May 10, 2016

The Honorable Orrin G. Hatch
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ronald L. Wyden
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch and Ranking Member Wyden:

In connection with the Senate Finance Committee's recent hearing on *Navigating Business Tax Reform*, we are submitting as a statement for the record the attached letter which was sent to the Committee's Business Income Tax Bipartisan Tax Working Group in April 2015. As discussed in the letter, we urge you preserve the current availability of the cash method of accounting as part of any business tax reform. Thank you for your consideration and your leadership on tax policy issues.

Sincerely,

The Cash to Accrual Accounting Stakeholder Coalition

April 15, 2015

The Honorable Orrin G. Hatch
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ronald L. Wyden
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch and Ranking Member Wyden:

We are writing in response to your invitation to stakeholders to submit ideas to the Committee's tax reform working groups on how best to reform the nation's tax code to make it simpler, fairer and more efficient. We applaud your efforts to improve the tax code and strengthen U.S. businesses, and we appreciate the opportunity to provide comments.

Specifically, we are writing to ask that you preserve the cash method of accounting for service pass-through entities, including partnerships and Subchapter S corporations, farmers and ranchers, and personal service corporations. The cash method of accounting is the foundation upon which these types of businesses have built their businesses for decades. Because these businesses are taxed at the owner level, forcing them to switch to the accrual method of accounting would result in an effective tax increase on their thousands upon thousands of individual owners that generate jobs and are integral to the vitality of local economies throughout our nation.

Under current law, there are two primary methods of accounting for tax purposes - cash and accrual. Under cash basis accounting, taxes are paid on cash actually collected and bills actually paid. Under accrual basis accounting, taxes are owed when the right to receive payment is fixed, even if that payment will not be received for several months or even several years. Internal Revenue Code section 448 allows the use of cash accounting for service pass-throughs; qualified personal service corporations; farmers and ranchers; and entities with average annual gross receipts of $5 million or less.

Proposals in the last Congress would have required any business with average annual gross receipts greater than $10 million to use the accrual method of accounting. By raising the threshold from $5 to $10 million, the proposals were intended to reduce recordkeeping burdens on small businesses. However, this expansion was paid for by forcing all other businesses currently using cash accounting to switch to accrual accounting. We do not oppose expanding the allowable use of cash accounting, but it is unfair and inconsistent with generally agreed upon tax reform principles to pay for good policy with bad policy that has no other justification than raising revenues. Further, there have been no allegations that the businesses affected by the proposals are abusing the cash method of accounting.

Pass-through entities account for more than 90 percent of all business entities in the United States and are represented across a diverse range of business professions and sectors. A substantial number of these businesses are service providers, farmers and ranchers that currently qualify to use cash accounting. These are businesses throughout America - farms, trucking, construction, engineers, architects, accountants, lawyers, dentists, doctors and other essential service providers - on which communities rely for services and jobs. These are not just a few big businesses and a few well-to-do owners. According to IRS data, there are over 60,000 Subchapter S corporations, 25,000 partnerships and at least 2,000 sole proprietors that would have to switch from cash to accrual accounting.

The negative impact of such a move would be significant:

Cash flow would be severely impaired. Businesses could be forced into debt to finance taxes, including accelerated estimated tax payments, on money they may never receive. Many cash businesses operate on very small profit margins, so accelerating the recognition of income could be the difference between being liquid and illiquid. Many cash businesses have contracts with the government, which is known for long delays in making payments that already stretch their working capital. Structured settlements and alternative fee arrangements can result in substantial delays in collections, sometimes over several years; taxes owed in the year a matter is resolved could potentially exceed the cash actually collected.

A bad crop year could make a farm go under. For farmers and ranchers, cash accounting is crucial due to the number and enormity of up-front costs and the uncertainty of crop yields and market prices. A heavy rainfall, early freeze or sustained drought can devastate an agricultural community. Farmers and ranchers need the flexibility and simplicity of cash accounting to manage their tax burden by evening out annual revenues that can fluctuate greatly from one year to the next.

Recordkeeping burdens would escalate, in cost, staff time and complexity. Cash accounting is simple - cash in/cash out. Accrual accounting is much more complex, requiring sophisticated analyses of when the right to collect income or to pay expenses is fixed and determinable. In order to comply with the more complex rules, businesses currently handling their own books and records may feel like they have no other choice than to hire outside help or buy expensive software.

These impacts are not about the size of a business or its gross receipts. Whether large or small, a business can have small profit margins, rely on government contracts, generate business through deferred fee structures or be wiped out through the vagaries of the weather. Cash diverted toward interest expense, taxes and higher recordkeeping costs is capital unavailable for use in the actual business, including paying wages, buying capital assets or investing in growth.

Proposals to limit the use of cash accounting are counterproductive to agreed-upon principles of tax reform. Tax reform should strengthen our economy, foster job growth, enhance U.S. competitiveness, and promote fairness and simplicity in the tax code. Accrual accounting does not make the system simpler, but more complex. Increasing the debt load of American businesses runs contrary to objectives to move toward equity financing instead of debt financing and will raise the cost of capital, creating a drag on economic growth and job creation. Putting U.S. businesses in a weaker position will put them at further disadvantage compared to foreign competitors. American businesses and their individual owners should not be asked to pay a significant price for reforms that will leave them in a worse position than when they started.

As discussions on tax reform continue, the undersigned respectfully request that the Committee and the working groups take our concerns into consideration and not propose to change the ability to use cash accounting. We would be happy to discuss any of these items further. Please feel free to contact Mary Burke Baker (mary.baker@klgates.com) or any of the signatories for additional information.

Thank you for your consideration of this important matter.

Sincerely,

American Council of Engineering Companies
American Farm Bureau Federation
American Institute of Architects
Americans for Tax Reform
American Institute of CPAs
Baker Botts LLP
Baker Donelson Bearman Caldwell & Berkowitz PC
Debevoise & Plimpton LLP
Dorsey & Whitney LLP
Dykema Gossett PLLC
Farmers for Tax Fairness
Federal Communications Bar Association
Foley & Lardner LLP
Hunton & Williams LLP
Investment Adviser Association
Jackson Walker LLP
K&L Gates LLP
Littler Mendelson PC
Miles & Stockbridge PC
Mitchell Silberberg & Knupp LLP
Morrison & Foerster LLP
Nelson Mullins Riley & Scarborough LLP
Ogletree, Deakins, Nash, Smoak & Stewart PC
Perkins Coie LLP
Richards, Layton & Finger PA
Ropes & Gray LLP
State Bar of South Dakota
Steptoe & Johnson LLP

cc:
The Honorable John Thune, Co-Chair, Business Income Tax Working Group
The Honorable Benjamin Cardin, Co-Chair, Business Income Tax Working Group
The Honorable Pat Roberts, Member, Business Income Tax Working Group
The Honorable Debbie Stabenow, Member, Business Income Tax Working Group
The Honorable Richard Burr, Member, Business Income Tax Working Group
The Honorable Tom Carper, Member, Business Income Tax Working Group
The Honorable Johnny Isakson, Member, Business Income Tax Working Group
The Honorable Bob Casey, Member, Business Income Tax Working Group

The Honorable Rob Portman, Member, Business Income Tax Working Group
The Honorable Mark Warner, Member, Business Income Tax Working Group
The Honorable Pat Toomey, Member, Business Income Tax Working Group
The Honorable Robert Menendez, Member, Business Income Tax Working Group
The Honorable Dan Coats, Member, Business Income Tax Working Group
The Honorable Bill Nelson, Member, Business Income Tax Working Group