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November 1, 2005

Tax Reform Panel Releases Recommendations

Earlier this year, President Bush appointed members to the President's Advisory Panel on Federal Tax Reform, which he tasked with analyzing the current tax system and making recommendations for reform in a revenue neutral manner. The panel presented its recommendations to Treasury Secretary Snow today.

The panel issued two alternative recommendations: a Simplified Income Tax Plan and a Growth and Investment Tax Plan. Each of the recommendations would, among other things, simplify the individual income tax rate structure, eliminate the home mortgage interest deduction and turn it into a limited tax credit, and eliminate the state and local tax deduction. Notably, each recommendation also includes re-packaged versions of the Employer Retirement Savings Account (ERSA), Retirement Savings Account (RSA), and Lifetime Savings Account (LSA) proposals contained in previous Bush Administration budget proposals. The tax treatment of contributions and distributions to the new accounts apparently would vary depending upon whether the Simplified Income Tax Plan or Growth and Investment Tax Plan were adopted. In general, contributions would be pre-tax and distributions taxable under the Simplified Income Tax Plan, whereas contributions would be after-tax and distributions tax-free (i.e., “Roth” treatment) under the Growth and Investment Tax Plan. The recommendations also include certain other fundamental changes to the tax treatment of employer-provided retirement and health plans.

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More specifically, the recommendations include the following proposals:

- "Save At Work Accounts" would be created to replace 401(k)s, 403(b)s, 457(b)s, SIMPLEs, and SARSEPs, with simpler nondiscrimination rules and rules intended to facilitate "auto enrollment".
- "Save For Retirement Accounts" would be created to replace IRAs and Roth IRAs, with no income limitations and permitting annual contributions of up to $10,000.
- "Save For Family Accounts" would be created to replace all other types of tax-favored savings accounts (e.g., HSAs, FSAs, section 529 education accounts), with annual contributions of up to $10,000.
- The savers' tax credit would be made permanent and refundable, and would be applicable to 25 percent of contributions up to $2,000.
- The exclusion for employer-provided health insurance would be capped at $11,500 for families and $5,000 for singles, with both amounts indexed for inflation. Employees who purchase their own health insurance would be able to use pre-tax dollars up to the exclusion amount.
- Most tax-free fringe benefits (e.g., for child care, life insurance premiums and education costs) would become taxable; however, in-kind benefits (e.g., meals at a company cafeteria) would remain tax-free if provided to all employees.

After the Panel makes its recommendations to Treasury Secretary Snow, the Treasury Department is to make recommendations to the White House which, if accepted, would be part of the Administration's budget proposal that is released in February. There are a number of politically unpopular issues in the panel's recommendations, and it is unclear what parts the Administration will adopt. However, it is clear that the Administration's budget proposal will have to address problems with the alternative minimum tax (AMT), so there will have to be some restructuring of the current tax system in order to address the looming AMT problem yet still address the concerns of mounting budget deficits.