



October 25, 2017

The Honorable Paul Ryan
Speaker
United States House of Representatives
H-232, US Capitol
Washington, DC 20515

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

The Honorable Steven T. Mnuchin
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Gary D. Cohn
Director, President's National Economic Council
The White House
1600 Pennsylvania Avenue, N.W.
Washington, DC 20500

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

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

RE: Unified Framework for Fixing Our Broken Tax Code

Dear Speaker Ryan, Majority Leader McConnell, Secretary Mnuchin, Director Cohn, Chairman Hatch and Chairman Brady:

The American Institute of CPAs (AICPA) supports comprehensive tax reform and appreciates your efforts in releasing the "Unified Framework for Fixing Our Broken Tax Code".

As the Administration and Congress develop legislative proposals, we encourage a holistic approach that is both equitable and meaningful to drive economic opportunities for individuals and families while leveling the playing field for American businesses not only in the United States (U.S.) but also abroad. The AICPA is a long-time advocate for an efficient and pro-growth tax system based on principles of good tax policy.¹ 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 have provided over 100 comment letters, position papers and statements for the record on tax reform over the last five years in the interest of good tax policy and effective tax administration. This letter is a brief summary of some of the key issues for our profession.

¹ AICPA, "[Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals](#)," January 2017.

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 2 of 8

1. Cash Method of Accounting

The AICPA supports the expansion of the number of taxpayers who may use the cash method of accounting.² The cash method of accounting is simpler in application than the accrual method, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the related income. Therefore, entrepreneurs often choose this method for small businesses.

We are concerned with, and oppose, any new limitations on the use of the cash method for any business, including those businesses whose income is taxed directly on their owners' individual returns (such as, partnerships and S corporations). Requiring businesses to switch to the accrual method upon reaching a gross receipts threshold unnecessarily creates a barrier to growth.³

The AICPA believes that further restricting the use of the cash method of accounting for businesses would:

- a. Discourage natural small business growth;
- b. Impose an undue financial burden on their individual owners;
- c. Increase the likelihood of borrowing;
- d. Impose complexities and increase their compliance burden; and
- e. Treat similarly situated taxpayers differently (merely because income is taxed directly on their owners' individual returns).

Congress should not further restrict the use of the long-standing cash method of accounting for the millions of U.S. businesses (e.g., sole proprietors, personal service corporations, and pass-through entities) currently utilizing this method.

2. Pass-through Entities

If Congress lowers the income tax rates for C corporations, all types of business entities should receive a rate reduction. Our laws should continue to encourage, or more accurately – not discourage, the formation of pass-through entities as these business structures provide the flexibility and control desired by many owners that is not available within the more formal corporate structure. The vast majority of America's businesses are structured as pass-through entities (partnerships, S corporations, limited liability companies or sole proprietorships).⁴ Tax reform should not disadvantage these entities or require businesses to engage in complex entity changes to obtain favored tax status.

² AICPA, "[Investment in New Ventures and Economic Success Today Act of 2017 \(S. 1144\)](#)," June 22, 2017.

³ A required switch to the accrual method affects many small businesses in certain industries, including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.

⁴ Census Bureau, [County Business Patterns](#); Census Bureau, [Nonemployer Statistics](#).

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 3 of 8

Tax reform should recognize the importance of consistent tax rates on business income generated from all of America's pass-through entities, including professional service firms. Professional service firms, such as public accounting firms, are an important sector in our economy and heavily contribute to the nation's goals of creating jobs and better wages.⁵ For example, according to the current employment statistics from the U.S. Bureau of Labor Statistics (BLS), the Accountants and Auditors service industry has a job growth outlook of 11% (as opposed to the average growth rate of 7% for all occupations) for the years 2014-2024.⁶ Furthermore, the jobs created by professional service firms are driving a more educated workforce for delivery of advanced services and products. These jobs are often coveted due to higher wages as well as health care, retirement and other benefits.

