



May 7, 2020

The Honorable Charles Grassley  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Richard Neal  
Chairman  
House Ways and Means Committee  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Ronald Wyden  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

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

**Re: Modernizing Tax Provisions to Reflect the Economic and Technological Environment in Response to the COVID-19 Pandemic**

Dear Chairmen and Ranking Members:

The American Institute of CPAs (AICPA) applauds the efforts of Congress to address the need for legislation to encourage economic recovery in response to the Coronavirus Disease 2019 (“COVID-19”). The AICPA believes that continuing this positive momentum while promoting good tax policy<sup>1</sup> will ensure that small businesses are not only helped in this environment, but in the future as well.

The pandemic spotlighted barriers the tax system creates when small businesses encounter a global risk, and our federal tax laws should adjust to reflect this changed environment. Main street businesses are a vital part of the economy and the tax system should support, encourage, and adapt to the rapid changes in technology and small business processes that continuously push us forward. The tax system is typically “behind” the current environment, perpetually catching-up. The pandemic highlighted the antiquated nature of some of these provisions and modernizing these for small businesses ensures that the system is proactive in responding to future events.

In response to this paradigm shift, the AICPA has identified a dozen small business barriers which Congress needs to address to “future-proof” our tax system and bring it into the 21<sup>st</sup> Century.

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<sup>1</sup> AICPA concept statement, [“Tax Policy Concept Statement 1, Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals.”](#)

The Honorable Charles Grassley  
The Honorable Richard Neal  
The Honorable Ronald Wyden  
The Honorable Kevin Brady  
May 7, 2020  
Page 2 of 11

Our letter is comprised of three sections as follows:

- I. Small Business Barriers
- II. Proposed Technical Corrections to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)
- III. Additional Legislative Recommendations

## **I. Small Business Barriers**

1. Alternative minimum tax (AMT).

Congress should repeal the AMT for individuals, trusts, and estates in order to provide consistent treatment and relief for all businesses and owners. Businesses in a non-corporate structure (such as a limited liability company (LLC)) are subject to a dual tax system that is complex and creates a burden for small businesses.<sup>2</sup> The tax system should be updated to reflect the current economic reality that many small businesses organize as passthrough entities. Many of the AMT preferences and adjustments affect business taxation and apply to individuals, estates, and trusts which create additional complexity and inequity for these non-corporate business taxpayers.

2. Limited business deduction of state and local taxes.

The deduction of state and local taxes (“SALT”) associated with business income should be allowed in computing adjusted gross income (AGI) for all businesses to eliminate disparate treatment small businesses face. Businesses in corporate form may deduct SALT, but the \$10,000 limit for individuals disproportionately affects small businesses operating as sole proprietorships, LLCs, or other passthrough entities. Main street small businesses are the backbone of the economy, and employees of those businesses in large part drive spending in both the overall economy and into other small businesses.

3. Unreasonable application of the syndicate rules.

Repealing the syndicate rules would allow businesses to properly deduct losses generated during a disruption as opposed to triggering the punitive tax shelter rules. In light of the COVID-19 pandemic and substantial losses incurred by businesses in 2020, a temporary suspension of the rules is appropriate but insufficient for helping businesses long-term. Many businesses (including start-ups) operate as LLCs, partnerships, and other passthrough entities that generally incur losses that are disallowed by the syndicate rules.

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<sup>2</sup> Approximately 200,000 taxpayers are subject to the AMT; however, a million taxpayers must complete the compliance obligations to determine if they are ultimately subject to the AMT. <https://files.taxfoundation.org/20190404102039/The-Alternative-Minimum-Tax-Still-Burdens-Taxpayers-with-Compliance-Costs.pdf>.

Many small businesses do not know that they have been unduly limited by these rules and cannot benefit from the changes enacted by Tax Cuts and Jobs Act of 2017 (“TCJA”) due to classification as a tax shelter. The syndicate definition dates back to before 1986 at a time when LLCs were not a common entity type. In today’s environment, an LLC is a preferred business entity for many reasons (including to obtain funding from inactive owners), but then this entity runs the risk of being a “tax shelter” even though there is no tax avoidance motive. These long-standing rules constrict, and in some cases outright disallow, the benefits the tax system provides to small businesses – such as a cash method of accounting and exemption from the complex interest expense limitation under section 163(j).<sup>3</sup> The rules serve more as a “trap” for small businesses who have investors, such as a restaurant, and generate a loss which may subject them to the syndicate rules and tax shelter status.

These businesses are an important part of the economy, and as we move further into a digital age, continue to provide services and employment to many Americans. The passive loss limitation rules under section 469 and the section 6662(d)(2)(C) definition of a tax shelter are appropriate deterrents to abusive structures or devices.

4. Limited home office deduction.

The AICPA recommends removing the strict use requirement for the home office deduction. This change would allow businesses to report taxable income that reflects operational costs by utilizing the deduction in computing AGI. The exponential rise of telework and pace of traditional working habits in response to the COVID-19 pandemic necessitates a modern approach to the home office deduction. This outdated requirement is highlighted when COVID-19 forced more people to run many aspects of their personal and working lives from a laptop computer and smartphone. But such combined use prohibits deduction for any space where that computer or phone are used.

5. Amortizing intangible assets and the classification of property under the depreciation rules.

Expanding qualified property that can be expensed under section 179 by small businesses to include intangibles,<sup>4</sup> startup costs under section 195, and organizational costs under sections 248 and 709 would benefit small businesses due to the simplicity and acceleration of tax deductions afforded by this provision. These provisions are complex for small businesses to administer and the expansion would better reflect today’s data-driven business decisions that are the focus of main street businesses.

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<sup>3</sup> Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

<sup>4</sup> These expenses are currently required to be capitalized under section 263(a) (section 197 intangibles, prepaid expenses and contract rights outside the 12-month rule and facilitative costs).

The statutory classification of property under section 168 and guidance provided in Rev. Proc. 87-56 do not include in the classification schedules the types of property used today.

6. Organizational and start-up expenses deduction limitations.

Small businesses need updated limits on organizational and start-up expenses under sections 195, 248 and 709, which limit current deductions to \$5,000. The deduction phases-out as expenditures exceed \$50,000. The limit should be increased and adjusted for inflation to continue encouraging small business development. These thresholds have not been increased since the enactment of the sections.

7. Small amounts of self-employment income.

The \$400 self-employed threshold under the Self-Employed Contributions Act (“SECA”) has not been changed for a few decades. This amount should be increased, indexed to inflation, and should also exceed what might be earned in one week or less. This change would benefit many individuals in the age of the gig-economy and reflect the changing working habits of Americans. Similarly, the \$600 reporting threshold for Form 1099-MISC, *Miscellaneous Income*, should be increased to reflect current wages.

8. Certain loss limitation rules.

Exempting small businesses from the section 461(l) rules and 80% limitation on net operating losses (NOLs) will provide an efficient and effective tax system. Substantial losses will be incurred in 2020, and NOL carryovers generated in 2018 and later years can only be used in post-2020 years to offset 80% of taxable income. These limitations substantially burden small businesses recovering from the pandemic. This change would provide small businesses with certainty in tax planning and streamline the system for future disruptions.

9. Small business employee benefit plans.

Congress should eliminate the top-heavy rules. A defined contribution plan<sup>5</sup> is considered top-heavy if as of the last day of the preceding plan year, the aggregate value of the key employees’ accounts exceeds 60% of the aggregate value of all of the employees’ accounts under the plan.<sup>6</sup> When a plan fails the top-heavy testing, a contribution equal to or greater than the highest employer contribution made to a key employee is required to be made by the employer, to all non-key employee accounts. For a small employer, the amount of the

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<sup>5</sup> A defined contribution plan is a pension plan in which the amount of the contributions made by the employer is fixed in advance and earnings are distributed proportionately.

<sup>6</sup> Section 416(g)(1)(A)(ii).

contribution could be financially prohibitive. In addition to the minimum contribution requirements, top-heavy plans are subject to minimum vesting requirements.

Generally, the top-heavy rules negatively affect small and family-owned businesses that sponsor 401(k) plans consisting of employee deferrals only, or employee deferrals and employer matching contributions. These types of plans should not be subject to the strict minimum contribution requirements of the top-heavy rules as other top-heavy plans. Smaller employers and their employees are most affected by the rules, which were designed to prevent intentional discrimination. Many small business retirement plans are subject to the top-heavy provisions for two reasons: 1) most small businesses are owned by family members or a close group of individuals and it is common for these owners to remain relatively static over the life of the business; and 2) in today's work environment, turnover of rank-and-file level employees is commonplace due to a more mobile workforce. Rank-and file employees may change jobs multiple times over their careers as personal goals change, their skills improve, or they move geographically. Due to the static ownership of small businesses and the transitory employee base, most retirement plans sponsored by small businesses will become top-heavy at some point during the life of the plan.

Since the top-heavy rules are financially burdensome and overly complicated, they cause many small employers to be unable to offer or be forced to terminate 401(k) plans for their employees. Furthermore, the vesting requirements are unnecessary as employees are protected under other provisions as there have been a number of statutory changes which have significantly decreased their effectiveness. Without the top-heavy rules, more small businesses would adopt plans to benefit their employees.

#### 10. Disparate tax treatment based on business entity.

Changes are needed to modernize the taxation of businesses that support large sectors of the economy. Many small businesses are passthrough entities and provide professional services. Complementary changes are needed to compensation definitions between profits interest and compensation of owner-members (including guaranteed payments), as well as codification of reasonable compensation. Expanding the scope of section 199A to include essential businesses and repealing the specified service trade or business ("SSTB") rules under section 199A will allow more small businesses to benefit from these changes and continue to grow. Alternatively, exclude essential businesses from the SSTB rules, such as healthcare and accounting.

#### 11. Uncertainty of continually expiring tax provisions.

Certainty is essential for an effective and administrable tax system. The tax extender legislation of expiring provisions injects systematic uncertainty for future business

planning and practitioners working to advise taxpayers. COVID-19 spotlights the effect of uncertain tax provisions coupled with uncertain economic and health times. Permanent provisions would allow businesses to appropriately plan both capital expenditures and workforce needs to minimize future disruptions.

12. Absence of a mobile workforce statute.

In order to future-proof both federal and state tax systems, Congress should enact a uniform national standard for non-resident state income tax withholding and a *de minimis* exemption from the multi-state assessment of state non-resident income tax. The current situation of having to withhold and file many state nonresident tax returns for just a few days of work in various states is too complicated and burdensome for both small businesses and their employees. The issue of employer tracking and complying with all the different state and local tax laws is quite complicated when employees are ordered to work from home while complying with shelter-in-place orders issued in response to a global pandemic; employees may work in different localities. Consistent and clear rules governing the tax treatment would create a 21<sup>st</sup> Century tax system reflective of how employees work today and in the future.

## II. Proposed Technical Corrections to CARES Act

1. Eliminate the section 382 limitation with respect to refundability of corporate AMT credit.
2. Extend benefits of the paycheck protection program (PPP) to section 501(c)(6) organizations.
3. Provide Congressional authority to expressly allow deductions for expenses paid with amounts forgiven under the PPP. The PPP loans are intended to help small businesses, and the ordinary business expense rules should apply to enable full benefit of Congress's intention.<sup>7</sup>
4. Provide that amounts repaid by certain PPP borrowers on or before the May 14, 2020 safe harbor deadline are to be recycled into the PPP.
5. Provide an exception to the section 52 aggregation rule for the Employee Retention Credit under which companies that do not obtain PPP loans, but are related to companies that received PPP loans, may still use the Employee Retention Credit (or use a narrower relationship rule for this purpose, such as the section 414(b) and 414(c) 80% ownership rules). Continue to use the section 52 aggregation for other purposes, such as determining the 100-employee limit and for determining the Decline in Gross Receipts.

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<sup>7</sup> See, e.g., Small Business Expenses Protection Act of 2020, S. 3612 (introduced May 5, 2020).

6. Provide a technical correction for section 170(b)(1)(G)(iii) as changed by TCJA Section 11023 for the 60% of adjusted gross income (AGI) charitable deduction limitation to function as intended.
7. Revise the rules under section 172 and allow taxpayers to use operating losses to offset only non-GILTI income. Allow NOLs to be carried to other years without regard to a taxpayer's current or prior-year GILTI.
8. Revise the definition under CARES Act section 2202(a)(4) so that the "coronavirus-related distribution" also includes distributions to an individual if the individual, spouse, or dependent of the individual experiences adverse financial consequences, including a reduction in compensation. Also, provide relief for individuals who received Required Minimum Distribution in January 2020, the ability to rollover the distributions until July 15, 2020.
9. Suspend until May 15, 2021 any required payment under section 7519 that was originally due May 15, 2020 and has been extended until July 15, 2020, for partnerships and S corporations that have made a section 444 election to use a tax year other than the required tax year. This change would provide economic assistance to partnerships and S corporations by permitting them to defer payments that would otherwise temporarily be paid to IRS and permit the business to use the payment directly in its business operations for this year.

