AICPA

November 10, 2017

The Honorable Paul Ryan
Speaker
United States House of Representatives
H-232, U.S. Capitol
Washington, DC 20515

The Honorable Nancy Pelosi
Minority Leader
United States House of Representatives
H-204, U.S. Capitol
Washington, DC 20515

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
House Committee on Ways and Means
1139E Longworth House Office Building
Washington, DC 20515

RE: Tax Cuts and Jobs Act of 2017 (H.R. 1, as amended)

Dear Speaker Ryan, Minority Leader Pelosi, Chairman Brady, and Ranking Member Neal:

The American Institute of CPAs (AICPA) applauds Chairman Brady and the Ways and Means Committee (the "Committee") for its efforts in reforming our nation's outdated Internal Revenue Code ("Tax Code"). We recognize the intent of the tax reform bill, the *Tax Cuts and Jobs Act* (hereinafter referred to as "the Proposal"), is to move us closer to a fairer, simpler Tax Code that drives economic opportunities for individuals and families, while leveling the playing field for American businesses in the United States (U.S.) and abroad.

The AICPA is a long-time advocate for an efficient and pro-growth tax system based on principles of good tax policy. We need a tax system that is fair, stimulates economic growth, has minimal compliance costs, and allows taxpayers to understand their tax obligations. These features of a tax system are achievable if principles of good tax policy are balanced in the design of the system.

We look forward to working with Congress as this process moves forward to ensure that the proposed reforms are fair and meet the needs of both taxpayers and tax practitioners. In this letter, we highlight some of the key issues we have identified for your consideration.

1. Cash Method of Accounting

The AICPA commends the Committee on its expansion of the number of taxpayers who may use the cash method of accounting. The cash method of accounting is simpler in application than the accrual method, has fewer compliance costs, reduces controversy and enforcement costs, and does not require taxpayers to pay tax before receiving the related income. The proposed change would help encourage small business growth and reduce compliance costs, creating an environment for increased economic growth.

2. Tax Rates for Pass-through Entities

The AICPA urges Congress to reconsider effectively excluding service firms from the tax rates proposed for other pass-through businesses. Professional service~~s~~ firms, such as accounting firms, are an important sector in our economy and heavily contribute to the nation's goals of creating jobs and better wages. Without the benefit of a fair and consistent rate reduction for all pass-through entities, the incentive to start or grow a business is diminished, with a corresponding loss of jobs and reduction in wages.

Excluding professional services reflects a view of the industry that may have applied in the 1950s, but certainly does not represent the current integrated global environment. In today's economy, professional service pass-throughs are increasingly competing on an international level with businesses organized as corporations, require a significant investment in tangible and intangible assets, and rely on the contribution of salaried, non-equity professionals to generate a significant portion of the revenue. Artificially limiting the use of a lower business rate, regardless of industry, would penalize a business for operating as a pass-through entity.

We recommend that Congress permit all pass-through businesses to avail themselves of the 70/30 safe harbor allocation provided in Section 1004 of the Proposal. While we appreciate the availability of an alternate calculation based on a return on tangible investment, Congress should consider additional alternatives that are based upon a more economically realistic view of an owner's capital investment.

3. Deduction for State and Local Taxes

The AICPA recommends that Congress preserve the full deduction for state and local taxes paid or accrued in carrying on a trade or business. Under current tax law, C Corporations may deduct state and local income taxes in determining their taxable income. Similarly, owners of pass-through entities may deduct state and local income taxes on income earned by the pass-through entity, whether paid at the entity level or directly by the partner/owner.

The AICPA recommends that Congress allow owners of pass-through entities to take an "above-the-line" deduction for state and local taxes paid or accrued in carrying on a trade or business, whether paid at the entity level or directly by the partner/owner.

