



August 15, 2013

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

The Honorable Sander M. Levin, Ranking Member
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

RE: Continued Availability of Cash Method of Accounting

Dear Chairman Camp and Ranking Member Levin:

As Congress moves forward on tax reform this year, the American Institute of Certified Public Accountants (AICPA) offers our comments on the cash method of accounting proposals in Chairman Camp's [small business tax reform discussion draft](#), Proposed Tax Reform Act of 2013, Title II – Tax Reform for Businesses (March 12, 2013) (“Proposal”).

The AICPA commends Chairman Camp and the House Ways and Means Committee on your continued efforts to simplify the Internal Revenue Code (IRC or “Code”) and your responsiveness to taxpayer concerns that the Code as written is currently too complex for taxpayers. We have consistently supported tax reform simplification efforts because we are convinced such actions will significantly reduce taxpayers’ compliance costs, encourage voluntary compliance through an understanding of the rules, and facilitate enforcement actions.

We support the expansion of the number of taxpayers that may use the cash method of accounting. The cash method of accounting is simpler in application, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the income being taxed. For these same reasons, we are extremely concerned with and oppose certain limitations included in the Proposal. We believe that Congress should not further restrict the use of the long-standing cash method of accounting for the thousands of U.S. businesses that use it.

Limitation on Use of Cash Method of Accounting (Section 212)

Generally, section 212 of the Proposal provides that the cash method of accounting is available for natural persons (in other words, “individuals”) and any other taxpayer who meets the gross receipts test and is otherwise eligible to use the cash method. A taxpayer satisfies the gross receipts test if the taxpayer’s average annual gross receipts for a three taxable-year period are \$10 million or less. The Proposal effectively eliminates exceptions that currently exist for certain pass-through entities (i.e., partnerships and S corporations), farmers and personal service corporations. Under current law, these businesses are permitted to use the cash basis method of accounting, regardless of their gross receipts, unless they have inventory.

The AICPA opposes the proposed limitation on the use of the cash method of accounting by non-natural persons under the Proposal, and opposes the elimination of the existing exceptions for personal service corporations and farmers.

Under the cash method, income is recognized when it is actually or constructively received, and expenses are recorded when paid. These are straightforward and easily applied tests. Under the accrual method, income is recognized when the right to receive the income exists, and expenses are recorded when they are fixed, determinable and economically performed. These tests are more complex, do not track the financial accounting concepts of the accrual method, and increase costs of compliance. Given that the cash method remains a far simpler method of accounting, we believe that simplicity justifies its continued use by pass-through entities, personal service corporations, and farmers, regardless of their gross receipts.

The AICPA urges you to consider the financial burden that the Proposal, if enacted, would place on businesses. For example, it would require partners and shareholders of pass-through entities to pay tax on income they have not yet received. In order to cover this accelerated need to pay taxes, some businesses would be forced to make cash distributions to their owners from other sources, potentially threatening their operations due to a tightening of cash flow. Other businesses would force their owners to deal with the financial burden regardless of their ability to pay. We believe either scenario would result in an unjustifiable burden.

The potential hardship created by restricting the use of the cash method by partnerships would be increased for those professional service firms that are subject to state regulations restricting ownership to individuals who actively participate in the business. For example, in many states, a firm engaged in the practice of accountancy may not have any passive (investor) ownership and a majority of the owners must hold active CPA licenses. We believe that similar restrictions also exist for firms engaged in the practice of law. As a result, many accounting and law firms must be capitalized solely by the individual professionals, who together own the firm, and cannot raise capital from outside investors. Because of these restrictions, an acceleration of tax on income that has not actually been collected in cash would place a significant strain on the ability of such professional owner-operators to properly capitalize and maintain capital in their firms.

The AICPA believes the Proposal would also discourage natural business growth from a sole proprietorship to a partnership or other pass-through entity, because exceeding \$10 million in annual receipts would trigger an accounting change. In other words, a business' inability to use the cash method of accounting would create an artificial obstacle to joint ventures or the joining of two or more owners. Consider, for example, a sole proprietor operating a successful business with more than \$10 million of gross receipts. If the sole proprietor adds a new partner to the business, the business is no longer operating as a natural person (sole proprietor), creating a disincentive to expand the business. The Proposal could also encourage complicated and economically inefficient tax planning as many partnerships and S corporations may seek alternative structures to allow them to operate as sole proprietors.

Repeal of Required Use of Accrual Method for Corporations Engaged in Farming (Section 213)

The AICPA supports section 213 of the Proposal, which would repeal the required use of the accrual method for larger corporations engaged in farming, but the AICPA opposes the elimination of the current exception to use the cash method of accounting for farmers under section 212 of the Proposal. If section 212 of the Proposal does not continue to exempt farmers, farmers operating their businesses as a sole proprietor would be able to use the cash method of accounting, but farmers operating as partnerships or corporations would be required to use the accrual method of accounting. We believe this disparate treatment provides an inequitable result.

Treasury Reg. § 1.162-12(a) allows cash method farmers to deduct costs incurred in raising crops and animals. The cash method of accounting presents simpler recordkeeping for most farmers. The repeal of the required use of the accrual method by corporate farmers would alleviate the burden imposed on these farming businesses.

However, we believe the repeal of IRC section 447 should only be passed with the cash method farmer exception in place. As noted above, section 212 of the Proposal provides for eliminating an exception allowing the use of the cash method for farmers, and the AICPA opposes the elimination of this exception. If the repeal provision (section 213) remains in the Proposal with the elimination of the farmer exception (section 212), the special method of accounting rules for corporations and partnerships with a corporate partner engaged in farming under IRC section 447 should be retained to provide those entities with an unchanged (IRC section 447) threshold on gross receipts for a farm corporation.

AICPA's Position

The AICPA opposes the limitation on the use of the cash method of accounting for non-natural taxpayers, personal service corporations and farmers. These businesses are located across the U.S. and comprise nearly all industries, including agriculture, finance, health care, personal services, professional services (e.g., attorneys, CPAs, engineers, architects), real estate, repair and maintenance, and transportation. These types of companies are some of the most dynamic American businesses and are part of the driving force behind economic expansion and job growth. The Proposal would require these companies to change to the accrual method, force their owners to pay tax before they have the cash to pay it, and add to complexity and costs.

The AICPA believes tax reform should promote simplicity and economic growth and should *not* create unnecessary administrative and financial burdens on taxpayers or impede the productive capacity of the economy. Simplicity is important both to improve the compliance process and to enable taxpayers to better understand the tax consequences of transactions in which they engage in or plan to engage.

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The AICPA appreciates the opportunity to provide comments as part of the tax reform process. If you have any questions or would like to discuss our comments, please contact me at (304) 522-2553 or jporter@portercpa.com; or you may contact Chris Hesse, Chair, AICPA Small Business Tax Reform Task Force, at (612) 397-3071, or Chris.Hesse@Cliftonlarsonallen.com; or Melissa Labant, AICPA Director – Tax Advocacy & Professional Standards, at (202) 434-9234, or mlabant@aicpa.org.

Sincerely,

A black and white image of a handwritten signature in cursive script, which appears to read "Jeffrey A. Porter". The signature is written in white ink on a solid black rectangular background.

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

cc: The Honorable Max Baucus, Chairman of the Senate Committee on Finance
The Honorable Orrin G. Hatch, Ranking Member of the Senate Committee on Finance
Members of the House Committee on Ways and Means
The Honorable Mark Mazur, Assistant Secretary for Tax Policy, Treasury Department
Mr. Daniel I. Werfel, Principal Deputy Commissioner, IRS
The Honorable William J. Wilkins, Chief Counsel, IRS