### **III. Additional Legislative Recommendations**

1. Provide a tax credit for small businesses to invest in technology and provide virtual offices.

In conjunction with recommendation #4, Part I, to modernize the home office deduction, the AICPA recommends enacting a tax credit to encourage small businesses to invest in home office technology for their employees. The uncertainties created by the public health crisis regarding continuation of ordinary business operations from a remote location caught many small businesses by surprise. This credit would minimize future disruptions if employees must relocate to a virtual office.

2. Repeal (or significantly increase) flexible spending account (FSA) caps.

With rising healthcare costs, taxpayers would be served best by allowing them to determine the appropriate amount of expected medical expenses in an upcoming year and save on a pre-tax basis. The "use it or lose it" year-end expiration would serve as a proper deterrent to taxpayers over-funding their accounts while maintaining flexibility for individual circumstances.

3. Modernize estimated tax payment dates.

Estimated tax payment dates should be due on the 15th day after quarter end. The spacing between these dates does not tie to normal quarters which can be confusing to self-employed individuals (and others) and even challenging to compute and timely pay. Changing the June 15 date to July 15 and the September date to October 15 would consistently schedule the dates to three months apart and tie to the normal quarter date (15 days after the quarter end).

4. Increase the \$3,000 individual capital loss limitation, indexed to at least \$13,000.

This change would help spread out losses taxpayers suffer due to unforeseen crises and counteract the cyclical nature of the stock market while encouraging investing.

5. Allow employees to deduct unreimbursed business expenses in computing AGI.

Employees now working from home who incurred costs not reimbursed by their employer should be allowed an above-the-line deduction for either home office expenses or all employee expenses to provide parity between employee status and partners/sole proprietor status.

6. Provide legislation on the High-Tax Exception for GILTI Income under section 954(b)(4), with a retroactive applicability to 2018.

Small unincorporated businesses and individuals with ownership in a Controlled Foreign Corporation (CFC) were hit particularly hard with the new international tax regime as GILTI assesses immediate income tax on all foreign income to these unincorporated taxpayers. Section 962 elections allow for some mitigation of the impact, however separate record-keeping and the unwieldy mechanics of the election create an undue compliance burden on small businesses including significant added compliance costs. The High Tax Exception would provide a mechanism across all entity types for the GILTI tax to only be assessed on the intended low-taxed foreign income.

7. Amend section 41(h)(1) and 41(h)(2)(C) to allow taxpayers who meet eligibility requirements to offset their payroll tax first.

The limitation on the amount of research credit that can be designated as an offset to the employer portion of OASDI liability in subsection 41(h)(2)(C) is redundant with the limitations imposed by subsections 41(h)(2)(A) and (B) if the qualified small business reports a loss for the credit year. If the intent of subsection (h)(2)(C) is to require profitable qualified small businesses to apply available research credits against income tax liabilities before payroll tax liabilities, it would be more clearly expressed as an ordering rule.



Treasury should be able to allow taxpayers to make their own decision on how to best apply available credits against their various federal tax liabilities.

8. Amend section 41(h)(3) to allow section 41(h) to be more broadly available for start-up businesses.
  - a) Increase the \$5M current year gross receipts limit to \$10M and the 5-year history of gross receipts test to 10 years to allow more taxpayers to qualify for the payroll offset under section 41(h)(3).

Under the current statute, the maximum benefit to an eligible taxpayer is \$1.25M over 5 years. Expanding the definition of qualified small business to include trades or businesses with up to \$10 million in gross receipts during the credit year, and up to a 10-year history of receiving gross receipts ending with the credit year, will expand access to the Payroll Credit, and increase the benefits qualified small businesses receive.

- b) The term “gross receipts” should include a *de minimis* rule similar to the rule described in Treas. Reg. § 1.41-3(c)(2)(vi), which excludes investment income, including interest and dividends from the stock of a 20 percent owned corporation.
9. Amend section 408(d)(8)(B)(ii) to allow a taxpayer to arrange a qualified charitable distribution (QCD) effective with the attainment of age 59.