4. Deferred Compensation

The AICPA applauds the decision to maintain the current tax treatment of nonqualified deferred compensation (NQDC). A change to the tax treatment of NQDC, as initially proposed in Section 3801 of the Proposal, would have discouraged the natural growth of businesses; placed U.S. businesses at a competitive disadvantage compared to foreign businesses that utilize NQDC arrangements; created an administrative burden on partnerships due to the difficulty of valuing the annuity stream; and increased the likelihood that businesses would incur costly debt. It also would have interrupted millions of employee's personal financial plans by taxing vested existing balances by 2025.

We also applaud the Committee for maintaining the current tax-deferred treatment of 401(k) plan contributions, which allows rank and file employees the freedom to continue to save for their retirement on a pre- or post-tax basis. These changes promote simplification, fairness and transparency.

5. International Tax Provisions

Treatment of Deferred Foreign Earnings

The AICPA recommends that the repatriation tax imposed by Section 4004 of the Proposal only apply to those taxpayers who would receive the benefit of the dividend received exemption created by Section 4001 of the Proposal.

Under Section 4004 of the Proposal, "U.S. shareholders owning at least 10% of a foreign subsidiary, generally, would include in income the shareholder's pro rata share of the net post-1986 historical earnings and profits (E&P) of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax," calculated as of a date specified in the Proposal. The rate of tax on such E&P would depend on the whether the E&P has been retained in the form of cash or cash equivalents or reinvested in the foreign subsidiary's business. Under an election, payment of the tax imposed would take place over an 8-year period.

The AICPA is concerned that non-corporate shareholders would have this repatriation tax imposed on their subsidiaries deferred foreign earnings, yet would not receive the benefit of the dividend received exemption on future earnings included in Section 4001 of the Proposal. We recognize the rationale for imposing a one-time tax on deferred earnings held by corporate owners. Those shareholders will generally not have U.S. tax imposed on their future foreign earnings and would have the ability to use the cash generated for U.S. based operations. However, non-corporate shareholders would remain subject to U.S. tax on any future foreign earnings that they elect to repatriate.

Foreign High Return Income

The AICPA commends the Committee for its efforts in developing effective base erosion provisions in the Proposal. However, we are concerned that the Foreign High Return (FHR) provision in Section 4301of the Proposal is unnecessarily burdensome and complex.

As an alternate, we recommend the creation of a new category of Subpart F income consisting of specifically identified intangible related income. To the extent the effective foreign tax rate imposed on this income (determined on a worldwide aggregate basis) is equal to or greater than 80% of the U.S. statutory rate (or 16% under the provisions of the Proposal), the income is not considered Subpart F income. Otherwise, the income is treated as Subpart F income for the tax year, and U.S. income tax is imposed.

For purposes of foreign tax credits (FTCs) attributable to such income, we recommend those FTCs are maintained as a separate bucket and applied only to this separate category of income. To alleviate potential unintended consequences resulting from base and timing differences between U.S. and foreign tax rules, we recommend that a carryback period of one year and carryforward period of three years apply to this separate bucket of FTCs.

6. Interest Expense Deduction

The AICPA commends the preservation of the deduction for business interest expense for small businesses. Owners incur interest on small business loans to fund operations prior to revenue generation, working capital needs, equipment acquisition and expansion, and to build credit for future loans. These businesses rely on financing to survive, and equity financing for small businesses is simply not available.

7. Education Tax Incentives

The AICPA commends the Committee on its efforts to simplify the tax rules surrounding education expenses. However, in the interest of simplification and consistency, we recommend that Congress offer the same maximum credit each year (as opposed to a reduced amount on the fifth year) for education-related expenses.

8. Alternative Minimum Tax

The AICPA supports repeal of the alternative minimum tax (AMT). The current system's requirement for taxpayers to compute their income for purposes of both the regular income tax and the AMT is a significant area of complexity of the Tax Code requiring extra calculations and recordkeeping. The AMT also violates the transparency principle because it masks the amount a taxpayer can effectively deduct or exclude, as well as the taxpayer's marginal tax rate. The repeal of the individual and corporate AMT would help reduce the complexity and unfairness of the current Tax Code.

