



American Institute of CPAs
1455 Pennsylvania Avenue, NW
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April 25, 2016

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

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

RE: Importance of Maintaining Cash Method of Accounting

Dear Chairman Hatch and Ranking Member Wyden,

The American Institute of CPAs (AICPA) writes to you today regarding the April 26, 2016 hearing to be held by the Senate Finance Committee on “Navigating Business Tax Reform.” The AICPA commends your ongoing efforts on tax reform and strongly encourages the importance of maintaining the cash method of accounting, as it is currently permitted, as part of the Internal Revenue Code. The AICPA is the world’s largest member association representing the accounting profession, with more than 412,000 members in 144 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 appreciate the work the Committee is doing to develop tax reform proposals and support the goal of simplifying the tax code. As the Committee drafts its proposals, we urge maintaining the current availability to use the cash method of accounting for pass-through entities and personal service corporations, such as accounting firms. Determining taxable income under the cash basis is simple in application, is a method of accounting which the service industry has used for decades, and must remain an option for these businesses.

Under the accrual method, many accounting and other service-type firms would need to accelerate a significant amount of income into the current taxable year despite not receiving the actual payment from their clients. Specifically, moving these businesses to the accrual method would simply shift tax receipts into the 10-year window, which would otherwise be collected by the Treasury in later years. This proposal may result in a more favorable revenue score under the current CBO budget model but comes at a high cost to service firms. We strongly oppose the imposition of such a financial and cash flow burden on the service industry. Requiring these firms to use the accrual method for tax purposes may also result in the only reason an owner is subject to a higher individual income tax rate for federal, state, or both purposes.

This increase in tax liability could have a significant negative impact on a new owner’s ability to finance entrance into a partnership. Additionally, limiting the use of the cash method may result in the requirement of a CPA to take out a personal bank loan for the sole purpose of paying his/her increased tax liability. We believe that this result contradicts the rationale for tax reform, including growing businesses, creating jobs, and making our country more competitive.

In addition to income tax consequences, some partners would also pay more self-employment taxes under the accrual method. Under current law, amounts received by a partner on account of

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retirement are generally excluded from self-employment income if certain conditions are met and are paid on a periodic basis under a partnership plan. However, if a partner's income is accelerated to a year when the partner is active in the business, the partner would pay self-employment taxes on that amount – *regardless of whether the partner receives the cash before or after retirement*. As a result, some partners would unfairly pay self-employment taxes on a portion of their retirement payments under the accrual method. Assuming the partners' income would exceed the FICA wage base (i.e., \$118,500 for 2016) prior to retirement, partners would pay an additional 2.9% for Medicare tax, plus an additional 0.9% in some higher income scenarios.

The AICPA has long advocated for a simpler, fairer tax code. One overriding principle for fairness is that similarly situated taxpayers should pay the same tax. A partnership is merely an aggregation of individuals, and individuals doing business as sole proprietors – regardless of taxable income – may use the cash method of accounting. If a limitation based on an entity's gross receipts were to be enacted, some partnerships would not qualify to use the cash method, which could drastically affect each individual owner's taxable income. As a result, a service provider working as a sole proprietor could have a significantly lower tax liability than a service provider in a partnership merely because of where they work. We believe that such disparate treatment under these circumstances is unjustifiable and essentially penalizes owners for participating in a partnership.

We also believe a gross receipts restriction on the use of the cash method would unfairly impact accounting firms and could threaten their ability to expand. Accounting firms are subject to state laws and regulations, many of which limit ownership to individuals who actively participate in the business. Such rules effectively prohibit owners from obtaining outside capital to finance their businesses. Thus, in order to achieve improved efficiency, reduced operational overhead, and higher profits, owners in the firm must fund the growth. In the accounting profession, this growth frequently comes from the acquisition of or merger with another accounting firm. However, accounting firms may be deterred from expanding if such a transaction would, or potentially could in the future, cause them to exceed a gross receipts limitation on the use of the cash method. The financial burden of reporting taxable income under the accrual method would certainly reduce any potential benefits from improved efficiency and reduced operational overhead.

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. An accrual method mandate falls short in that regard. We strongly urge retaining use of the cash method of accounting.

Sincerely,



Barry C. Melancon, CPA, CGMA
President and CEO

cc: Members of the Senate Committee on Finance