



February 13, 2019

Mr. William M. Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Scott K. Dinwiddie
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Small Business Relief from Definition of Tax Shelter

Dear Messrs. Paul and Dinwiddie:

The American Institute of CPAs (AICPA) requests that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) provide certain small businesses relief from the definition of a tax shelter to ensure that they will qualify for the small business simplifying provisions available under Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA).

TCJA contains numerous simplifying provisions for small businesses. In particular, small businesses that meet the \$25 million gross receipts test have the ability to use the overall cash method of accounting; account for inventory under special rules of section 471(c); receive an exemption from the uniform capitalization rules; receive an exception for certain construction contracts from using the percentage-of-completion method; and receive an exemption from the section 163(j)¹ limitation on business interest deduction for years beginning after December 31, 2017. However, a small business that meets the definition of a tax shelter, regardless of its ability to meet the \$25 million gross receipts test, is ineligible to use the above simplifying provisions.

BACKGROUND

Many simplifying provisions under TCJA provide an exception for certain small businesses. Certain small businesses are generally defined as “any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c).” Specifically:

- Section 448(b)(3) provides an exception to the limitation on the use of the cash method of accounting to “entities which meet gross receipts test” of section 448(c).

¹ All references to “section” or “§” are to the Internal Revenue Code of 1986, as amended, and all references to “Treas. Reg. §” and “regulations” are to U.S. Treasury regulations promulgated thereunder.

- Section 471(c) provides an exemption for certain small businesses from the section 471 general rule for inventories.
- Section 263A(i)(1) provides an exemption for certain small businesses from the section 263A capitalization and inclusion in inventory costs of certain expenses.
- Section 460(e)(1)(B)(ii) provides an exception for certain construction contracts entered into by small businesses from the section 460 special rules for long-term contracts.
- Section 163(j)(3) provides an exemption for certain small businesses from the section 163(j) limitation on business interest deduction.

An entity meets the Section 448(c) gross receipts test if the “average annual gross receipts of such entity for the 3-taxable-year ending with the taxable year which precedes such taxable year does not exceed \$25,000,000.”

Section 448(a)(3) provides that “in the case of a tax shelter, taxable income shall not be computed under the cash receipts and disbursements method of accounting.”

Section 461(i)(3) defines a tax shelter as “(A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale, (B) any syndicate (within the meaning of section 1256(e)(3)(B)), and (C) any tax shelter (as defined in section 6662(d)(2)(C)(ii)).”

Section 1256(e)(3)(B) defines a syndicate as “any partnership or other entity (other than a corporation which is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners or limited entrepreneurs.”

RECOMMENDATION

The AICPA urges Treasury and the IRS to provide relief to certain small businesses from the definition of a syndicate, which if unaddressed, would result in their treatment as a tax shelter. To allow these businesses to avoid treatment as a syndicate and utilize the simplifying provisions under TCJA, guidance must provide that the interests in these entities are attributable to active management. Specifically, the guidance should provide that if an entity:

- a) Qualifies under the gross receipts test of section 448(c); and
- b) Meets the definition of a syndicate under section 1256(e)(3)(B); and

- c) Does not qualify “for making an election under section 163(j)(7)(B) to be an electing real property trade or business”² or “an election under section 163(j)(7)(C) to be an electing farming business”³

the Secretary should determine (by regulations or otherwise) that all interests in the entity “should be treated as held by an individual who actively participates in the management of such entity”⁴ provided that the entity and the interests were not used for tax avoidance purposes.

ANALYSIS

Many small businesses have significant concerns with the specific definition of a syndicate, as the disallowance of the simplifying provisions for such entities erodes Congressional intent to reduce uncertainty and complexity for small businesses. If an entity meets the \$25 million gross receipts test, the entity should benefit from the simplifying provisions, regardless of whether the entity has taxable income or loss for the tax year.

Businesses that fluctuate between having taxable income and loss are eligible for the simplifying provision in some years but not others. The fluctuation between income and loss would require small businesses to frequently change methods of accounting. This inconsistency creates unnecessary administrative burdens for small businesses and the IRS.

The Secretary has the authority to provide for exceptions from the definition of a syndicate. Section 1256(e)(3)(C) lists several examples of interests in an entity that “shall not be treated as held by a limited partner or a limited entrepreneur,” therefore, excluding the entity from the definition of a syndicate. In particular, section 1256(e)(3)(C)(v) allows the Secretary to determine (by regulations or otherwise) “that such interest should be treated as held by an individual who actively participates in the management of such entity, and that such entity and such interest are not used (or to be used) for tax-avoidance purposes.”

Accordingly, we recommend that Treasury and the IRS use their authority under section 1256(e)(3)(C)(v) to provide relief from the definition of syndicate to small business entities that meet certain conditions. The first condition is that an entity must qualify under the gross receipts test. Secondly, an entity must meet the definition of a syndicate. Finally, an entity must not qualify to make an election as an electing real property business or electing farming business.⁵ If a small business satisfies these three conditions, then the Secretary should determine that all interests in

² [Proposed Reg. § 1.163\(j\)-9\(a\)](#) (2018).

³ *Id.*

⁴ Section 1256(e)(3)(C)(v).

⁵ [Limitation on Deduction for Business Interest Expense, 83 Fed. Reg. 248 \(December 28, 2018\)](#). *Federal Register: The Daily Journal of the United States*. Web. 28 December 2018; page 67520, “The Treasury Department and the IRS also have determined that small businesses that are exempt under section 163(j)(3) and proposed §1.163(j)-2(d)(1) may not make an election under proposed §1.163(j)-9.” Proposed §1.163(j)-9 is the “Elections for Excepted Trades or Businesses” regarding section 163(j)(7)(B) to be an electing real property trade or business and an election under section 163(j)(7)(C) to be an electing farming business.

Mr. William M. Paul
Mr. Scott K. Dinwiddie
February 13, 2019
Page 4 of 4

the entity are treated as held by partners or owners who actively participate in the management of such entity.

* * * * *

The AICPA is the world's largest member association representing the CPA profession, with more than 431,000 members in 137 countries and territories, 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 appreciate your consideration of these comments. If you would like to discuss these issues, please feel free to contact Jennifer Kennedy, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (415) 498-5952, or Jennifer.Kennedy@pwc.com; Melanie Lauridsen, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9235, or Melanie.Lauridsen@aicpa-cima.com; or me at (408) 924-3508 or Annette.Nellen@sjsu.edu.

Sincerely,



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

cc: Krishna P. Vallabhaneni, Deputy Tax Legislative Counsel, Department of the Treasury