9. Repeal Technical Terminations

We support repeal of section 708(b)(1)(B) relating to technical terminations of partnerships. The AICPA has long advocated for repealing this provision, which results in the technical termination of the entity for tax purposes only (i.e., the legal entity continues) and treatment of the partnership as a newly formed entity. In tax compliance, the earlier filing of the partnership return often goes unnoticed and penalties are assessed because companies are unaware of the accelerated filing deadline. The acceleration of the filing date of the tax return, the reset of depreciation lives, and the selection of new accounting methods arguably serve more as a trap for the unwary than a process to help prevent tax abuse.

10. Tax Preparation Expenses

We encourage retention of the deduction for tax preparation expenses to recognize that this is a necessary cost for most individuals to properly comply with their federal, state and local tax obligations.

11. Contributions to Capital

The Proposal creates a new Tax Code section 76 and repeals section 118, affecting the ability of taxpayers to make tax-free contributions to the capital of a corporation or other entity. The overall effect is to eliminate the existing exclusion of income for capital contributions and to create a new "fair market value" test to determine the amount of a capital contribution that a corporation, and all other entities such as partnerships, must include in income.

The AICPA recommends that section 118 remain in the Tax Code (i.e., not repealed) and that the new section 76 is modified to create an exception from the section 118 general non-inclusion treatment of capital contributions for those payments received from state and local governments, limiting the impact of the section to its intended purpose. We also request maintaining section 108(e)(6) to preserve capital contribution treatment for when a shareholder contributes a corporation's debt to the debtor corporation.

12. Accounting for Inventories & Long-Term Contracts

The AICPA commends the Committee on its efforts to simplify the inventory rules for small businesses. Exempting taxpayers that meet the $25 million gross receipts test from the requirement to account for inventories under section 471 will reduce compliance costs, taxpayer controversy with the Internal Revenue Service, and other non-tax administrative costs.

The AICPA also supports the expansion of the exception for small construction contracts from the requirement to use the percentage-of-completion method under section 460. However, section 460 also applies to manufacturers of unique equipment. Congress may want to consider expanding the exception to include small manufacturers of unique equipment as it would ensure that all small business taxpayers subject to section 460 are entitled to the same exemption.

13. Uniform Capitalization

The AICPA commends the Committee on its efforts to expand the exception for small taxpayers from the uniform capitalization rules under section 263A. The primary effect of section 263A on inventory is the capitalization of costs for tax purposes that are not normally capitalized for financial purposes, thereby requiring two sets of record keeping. The elimination of this requirement would ease the administrative burden for small businesses by allowing them to follow their financial reporting method (books and records) for tax purposes.

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As Congress moves forward with tax reform, we urge you to consider appropriate transitional provisions. For example, we recommend providing penalty relief for estimated payments due prior to the later of June 30, 2018, or 120 days after the effective date of the legislation. Taxpayers and preparers need sufficient time to determine the appropriate estimated tax payments for businesses and individuals that may have a dramatically different tax liability in the 2018 year as a result of the Proposal.

The AICPA is the world's largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We welcome the opportunity to discuss these comments on the *Tax Cuts and Jobs Act* or to answer any questions that you may have. If you have any questions, please contact Jeffrey A. Porter, Chair of the AICPA Tax Reform Task Force, at (304) 522-2553, or jporter@portercpa.com; Melissa Labant, AICPA Director of Tax Policy & Advocacy, at (202) 434-9234, or melissa.labant@aicpa-cima.com; Melanie Lauridsen, AICPA Senior Manager of Tax Policy & Advocacy, at (202) 434-9235, or melanie.lauridsen@aicpa-cima.com; Lakecia Foster, AICPA Director of Congressional & Political Affairs, at (202) 434-9208, or lakecia.foster@aicpa-cima.com; or me at (408) 924-3508 or annette.nellen@sjsu.edu.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

cc: Members of the United States House of Representatives
The Honorable Mitch McConnell, Senate Majority Leader
The Honorable Chuck Schumer, Senate Minority Leader
Members of the Senate Finance Committee
The Honorable Steve Mnuchin, Secretary of the Treasury
The Honorable Gary Cohn, Director, President's National Economic Council
The Honorable David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury