The Independent Community Bankers of America

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President and CEO

Second Submission to the President's Advisory Panel on Federal Tax Reform

April 26, 2005

Submitter Category:
Organizations and Associations

The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. Founded in 1930, ICBA is celebrating its 75th anniversary year. For more information, visit ICBA's website at www.icba.org.

April 26, 2005

The Honorable Connie Mack, Chairman
The Honorable John Breaux, Vice Chairman
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue, N.W.
Suite 2100
Washington, DC 20220

RE: Request for Comments No. 2

Dear Senators Mack and Breaux:

On behalf of the 5,000 members of the Independent Community Bankers of America, I am pleased to submit comments to the President's Advisory Panel on Federal Tax Reform (the "Panel"). The ICBA commends President Bush and the Panel members for undertaking this important and complex project to examine thoroughly our current tax code and to recommend ways to create a more simple and equitable tax system.

The Panel's second request for comments concerns the specific proposals to reform the tax code. The ICBA would like to highlight the principles we support for a model tax system and recommended reform options to help improve our current tax system. The ICBA has also conducted a comprehensive study on tax relief and simplification options with Grant Thornton, LLP and has made available copies of this report to Panel members.[1]

Independent Community Bankers of America

<u>Principles of a Model Tax System</u>

- **The tax system should be simple. Complexity makes the system expensive, punitive, and results in an efficiency loss to the economy.**

- **All taxpayers must be fully informed on exactly what is being taxed, how they are being taxed, and what their true tax liability is. Taxes should be as visible to the taxpayer as possible.**

- **A low tax rate across a broad tax base creates the least distortions in the economy. High marginal tax rates damage economic growth by reducing the incentives to work, save and invest.**

- **The tax system should provide the same tax treatment for similar economic actions and transactions rather than taxation based on the attributes of the taxpayer.**

[1] "Community Bank Tax Relief and Simplification Options." A study prepared for the Independent Community Bankers of America by Grant Thornton LLP, 2003. www.icba.org

- **Multiple layers of taxation on the same income or transaction should be avoided.**

- **Changes in the tax law intended to raise revenues should not be retroactive. All taxpayers must have confidence in the law as it exists when planning and entered into transactions.**

- **The U.S. tax code must be competitive with other industrialized nations.**

The ICBA believes following such tax system principles in assessing recommending tax reforms will help foster a more equitable, and simple tax code.

The ICBA also recommends that any new tax structure works to increase much-needed private savings and investment. There is a genuine concern that Americans are simply not saving enough for retirement or many other important financial needs such as health care or education. A new tax structure can help address this dilemma by removing many of savings disincentives inherent in the current Code.

Importantly, savings is the fuel needed for investment that allows our communities and Nation to grow, create jobs, and compete successfully in the global marketplace. The low personal savings rate in the U.S. is detrimental to the long-term strength of our communities and our Nation. The current tax code discourages or punishes savings and investment with double or even triple taxation. While the Code offers some taxadvantaged savings accounts, they are often too limited, restrictive, complex, and confusing -- which only works to discourage much-needed savings.

A superior tax system would promote savings not punish it. ICBA advocated recently adopted changes in tax laws to promote greater savings including allowing contribution amounts for IRAs to increase from $3,000 to $5,000 by 2008; and 401(k) plan contributions to expand from $10,500 to $15,000 by 2006. While this was a positive tax policy step to encourage savings, much more must be done. These recent increased savings incentives are set to expire and should be made permanent and indexed for inflation.

We encourage the Panel to consider the ICBA-backed savings accounts that have been advanced by the Administration in the FY 2006 federal budget. Specifically, the proposed Retirement Savings Account (RSA) and Lifetime Savings Account (LSA) would go a long way in removing the tax complexities and restrictions on current savings accounts. These new simplified savings options would allow many more Americans to save up to $5,000 after-tax per year in *both* accounts and remove counterproductive restrictions now seen on savings accounts. Earnings and qualified distributions would be tax-free and the accounts would be available to *all* individuals with no income or age limit restrictions. ICBA will work to have such accounts passed into law.

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Tax Reform Should Mitigate Punitive Double Taxation

Multiple layers of tax on the same income impairs saving and causes tremendous administrative and compliance costs and complexities in the tax system. Double taxation of savings and investment distorts the choice to save income in favor of spending. The current tax system more-heavily taxes savings verses consumption -- discouraging needed savings and investment. Most often income is hit with double taxation when it is received as interest, dividends or capital gains.

The ICBA strongly encourages the Panel to adopt tax policies that would reduce the tax burden on interest, dividends and capital gains. The associated reporting and tax filing complexities and costs can also be greatly reduced by eliminating or reducing the tax levy on interest, dividends and capital gains. Individuals and businesses currently have to keep track of millions of 1099 forms needed to document even de minimus amounts of interest or dividends paid and received. Lost or inconsistent 1099 forms often trigger IRS audits. ICBA supports tax policy changes that would exclude a portion of both interest and dividend income from federal income taxation and efforts to work toward the full elimination of the tax on individual dividends and savings. Reducing the punitive double-taxation on interest and dividends can free up needed capital to ensure our economy remains on a sustained growth path and would greatly simplify tax filing.

Tax Reform Should Address Punitive Estate Tax

The estate tax represents a double or even triple layer of tax on savings and investment. The uncertainty in existing estate tax laws makes proper tax planning nearly impossible since the estate tax is eliminated by 2010 but would be fully reinstated in 2011. The steep estate tax rates can force a family to liquidate and sell their small business or farm just to pay the tax collector -- rather than being able to pass those assets on to the next generation -- often wiping out a lifetime of hard work. Permanent estate tax relief is important to the ongoing viability of our nation's small businesses. ICBA supports making permanent the repeal of the estate tax now scheduled for 2010 and sharply increasing the fair market value allowance at date-of-death to dramatically simplify the tax treatment of family assets.

Tax Fairness and Parity with Tax-Exempt Credit Unions

Ways and Means Committee Chairman William Thomas (R-CA) recently launched a series of special hearing to re-assess the tax-exempt sectors. The hearings are meant to review whether those benefiting from a special tax subsidy are living up to their legal responsibilities and tax-exempt mission and purpose. The ICBA requests the Panel examine the tax system inequities posed by the $655 billion tax-exempt credit union industry. The top federal income tax rate applied to C corporation community bank income and S corporation community bank income allocated to shareholders is 35%. Additionally, income generated by C corporation community banks is subject to double taxation when distributed in the form of dividends or capital gains, creating a combined tax burden exceeding 57%. In sharp contrast, tax-exempt credit unions pay no federal income tax yet compete directly with taxpaying community banks. The dramatic tax burden differential between taxpaying commercial banks and tax-exempt credit unions places community banks at a severe competitive disadvantage and highlights a specific example of where the tax code is extremely unfair. A fair and unbiased tax system would apply the same tax treatment to similar industries and economic actions and transactions.

Recent studies have concluded that credit unions have used their tax subsidized status to greatly expand in size and scope and jeopardize the ongoing viability of taxpaying community banks serving the same customer base. A new 2005 credit union study by the nonpartisan Tax Foundation estimated that the credit union tax subsidy will cost $31 billion in lost Federal revenue to the U.S. Treasury over the next decade.[2] This study noted how large, multi-group and geographic-based credit unions have far exceeded their original tax-exempt statutory mission and unfairly use their tax-free status to compete with taxpaying community banks.

Community banks play a vital role in the U.S. economy as a critical source of lending for individuals, small businesses and farms across Main Street America. The ICBA respectfully requests the Panel to promote tax reforms that would help make the tax code more equitable as it is applied to tax-exempt credit unions and taxpaying community banks.

As the Panel seeks ways to improve fairness in the tax system in a revenue-neutral manner, we recommend a fresh policy evaluation of the estimated $31 billion in lost tax revenue from the tax-exempt credit union industry over the next ten years.

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[2] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005. www.taxfoundation.org

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We sincerely appreciate the opportunity to offer our comments on a few areas of the tax code that are most problematic and unfair. The ICBA looks forward to working with this distinguished Panel and are encouraged by your hard work in recommending a more simple, fair, and pro-growth tax system.

Respectfully,

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ICBA SUMMARY of Tax Reform Proposal Recommendations

ICBA Principles of a Model Tax System:

The tax system should be simple. Complexity makes the system expensive, punitive, and results in an efficiency loss to the economy.

All taxpayers must be fully informed on exactly what is being taxed, how they are being taxed, and what their true tax liability is. Taxes should be as visible to the taxpayer as possible.

A low tax rate across a broad tax base creates the least distortions in the economy. High marginal tax rates damage economic growth by reducing the incentives to work, save and invest.

The tax system should provide the same tax treatment for similar economic actions and transactions rather than taxation based on the attributes of the taxpayer.

Multiple layers of taxation on the same income or transaction should be avoided.

Changes in the tax law intended to raise revenues should not be retroactive. All taxpayers must have confidence in the law as it exists when planning and entered into transactions.

The U.S. tax code must be competitive with other industrialized nations.

Summary of Specific Reform Proposals:

Increase savings by adopting new Retirement Savings Accounts (RSAs) and Lifetime Savings Accounts (LSAs) proposed by the Administration and in Congress.

Make permanent the enhanced savings reforms in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that boosted IRA, and 401(k) account limits.

Permanently eliminate punitive estate tax.

Eliminate punitive double taxation on interest, dividends, and capital gains.

Re-assess the $31 billion, ten-year tax-subsidy for tax-exempt credit unions.

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