



November 21, 2017

The Honorable Mitch McConnell
Majority Leader
United States Senate
317 Russell Senate Office Building
Washington, DC 20510

The Honorable Charles E. Schumer
Minority Leader
United States Senate
322 Hart Senate Office Building
Washington, DC 20510

The Honorable Orrin G. Hatch
Chairman
United States Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

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

RE: Tax Cuts and Jobs Act

Dear Majority Leader McConnell, Minority Leader Schumer, Chairman Hatch and Ranking Member Wyden:

The American Institute of CPAs (AICPA) applauds Chairman Hatch and the Senate Finance Committee (the “Committee”) for its efforts in reforming our nation’s outdated Internal Revenue Code (“Tax Code”).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. For example, we commend the preservation of the deduction for business interest expense for small businesses, repeal of the alternative minimum tax (AMT), expansion of the exception for small taxpayers from the uniform capitalization rules under section 263A, and simplification of the “kiddie tax.” These provisions would eliminate a significant amount of compliance burdens for small businesses and help reduce the complexity and unfairness of the current Tax Code.

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. We support the increase of the qualifying threshold from \$5 million of average gross receipts, without further restricting its use for the millions of U.S. businesses currently utilizing this method. 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 encourage small business growth and reduce compliance costs, creating an environment for increased economic growth.

2. Tax Rates for Pass-through Entities

The AICPA applauds the Committee's efforts to provide certain service businesses¹ with the 17.4% deduction available to other pass-through entities. Professional services providers, such as accounting firms, are an important sector in our economy and contribute to the nation's goals of creating jobs and better wages. Without the benefit of a fair and consistent rate reduction, the incentive to start or grow a business is diminished, with a corresponding loss of jobs and reduction in wages. However, Congress should provide parity for all pass-through entities, regardless of their line of business, in order to achieve a fairer, simpler, and more competitive tax code. Avoiding unnecessary exceptions from the qualified business income deduction would promote both equity and fairness.

3. 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, 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 2026.

4. 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

¹ Under the Chairman's Modification to the Chairman's Mark of the "Tax Cuts and Jobs Act" dated November 17, 2017, Section II A.4, the 17.4% deduction applies to specified service businesses whose taxable income does not exceed \$500,000 for married individuals filing jointly or \$250,000 for other individuals.

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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.

5. International Tax Provisions

Treatment of Deferred Foreign Earnings

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

Under the Proposal, “any U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the corporation,” calculated as of a date specified in the Proposal. The rate of tax on such foreign earnings would depend on whether the foreign earnings have 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 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 which they elect to repatriate.

Inbound Transfers of Intangible Property

The AICPA applauds the provision regarding the treatment for intangible property distributed from a Controlled Foreign Corporation (CFC) to a domestic corporation which is a U.S. shareholder of that CFC. Under this provision, the fair market value of the intangible property is treated as not exceeding the adjusted basis of the property immediately before the distribution. However, this beneficial treatment is only permitted for distributions received by a domestic corporation from a CFC with respect to its U.S. shareholder which occur before the last day of the third taxable year of such CFC that begins after December 31, 2017.

We believe that the positive policy objectives of this provision, which encourage businesses to transfer foreign located intangible property to the U.S., warrant making the provision permanent. In addition,

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such permanent extension should also apply this treatment to newly acquired foreign based intangible property to further promote the policy objectives.

6. Tax Preparation Expenses

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

7. 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 a high-level of gross receipts test (adjusted for inflation) 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. The Committee 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.

8. Head of Household Paid Preparer Due Diligence

The AICPA applauds the efforts of the Committee to reduce fraudulent claims for head of household status. However, the proposed process would add to the multiple layers of due diligence requirements with which tax practitioners are already required to comply, such as section 6694 preparer penalty regulations and the Department of the Treasury's ("Treasury") Circular 230 rules. We urge Congress to consider simplified approaches that recognize taxpayers are responsible for the accuracy of their returns. We question whether this increased burden and administrative strain on an overwhelming number of taxpayers and tax preparers who are compliant would achieve the result of a significant deterrence on fraudulent filers.

9. Internal Revenue Service (IRS) Customer Service

We commend the Senate for recognizing the need for appropriate IRS funding. Congress and the administration should determine the appropriate level of service and compliance they want the IRS accountable to provide and then dedicate appropriate resources for the agency to meet those goals. Agreed upon measures of success are necessary to improve both customer service and voluntary compliance. To instill trust in the tax administration system, we recommend taxpayer service goals based on the following two guiding principles:

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- The IRS should only initiate contact with a taxpayer if the IRS is prepared and able to devote the resources necessary for a proper and timely resolution of the matter.
- Customer satisfaction must be a goal in every interaction the IRS has with taxpayers, including enforcement actions. Taxpayers expect quality service in all interactions with the IRS, including taxpayer assistance, filing tax returns, paying taxes, and examination and collection actions.²

Additionally, as outlined in AICPA Framework on ensuring a Modern-Functioning IRS for the 21st century, we recommend that the IRS create a new dedicated practitioner services unit to rationalize, enhance, and centrally manage the many current, disparate practitioner-impacting programs, processes, and tools.³ As part of this new unit, the IRS should provide practitioners with a secure online tax professional account with access to all of their clients' information. The IRS should offer robust practitioner priority hotlines with higher-skilled employees that have the experience and training to address complex issues. Furthermore, the IRS should assign customer service representatives (a single point of contact) to geographic areas in order to address challenging issues that practitioners could not resolve through a priority hotline.

* * * * *

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; Ogochukwu Eke-Okoro, Lead Manager – AICPA Tax Policy & Advocacy, at (202) 434-9231, or ogo.eke-okoro@aicpa-

² Verbatim quote of the two guiding principles, The National Commission of Restructuring the Internal Revenue Service, [A Vision for a New IRS, Report of the National Commission on Restructuring the Internal Revenue Service](#), page 23, June 25, 1997.

³ See [AICPA Framework on Ensuring a Modern-Functioning IRS for the 21st Century](#).

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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,

A handwritten signature in black ink, appearing to read "Annette Nellen". The signature is fluid and cursive, with the first letter of each word being capitalized and prominent.

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

cc: Members of the United States Senate
The Honorable Paul Ryan, Speaker, United States House of Representatives
The Honorable Nancy Pelosi, Minority Leader, United States House of Representatives
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