Taxpayers who are able and willing to donate to charities should not be arbitrarily barred from pursuing a QCD until age 70 ½. This change would encourage the option of charitable giving earlier.

10. Create a uniform rule regarding the determination of basis in distributions from retirement plans to allow for the distribution of basis first.

Currently, depending on the plan type, there are different methodologies used to determine basis in a distribution from a retirement plan. For example, in a Roth Individual Retirement Account (IRA) or 401(k), basis is considered distributed first, while in a traditional IRA or 401(k), basis is distributed on a pro-rata basis over all accounts in the case of a total distribution, and distributed based on an algebraic formula if there are a series of payments. The creation of a uniform rule would simplify the determination of tax basis in distributions from retirement plans. Many employees have little basis in employer provided retirement plans; a rule allowing the immediate recovery of that amount would simplify income taxes for the years after this basis has been recovered.

11. Create a uniform attribution rule for qualified retirement plans.

Currently, the rules of attribution in determining ownership related to qualified retirement plans are governed by three different sections of the IRC and each have slight subtleties that are used for different purposes as follows:

- a) The attribution rules in section 267(c) are used in determining a disqualified person under prohibited transaction rules under section 4975(e).
- b) The attribution rules in section 318 are used for the determination of highly compensated and key employee status.
- c) The attribution rules in section 1563 are used in the determination of controlled group status.

In order to simplify the attribution rules, we suggest creating a uniform rule using the section 267(c) rules since it is easier to apply and generally broader than the more complicated section 318 rules.

12. Create a uniform definition of owners.

Currently, there are different definitions for the terms “highly compensated employee” and “key employee.” A defining factor in determining if someone is a “highly compensated employee” is if they are a 5 percent owner, which is further defined as an individual with a direct or indirect ownership interest of more than 5 percent. The ownership rules governing who is considered a “key employee” also use the 5 percent ownership rule but only consider persons owning directly or indirectly more than 1 percent with compensation of \$150,000. The creation of a consistent definition will simplify the rules.

13. Create uniform rules for early withdrawal penalties.

There are currently different rules governing penalties related to the early distribution of retirement funds depending on whether an account is an IRA or a qualified plan. For example, there is no 10 percent excise tax on the distribution of funds used for higher education expenses, first-time homebuyer distributions, or for distributions for medical insurance for unemployed persons with respect to an individual retirement plan. However, these exceptions do not apply to qualified plan distributions. Thus, while a participant in a qualified plan can roll over an amount received to an IRA and take advantage of the exceptions, there is no exception for amounts distributed from a qualified plan.

The Honorable Charles Grassley  
The Honorable Richard Neal  
The Honorable Ronald Wyden  
The Honorable Kevin Brady  
May 7, 2020  
Page 11 of 11

14. Change the retirement plan withdrawal rules related to sections 72(t) and 401(k) to remove the half-year age references.

Plan participants may begin taking withdrawals from certain retirement accounts, without the penalty imposed by section 72(t), as long as certain criteria are met, following the attainment of age 59 ½. In addition, plan participants can begin withdrawing money from their 401(k) account after attaining age 59 ½. Modifying the age requirements of the withdrawal rules of sections 72(t) and 401(k) from 59 ½ to 59 would ease the complexity of tracking half-year birthdays for both tax practitioners and taxpayers. As precedent, the Secure Act changed the required minimum distribution rules by removing the half-year age reference (changing the age requirement from 70 ½ to 72).

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We appreciate your consideration and welcome the opportunity to discuss this issue further. If you have any questions, please contact Alexander Scott, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9204 or [Alexander.Scott@aicpa-cima.com](mailto:Alexander.Scott@aicpa-cima.com); Lauren Pfingstag, AICPA Director - Congressional and Political Affairs, at (202) 434-9208 or [Lauren.Pfingstag@aicpa-cima.com](mailto:Lauren.Pfingstag@aicpa-cima.com); or me at (612) 397-3071 or [Chris.Hesse@CLAconnect.com](mailto:Chris.Hesse@CLAconnect.com).

Sincerely,



Christopher W. Hesse, CPA  
Chair, AICPA Tax Executive Committee

cc: The Honorable David J. Kautter, Assistant Secretary for Tax Policy, Dept. of the Treasury  
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service  
The Honorable Michael J. Desmond, Chief Counsel, Internal Revenue Service  
Mr. Thomas West, Tax Legislative Counsel, Department of the Treasury  
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation