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Capitol Account

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May/June 1994

AICPA Endorses Senate Securities Litigation Reform Bill

A long-awaited securities litigation reform bill, introduced in the Senate by Senators Christopher Dodd (D-CT) and Pete Domenici (R-NM), was overwhelmingly endorsed by the AICPA Board of Directors at its April meeting.



Senator Christopher Dodd
(D-CT)

rights of defrauded investors and gives them increased control over the current lawyer-driven system.

"The AICPA applauds the efforts of Senators Dodd and Domenici to protect the interests of investors by repairing a seriously flawed litigation system," John E. Hunnicutt, AICPA group vice president for government affairs, said.

In introducing S. 1976, the Private Securities Litigation Reform Act of 1994, Senator Dodd said the bill would limit opportunities for frivolous litigation and empower investors so that they—not their lawyers—would have greater control over class action cases.

Hunnicutt cited as particularly important the provision in the bill establishing a form of pro-

The measure aims to discourage the filing of baseless suits that are currently diverting precious resources from U.S. businesses and inhibiting voluntary corporate disclosures. At the

same time, the

bill protects the

rights of defrauded investors and gives them increased control over the current lawyer-driven system.

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Hunnicutt cited as particularly important the provision in the bill establishing a form of pro-

portionate liability for defendants who are not the primary wrongdoers in the suit.

Some of the other key provisions in the bill that will help restore balance and fairness to the litigation system include

the following:

- ☛ Lead plaintiffs in class actions must hold in the aggregate a certain percentage or value of the securities at issue;
- ☛ Brokers and dealers are prohibited from receiving payments for referring prospective plaintiffs to attorneys;
- ☛ Plaintiffs' attorneys' fees are limited to a



Senator Pete Domenici
(R-NM)

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A
Monthly
Report on
Federal
Legislative
Matters
Affecting
CPAs

AICPA

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- reasonable percentage of the actual amount recovered by plaintiffs;
 - ☞ An attorney may be disqualified from representing a class if he/she is the beneficial owner of the securities that are the subject of the litigation;
 - ☞ A guardian or plaintiff steering committee could be appointed by the court to ensure lawyers act in their clients' best interests;
 - ☞ Proposed settlement agreements distributed to class members must include certain detailed information, including the amount of attorneys' fees sought by class counsel;
 - ☞ Codifies current law to require the plaintiff to prove it was management's misstatement or omission that caused the gain or loss of the market value of plaintiff's stock;
 - ☞ Establishes guidelines for determining the amount of damages owed to plaintiffs; and
 - ☞ Permits either party to request non-binding alternative dispute resolution at the beginning of the lawsuit.
- The bill also gives the SEC authority to modify or supplement Generally Accepted Auditing Standards for audits of public companies, and establishes a Public Auditing Self-Disciplinary Board.

Number of Tauzin Bill Co-Sponsors Breaks 100

The number of House members signing on as co-sponsors of H.R. 417, Rep. Billy Tauzin's (D-LA) securities litigation reform bill, broke 100 recently. As of May 25, H.R. 417 had 111 co-sponsors. If you'd like a list, write Shirley Twillman at AICPA, 1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004-1081 or call her at 202/434-9220. Thanks for all your hard work in signing up co-sponsors!

The Board is an attempt by the sponsors to make the accounting profession's self-discipline swifter and more efficient.

In addition, S. 1976 includes the AICPA-backed Wyden bill provisions which require more rapid notification by public auditors to the SEC of illegal acts that have not been properly addressed by management (*Capitol Account*, April 1993).

Senators Lauch Faircloth (R-NC), Bennett Johnston (D-LA), Barbara Mikulski (D-MD), Slade Gorton (R-WA), and Thad Cochran (R-MS) are co-sponsors of S. 1976, which was introduced on March 24, 1994. We have begun the push for more co-sponsors by asking AICPA Key Persons for members of the Senate to ask their senators to co-sponsor S. 1976.

On other fronts in the securities litigation battle, the U.S. Supreme Court handed down a decision in *Central Bank of Denver v. First Interstate of Denver*. In this case, decided after S. 1976 was introduced, the Court limited lawsuits that charge accountants and other outside professionals with

taking part indirectly in a securities fraud as an "aider and abettor." However, professionals can still be sued as a "primary violator." The decision is important progress in curbing abuses of the federal securities laws, but it does not eliminate the need for further reforms such as those contained in S. 1976.

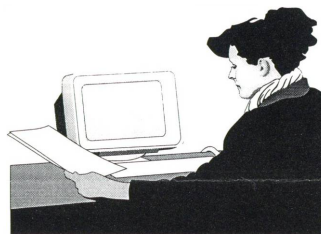
Outlook

The bill faces stiff opposition. How stiff was underscored by the flurry of activity touched off by opponents after a draft of S. 1976 was circulated. The draft so concerned opponents that they staged a press conference when they learned that the bill was about to be introduced. Based on the draft, opponents decried the bill as detrimental to small investors. Those claims were rebutted later the same day at press conferences called by supporters of the bill and by its Senate sponsors.

The incident is representative of the atmosphere in Washington surrounding litigation reform. As we've said before, we face an uphill battle.

AICPA Supports Home Office Deduction Act

The AICPA has endorsed proposed legislation to liberalize the home office



deduction following the 1993 Supreme Court case that narrowed availability of the deduction.

In *Commissioner v. Soliman*, the Supreme Court raised serious questions as to whether a deduction is allowable unless 1) the customers of the home-based business physically visit the home office and 2) the business revenue is produced within the home office.

In letters to the bills' sponsors, Rep. Peter Hoagland (D-NE) and Senator Orrin

Hatch (R-UT), the AICPA said it believes the proposed legislation "upholds the original intent of the home office deduction, but provides standards that reflect the realities of the business world." Under the legislation, H.R. 3407 and S. 1924, a home-office deduction would be allowed in circumstances where management activities carried on from the home office are a significant part of the entire business.

We think the many home-based businesses in our country will support the Home Office Deduction Act. However, passage of the bill by Congress this year will depend upon there being a larger tax bill to which it can be attached and the ever present consideration of how much it would cost the Treasury in tax dollars. The estimate of the bill's cost, by the Congressional Budget Office, is not in yet.

Tax Simplification Bill Passed by House

A tax simplification bill supported by the AICPA passed the House of Representatives for the third time on May 17, 1994. Congress twice passed virtually the same bill in 1992 as part of larger bills, but they were vetoed by then-President Bush.

The tax simplification provisions of the vetoed bills were non-controversial, and were championed by the House Ways and Means Committee chairman, as well as the AICPA. The simplification package, H.R. 3419, was reintroduced early in 1993 and gained Committee approval last November.

House leaders delayed acting on H.R. 3419 because they feared it would be loaded up with extraneous amendments in the Senate, which has more liberal rules about adding amendments to a bill during floor debate. House leaders oppose using the bill as a vehicle for a broader tax bill because they think it would jeopardize the bill's chances of being approved this year.

Joseph H. Gale, chief tax counsel for the Senate Finance Committee, told the 500 participants at the AICPA Spring Tax Division Meeting that he thinks the budget law's revenue-neutrality requirement will act as a natural discipline to keep the bill clean. As to prospects for Senate passage, Gale said members of the Finance Committee have "lots of interest" in getting a tax simplification bill done this year and that passage by the House would help create momentum for Senate action. However, he cautioned that two factors counter the senators' interest. First, the committee's crowded schedule, which is dominated by health care reform, and second, the fact that some of the revenue off-setting provisions in H.R. 3419 have never been considered by the Finance Committee. His final assessment—"Passage is not a foregone conclusion."

It appears that persistence will continue to be the key to achieving any simplification of the tax code.

Pension Bill Due—Pay Now, or Later, AICPA Tells Congress

“We will pay now, or we will pay later,” Harvey Coustan, chair of the AICPA Tax Executive Committee, said in written testimony to Congress about the funding status of qualified pension plans. He made the statement in reference to the fact that removing certain disincentives to full funding of plans may result in decreased tax revenues.

“We think there is serious potential for a far greater cost to the American taxpayers if plan funding is not improved in the near term,” Coustan testified at a hearing by the House Ways and Means Committee on H.R. 3396, the Retirement Protection Act of 1993.

The bill, proposed by the Clinton Administration, would reform the federally insured defined benefit pension system and improve the security of certain pension benefits insured by the Pension Benefit Guaranty Corporation (PBGC).

The AICPA endorsed key reforms in the bill to improve plan funding levels, including rules that would encourage more rapid funding, such as elimination of the 10% excise tax on certain nondeductible contributions.

Coustan identified some of the major existing disincentives to adequate long-range funding as:

- ✎ The 150% full-funding limitation, which disallows deductions for employer contributions that exceed 150% of “current liabilities.” “Full funding” in this context does not mean the plan has enough funds to pay all benefits when they become due, because full funding is based on an artificial assumption of the plan terminating today and an arbitrary 150% cap.
- ✎ The 50% reversion penalty, which is a disincentive to fully funding some plans. Under current law, these excise taxes are still applicable even if the employer uses any related reversion amounts to enhance the security of other employee benefit programs (for example, retiree health care).

Ways and Means Committee members showed particular interest in the proposal in H.R. 3396 that would eliminate the cross-testing method for discrimination testing in qualified plans. (Cross testing is used when plans provide different allocations, as a percentage of compensation, to different employees.) The Administration has proposed eliminating the test because, in its view, some employers are manipulat-

ing the rules to obtain a tax subsidy for their retirement plan. However, the Institute opposes the elimination of cross testing because the inevitable result, Coustan told committee members, would be the termination of a “significant number” of qualified retirement plans, leaving more employees without coverage. The tax system, he added, includes significant and important incentives for employers to provide retirement security for employees, and we believe it critical that those incentives continue.

A year ago, the AICPA launched an effort encouraging workers to educate themselves about their pensions, and warning that if their nest egg is rotten the time to find out is now, not when they retire (*Capitol Account*, May/June 1993). Specifically, the Institute offered a series of recommendations to increase the amount of information available to plan participants about the financial status of their plan—including how much the plan has promised to pay participants and whether it is adequately funded to meet those promises, whether its investments are sound, and whether the pension benefits are insured by the PBGC.

Subchapter S Reform Bill Introduced in House; Drive for Co-Sponsors Launched

The AICPA's long-time effort to assist more than 1.5 million of our country's small and family-owned businesses moved another step forward with the introduction of a bill in the House of Representatives that would open up new sources of investment and simplify the rules under which S corporations operate. It is nearly identical to the AICPA-backed bill, S. 1690, introduced last fall in the Senate (*Capitol Account*, Nov./Dec. 1993).

Introduction of H.R. 4056 on March 16, 1994 by Rep. Peter Hoagland (D-NE) and other members of the House Ways and Means Committee represents a continuation of the push by the AICPA and others to reform subchapter S. "We're going to keep pressing Congress to reform the S corporation laws," AICPA Vice President for Taxation Gerald W. Padwe said. "We see the introduction of the bill in the House as a sign that our efforts are having an impact."

Rep. Hoagland noted in introducing H.R. 4056 that the S corporation rules were enacted in the 1950s and that it is time to "eliminate antiquated rules that impede the growth of small businesses and burden them with unnecessary administrative complexity."

S. 1690 and H.R. 4056 are identical except for their effective dates. The bills would make S corporations more attractive investment vehicles for venture capitalists, make it easier to pass on family-owned businesses to younger generations, and remove traps and unnecessary tax burdens that cause small business owners to avoid forming S corporations.

A drive is now underway by the AICPA and other organizations to sign up members of the House Ways and Means and Senate Finance Committees as co-sponsors of these bills. AICPA Key Persons have been asked to help.

Key Persons who do not serve as contacts for members of the tax writing committees can bolster this effort by asking their House and Senate members when they see them to co-sponsor H.R. 4056 or S. 1690.

As a Key Person, you should be prepared to explain to members of Congress what S corporations are, how they operate, and why it is so critical to the small business community that the laws governing S corporations be modernized.

Co-Sponsors of H.R. 4056 and S. 1690 (As of May 25, 1994)

H.R. 4056:

Wayne Allard (R-CO)
 Bill Archer (R-TX)*
 Bill Brewster (D-OK)*
 Dave Camp (R-MI)*
 William Coyne (D-PA)*
 Robert E. Cramer (D-AL)
 George Darden (D-GA)
 Peter Deutsch (D-FL)
 Eric Fingerhut (D-OH)
 Fred Grandy (R-IA)*
 Melton D. Hancock (R-MO)*
 Earl Hilliard (D-AL)
 Tim Holden (D-PA)
 Timothy P. Johnson (D-SD)
 Joseph Knollenberg (R-MI)
 Mike J. Kopetski (D-OR)*
 David Levy (R-NY)
 John Lewis (D-GA)*
 Bob Livingston (R-LA)
 Robert T. Matsui (D-CA)*
 John McHugh (R-NY)
 J. Alex McMillan (R-NC)
 Dan Miller (R-FL)
 James P. Moran (D-VA)
 Rob Portman (R-OH)
 Nick Rahall (D-WV)
 E. Clay Shaw, Jr. (R-FL)*
 Don Sundquist (R-TN)*
 William Thomas (R-CA)*
 Charles Wilson (D-TX)
 Richard A. Zimmer (R-NJ)

S. 1690:

Robert Bennett (R-UT)
 David Boren (D-OK)*
 John Breaux (D-LA)*
 Richard Bryan (D-NV)
 Thad Cochran (R-MS)
 Kent Conrad (D-ND)*
 Larry E. Craig (R-ID)
 John Danforth (R-MO)*
 Dennis DeConcini (D-AZ)
 Byron L. Dorgan (D-ND)
 Dave Durenberger (R-MN)*
 Lauch Faircloth (R-NC)
 Slade Gorton (R-WA)
 Orrin Hatch (R-UT)*
 Mark O. Hatfield (R-OR)
 Bennett Johnston (D-LA)
 Nancy Kassebaum (R-KS)
 Dirk Kempthorne (R-ID)
 Robert J. Kerrey (D-NE)
 Patrick J. Leahy (D-VT)
 Richard Lugar (R-IN)
 Harlan Mathews (D-TN)
 Patty Murray (D-WA)
 Bob Packwood (R-OR)*
 Charles S. Robb (D-VA)
 Jay Rockefeller (D-WV)*
 Jim Sasser (D-TN)
 Richard C. Shelby (D-AL)
 Alan K. Simpson (R-WY)
 Robert C. Smith (R-NH)
 Malcolm Wallop (R-WY)*

*Designates House Ways and Means Committee or Senate Finance Committee member

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