Excluding professional services does not represent the current integrated global environment. Professional service pass-throughs are increasingly competing on an international level with businesses organized as corporations, require a significant investment in tangible and intangible assets, and rely on the contribution of salaried, nonequity professionals to generate a significant portion of the revenue.⁷ Artificially limiting the use of a lower business rate, regardless of industry, would penalize a business for operating as a pass-through entity. An additional provision that would further disadvantage pass-through entities vis-à-vis corporations – changes to the federal deduction for state and local taxes – could have a distortive impact and dull the job-creating and economy-boosting effects of tax reform.

Some lawmakers have questioned whether professional service providers would unfairly take advantage of a lower business rate. However, these professionals face the same economic and legal challenges as other businesses. Any perceived tax savings of restructuring as an independent contractor, are unlikely to cover the incremental business cost of obtaining one's own employment benefits, losing unemployment coverage, providing for self-funded health care and incurring business-related costs (investment in technology, malpractice insurance, annual continuing education, office rental expense, etc.).

Furthermore, employers are bound by case law in determining employment status, which would prevent them from contracting with former employees who impulsively changed their status to independent contractor. If an employer claims independent contractor status for a worker without a reasonable basis, both the worker and employer are subject to penalties and taxes.

⁵ In 2014 (the latest data available), the U.S. professional services industry comprised about 883,000 firms and employed 8.6 million Americans. The industry achieved combined annual revenues of \$1.6 trillion in 2015. Selectusa.gov; [Professional Services Spotlight](#).

⁶ U.S. Bureau of Labor Statistics website, Publications, Business and Financial, [Accountants and Auditors](#).

⁷ The U.S. is the world's most desired location for professional services firms. In today's integrated global environment, businesses find it critical to access the talent, institutions, business processes, and client base offered in the U.S.; Selectusa.gov; [Professional Services Spotlight](#).

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 4 of 8

3. Distinguishing Compensation Income

If Congress provides a reduced rate for active business income of sole proprietorships and pass-through entities, we recognize that it will place additional pressure on the distinction between the profits of the business and the compensation of owner-operators. We recommend determining compensation income by codifying traditional definitions of “reasonable compensation” supplemented, if necessary, by additional guidance from the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS).

The definition of reasonable compensation should reflect the type of business, the time spent by owners in operating the business, owner expertise and experience, and the existence of income-generating assets in the business (such as non-owner employees and capital invested). Other relevant factors include available guidance (if any) used to help determine reasonable compensation for the geographic area and years of experience (such as, wage data guides provided by the BLS), and the book value and estimated fair market value of tangible and intangible assets that generate income for the business.

Former Ways & Means Committee Chairman Dave Camp’s 2014 discussion draft⁸ included a proposal to treat 70% of pass-through income of an owner-operator as employment income. While this proposal presented a simple method, it would result in an inequitable outcome in many situations. If Congress moves forward with a 70/30 rule, or other percentage split, we recommend limiting it to active owners and making the proposal a safe harbor option. The reduced rate should apply to owners who do not work in the business (i.e., none of their income should qualify as employment income). Congress should also avail the reasonable compensation standard (currently utilized for corporations) to all taxpayers. These rules would provide uniform treatment among closely-held business entity types.

4. Centralized Partnership Audit Regime

The AICPA requests that Congress pass legislation to delay by one year the effective date of the new “Centralized Partnership Audit Regime” (the “Regime”) which was enacted by the Bipartisan Budget Act of 2015. The current effective date is December 31, 2017.

This new Regime represents a significant departure from previous law. It requires a substantial effort on the part of Treasury, the IRS, the tax practitioner community and the affected taxpayers (which includes virtually every partnership and their partners) to develop and comply with new rules, regulations and procedures to establish a fair, equitable and administrable Regime.

⁸ H.R. 1 (113th Congress), [The Tax Reform Act of 2014](#), Sec. 1502; also see [Section-by-Section Summary](#), pages 32-33.

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 5 of 8

The AICPA believes that it is unlikely that all the procedures and guidance necessary for taxpayers to make informed decisions regarding its provisions will be established before the current effective date at the end of this year.

5. Permanent Disaster Relief

A comprehensive tax reform package should include permanent tax provisions that will quickly aid affected taxpayers as they recover from the impacts of natural disasters. Families and communities impacted unexpectedly by disasters are often displaced from their homes, their livelihoods, and their businesses. We believe permanent relief, which is long-overdue, will provide disaster victims with certainty, fairness, and the ability to promptly receive the aid they need after a natural disaster, while reducing the administrative burdens on disaster victims and the IRS.

Therefore, we continue to urge Congress to enact tax legislation that permanently provides meaningful and timely relief, which would take effect immediately when a declaration of a federal disaster occurs, rather than providing delayed tax relief through separate individual bills following each disaster.⁹

Additionally, we recommend¹⁰ that Congress grant the IRS specific authority to quickly postpone certain deadlines in response to state-declared disasters. This provision would allow the IRS to offer disaster victims the certainty they need as soon as possible.

6. Modernize the Internal Revenue Service

Whether addressed within or outside of tax reform, we urge Congress and the Administration to address IRS taxpayer services, and any effort to modernize the IRS and its technology infrastructure should build on the foundation established by the [Report of the National Commission on Restructuring the IRS](#).

In April, we submitted recommendations¹¹ to modernize the IRS business practices and technology, re-establish the annual joint hearing review, and enable the IRS to utilize the full range of available authorities to hire and compensate experienced professionals from the private sector to meet its mission. The legislative and executive branches should determine the appropriate level of service and compliance they want the IRS accountable for and then dedicate appropriate resources to meet those goals.

⁹ See AICPA letters on "[Request for Permanent Tax Provisions Related to Disaster Relief](#)," November 22, 2013; "[AICPA Suggestions to Tax Reform Working Group on Community Development and Infrastructure](#)," April 13, 2015; and brochure on "[Natural Disaster: the Case for Permanent Tax Relief](#)," September, 2015.

¹⁰ See item 13 of AICPA's written [statement](#) for the U.S. Senate Committee on Small Business & Entrepreneurship hearing on "Tax Reform: Removing Barriers to Small Business Growth," June 14, 2017.

¹¹ AICPA letter, "[Ensuring a Modern-Functioning IRS for the 21st Century](#)," April 3, 2017.

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 6 of 8

Additionally, we recommend that Congress direct the IRS to create a new dedicated practitioner services unit to rationalize, enhance, and centrally manage the many current, disparate practitioner-impacting programs, processes, and tools.

7. IRS Regulation of Tax Return Preparers

The AICPA has always been a steadfast supporter of the goals of enhancing compliance and elevating ethical conduct. We fully support the use of a preparer tax identification number (PTIN) for all signing tax preparers, and subjecting all tax preparers to the reach of Treasury Circular 230. However, the AICPA has serious concerns about granting the IRS unlimited authority to regulate tax return preparers.

Congress should mandate that the IRS enact a testing and continuing education program similar to the registered tax return preparer program in effect prior to *Loving* that would apply exclusively to so-called “unenrolled” tax return preparers who are not licensed by the states. The one-time basic 1040 “entrance” examination to ensure basic competency in individual income tax return preparation and the requirement for unenrolled preparers to satisfy 15 hours of annual continuing education were both appropriate and necessary to protect taxpayers from incompetence and misconduct.

In order to prevent potential overregulation and duplicative filing obligations, any legislation should also limit the IRS’s authority to require a PTIN to only those individuals who (1) sign a tax return or claim for refund, and (2) are involved in the preparation of tax returns or claims for refund, but are *not* supervised by an attorney, CPA, or “enrolled preparer.”

The IRS should also more effectively utilize their current PTIN system to protect the public from incompetent and fraudulent tax return preparers. We recommend that Congress grant the IRS specific authority to revoke a PTIN to efficiently stop incompetent and unscrupulous preparers from continuing to file inaccurate and fraudulent tax returns.

Finally, Congress should require the IRS to take steps to mitigate marketplace confusion.¹² To mitigate marketplace confusion, we recommend that currently-unenrolled PTIN holders using any paid advertising display or broadcast a statement explaining the differences between the different types of preparers (e.g., qualifications) and, most importantly, educating the public that the IRS does not endorse any particular tax return preparer.

¹² Prior to *Loving v. IRS*, the IRS recognized the potential for marketplace confusion when they required the currently-unenrolled community be made subject to the guidance in Notice 2011-45, 2011-25 IRB 886 with regard to advertising restrictions.

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 7 of 8

8. Mobile Workforce

The AICPA supports the Mobile Workforce State Income Tax Simplification Act of 2017, [S. 540](#) and [H.R. 1393](#), which provides a uniform national standard for non-resident state income tax withholding and a *de minimis* exemption from the multi-state assessment of state non-resident income tax.¹³ The current situation of having to withhold tax and file many state nonresident tax returns for just a few days of work in various states is too complicated for both small businesses and their employees.

S. 540 and H.R. 1393 would provide long-overdue relief to all businesses from the current web of inconsistent state income tax and withholding rules on nonresident employees. Therefore, we urge Congress to pass S. 540 and H.R. 1393 that provide national uniform rules and a reasonable 30 day *de minimis* threshold before income tax withholding is required.

9. Other Tax Simplification & Administration Issues

As part of the comprehensive tax reform efforts, we support a new, simplified income tax rate structure. We suggest Congress and the Administration avoid, as well as eliminate, all surtaxes which are complicated, confusing, and lack transparency, including the alternative minimum tax (AMT). We also urge policy makers to use a consistent definition of taxable income without the use of any phase-outs. The use of phase-outs – to increase the effective tax rate – has contributed to the complexity of the present tax law. Phase-outs also create marginal rates greater than the statutory rate. We are concerned that provisions to limit or eliminate the use of certain deductions and exclusions for the top tax bracket will continue the flaws of the current system.

It is also important that special care is given to transition rules and grandfathering of existing carryover rules. Congress should provide sufficient time and flexibility to implement transition rules (e.g., AMT carryovers, suspended and passive losses, etc.).

Finally, in the interest of effective tax administration, we recommend that Congress allow pass-through entities to choose fiscal year ends for tax purposes. This flexibility would allow advisors to spread out their workload during the year and improve the tax compliance process.

* * * * *

As Congress continues tax reform deliberations, we also encourage policymakers to consider our recent submissions to Chairman Hatch's request for feedback on [Individual, Families and Tax Administration](#), [Business Income Tax](#), [Taxation on Savings and Investments](#), and the [International Tax System](#) and the

¹³ See AICPA [written statement](#), "AICPA Statement for the Record of the April 13, 2016 Hearing on "Keep it Simple: Small Business Tax Simplification and Reform, Main Street Speaks," April 7, 2016.

The Honorable Paul Ryan
The Honorable Mitch McConnell
The Honorable Steven T. Mnuchin
The Honorable Gary D. Cohn
The Honorable Orrin G. Hatch
The Honorable Kevin Brady
October 25, 2017
Page 8 of 8

AICPA's [2017 Compendium of Tax Legislative Proposals](#) which addresses technical provisions that need modification and promote simplicity and fairness.

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 appreciate the opportunity to provide comments on these tax reform issues related to individuals, families and tax administration. If you have any questions, please contact me at (408) 924-3508 or annette.nellen@sjsu.edu; or Melanie Lauridsen, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9235, or melanie.lauridsen@aicpa-cima.com.

Sincerely,



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

cc: Members of the Senate Committee on Finance
Members of the House Committee on Ways and Means
The Honorable David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
The Honorable John Koskinen, Commissioner, Internal Revenue Service