



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

April 25, 2014

The Honorable Dave Camp  
Chairman, Committee on Ways and Means  
U.S. House of Representatives  
1102 Longworth House Office Building  
Washington, DC 20515

**RE: Sec. 3301 Limitation on use of cash method of accounting**

Dear Chairman Camp,

The American Institute of CPAs (AICPA) writes to you today regarding Section 3301, limitation on use of cash method of accounting, in the *Tax Reform Act of 2014*. The AICPA is the world's largest member association representing the accounting profession, with more than 394,000 members in 128 countries and a 125-year heritage of serving the public interest. 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 commend you on your commitment to enact comprehensive tax reform and support your goal of simplifying the tax code. We are currently reviewing all provisions within the draft legislation and will soon offer our thoughts on the comprehensive proposal. While we generally support increasing the threshold from \$5 million to \$10 million in average annual gross receipts for businesses that are allowed to use the cash method of accounting, we strongly oppose limiting the use of the cash method of accounting for pass-through entities and personal service corporations with average annual gross receipts over \$10 million. Additionally, including any positive adjustments in income due to the transition from cash to accrual methods of accounting over a four-year stepped period within eight years provides limited relief but does not outweigh the significant costs of using the accrual method of accounting.

Importantly, because the accrual method requires recognizing revenue when it is earned and not when it is received and expenses when they are incurred and not when they are paid, changing to this method for tax purposes would have the effect of tax revenues reaching the Treasury earlier. Specifically, moving these businesses to the accrual method would bring tax receipts into the 10-year window but would not generate any additional revenue over the long-term. We believe that limiting the use of the cash method unfairly accelerates revenue for the federal government by shifting the recognition of taxable income for pass-through entities and personal service corporations.

Determining taxable income using the cash method is also simpler in application and is a method of accounting which the service industry has used for decades. Importantly, the requirement to use the accrual method would accelerate the taxable income of CPAs resulting in an increased tax liability on earnings they have not yet received.

We also note that requiring CPA firms to use the accrual method of accounting for tax purposes may result in the only reason that an owner would be taxed at 35 percent, the highest tax bracket in your proposal. Not only would firm owners be taxed at this higher rate, under another provision in your draft, they could also lose some of the benefit of itemizing certain deductions. This increase in tax liability could have a significant impact on both a new owner's ability to finance entrance into a partnership and a firm's ability to grow either independently or through merging with another firm.

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As laid out in the proposal, the average annual gross receipts test of \$10 million would be based on the revenues of the entity, not the individual owner and ultimate taxpayer. It is important to highlight that a partnership is merely an aggregation of individuals. Earnings are distributed among the owners and each owner is taxed as an individual. A sole proprietor, regardless of taxable income, may use the cash method of accounting. Under this proposal, however, an owner in a partnership, whose taxable income is derived from the partnership's profits and is likely to be significantly less than \$10 million, would be required to use the accrual method of accounting if the partnership exceeds the gross receipts threshold. Therefore, individuals are penalized simply for participating in a partnership.

CPAs are subject to state laws and regulations, many of which limit ownership to individuals who actively participate in the business, thus prohibiting owners from obtaining outside capital to finance their businesses. Any growth must, therefore, be funded individually by the owners. The increase in tax liability due to the accrual method is an unjustifiable burden that could threaten the ability of many of these businesses to expand.

For retiring owners of service partnerships, accelerating and recognizing income under the accrual method of accounting could also create undistributed income taxed before retirement at potentially higher rates and subject the undistributed income to an additional 3.8 percent for self-employment tax (the Medicare (HI) tax rate of 2.9% plus the additional .9% on certain taxpayers). Under current law, a retiring owner is taxed on lifetime retired owner payments received during the retirement years and exempt from all self-employment tax. This additional tax paid during the working years and loss of self-employment tax exemption may offset any potential savings of lowering the top individual rate from the current 39.6 percent to the proposed 35 percent.

The AICPA has long advocated for a simpler, fairer tax code. One overriding principle that must be considered for fairness is that similarly situated taxpayers should pay the same tax. Under this proposal, an individual working in a corporate entity with the same cash basis income, deductions, and credits would have a lower taxable income than an individual in a growing partnership if not for the limitation on use of the cash method of accounting. We believe that this is unjustifiable and unfair to penalize an individual for joining other business partners to form a partnership.

The AICPA has consistently supported tax reform efforts that promote simplicity and economic growth and do not create unnecessary administrative and financial burdens on taxpayers. The accrual accounting mandate falls short in that regard. We strongly urge you to reconsider limiting the use of the cash method of accounting.

Sincerely,

A handwritten signature in black ink, appearing to read "B. C. Melancon", with a long horizontal flourish extending to the right.

Barry C. Melancon, CPA, CGMA  
President and CEO

cc: The Honorable Sander Levin, Ranking Member of the House Committee on Ways and Means  
Members of the House Committee on Ways and Means