 1, 2013].

And when their children die it will take another bite until the business finally collapses or some future generation says, "We've had enough."

And all for nothing. According to a recent study by economist Stephen Entin for the American Family Business Foundation, of which I am a member, the economic damage the estate tax does to businesses such as ours—and to the economy as a whole—reduces total tax revenues by more than the estate tax brings in to the Treasury.

The music of Michael Jackson will live on, like Elvis' before him. But our business may not survive our deaths.

Family businesses are the backbone of the U.S. economy, producing an estimated 60 percent of gross domestic product. While bailing out everybody else, government does the opposite to our businesses: taxing us to death.

(Eugene Sukup is chairman of Sukup Manufacturing Co. in Sheffield, Iowa. Copyright McClatchy-Tribune Information Services. All rights reserved. Reprinted with permission.)

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Statement of the U.S. Chamber of Commerce

ON: THE NEED FOR COMPREHENSIVE TAX REFORM

TO: THE HOUSE COMMITTEE ON WAYS AND MEANS

DATE: APRIL 21, 2011

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

The Chamber's members are businesses of all sizes. Our membership consists of small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are cognizant of the problems and challenges facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The U.S. Chamber of Commerce thanks Chairman Camp and Ranking Member Levin for the opportunity to comment on how the burdens placed on individuals and families by the federal tax code¹ demonstrate the need for comprehensive tax reform. It is important for the Committee to consider the challenges individuals face in dealing with the tax code. In that regard, the Committee should pay particular attention to the important role flow-through businesses play in the economic health of the United States as the Committee evaluates the need for comprehensive tax reform.

THE CASE FOR COMPREHENSIVE REFORM

Some proponents of tax reform recently have suggested that corporate tax reform be undertaken before focusing on individual tax reform. This approach is problematic because it ignores the impact of corporate tax reform on businesses that operate in pass-through form and, thus, remit tax under the individual code.

According to a recent study by Ernst & Young, more than 90 percent of businesses in the United States are organized as flow-through entities.² That study also found that individual owners of flow-through entities paid 44 percent of all federal business income taxes between 2004 and 2008 and, moreover, that flow-through businesses employ 54 percent of the private sector work force in the United States.³ Thus, flow-through businesses are a critical source of job creation and innovation in the United States.

There appears to be widespread agreement in Congress that the 35 percent corporate income tax rate is too high and places U.S.-based worldwide corporations at a competitive disadvantage in the world marketplace. Advocates for corporate reform have argued for a rate reduction to as low as 20%. In order to pay for a corporate rate reduction, some have proposed eliminating or limiting business tax expenditures such as accelerated depreciation.

Lowering the corporate rate by eliminating business tax expenditures could cause economic hardship for flow-through businesses. Currently, flow-through businesses receive the benefit of the same business tax expenditures that are available to corporations. In addition, the top income tax rate for the individual owners of flow-throughs currently is the same as the top corporate rate, 35 percent. Thus, in terms of the rate and the availability of business tax expenditures, the tax code generally treats corporations and flow-through businesses the same.

If corporate reform is undertaken separately from individual reform, flow-through entities could lose the benefit of business tax expenditures without receiving the benefit of a corresponding rate reduction. The Ernst & Young study indicates that corporate tax reform that

¹ All references to the "tax code" are to the Internal Revenue Code of 1986, as amended.

² Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," April 2011, available at <http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf>.

³ Id.

lowers the corporate rate and eliminates business tax expenditures would increase the income taxes paid by individual owners of flow-through businesses, on average, by 8 percent or \$27 billion annually from 2010 through 2014.⁴

Thus, corporate tax reform could have a significant detrimental impact to flow through businesses which in turn could have a negative impact on jobs and the overall economy. For these reasons, the Chamber prefers that Congress pass comprehensive tax reform legislation that addresses both the corporate and individual tax code.

CONCLUSION

The Chamber thanks the Committee for the opportunity to comment on how the tax code's burdens on individuals and families demonstrate the need for comprehensive reform. As the Committee considers tax reform, the importance of, and challenges facing, the individual owners of pass-through entities must be given the utmost consideration to ensure tax reform allows these businesses to grow, compete and innovate. We look forward to working with the Committee on this vital issue.

⁴ Id.