



NEW JERSEY STATE BAR ASSOCIATION

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The Honorable Robert Menendez
Business Income Tax Working Group
Committee on Finance
United States Senate
Washington, D.C. 20510

Re: Proposed Legislation Requiring Law Firms and Other Personal Service Businesses to Pay Taxes Using the Accrual Method of Accounting

Dear Senator Menendez:

On behalf of the New Jersey State Bar Association (“NJSBA”) and its more than 18,000 members, I am writing in response to the Senate Finance Committee’s invitation to stakeholders to express their views to the Committee’s tax reform working groups on how to improve the nation’s tax code. In particular, the NJSBA supports preserving the traditional cash receipts and disbursements method of accounting for law firms and other personal service businesses. We also strongly oppose proposals—such as Section 51 of the Senate Finance Committee staff discussion draft bill from the 113th Congress and similar proposals now under consideration—that would require all personal service businesses with annual gross receipts over \$10 million to switch from the cash method of accounting to the more complex and costly accrual method. If these proposals are enacted, many law firms, accounting firms, and other professional service providers would be forced to pay taxes on “phantom” income long before it is actually received.

Under current law, individuals and most partnerships, S corporations, and other pass-through entities—as well as other types of businesses with annual gross receipts of \$5 million or less—are permitted to use the simple cash method of accounting, in which income is not recognized until cash or other payment is actually received. In addition, all law firms and various other types of personal service businesses are allowed to use the cash method of accounting regardless of their annual revenue unless they have inventory. Most other businesses are required to use the accrual method, in which income is recognized when the right to receive the income arises, not when it is actually received. Proposals like Section 51 would dramatically change current law by raising the gross receipts cap to \$10 million while eliminating the existing exemption for law firms and other personal service businesses, other individuals and pass-through entities, and farmers.

Although we commend Congress’ efforts to simplify the tax laws, we are concerned that proposals like Section 51 would have the opposite effect and cause other negative unintended consequences. These far-reaching proposals would create unnecessary new complexity in the tax law and increase compliance costs by disallowing the use of the simple, straightforward cash method of accounting. The proposals would also impose significant new financial burdens and hardships on many law

firms and other personal service businesses throughout the country by requiring them to pay tax on phantom income they have not yet received and may never receive.

In addition to the financial harm that the mandatory accrual accounting proposals would impose on individual law firms, the proposals would also adversely affect many other personal service businesses and the legal profession in several ways. First, the proposals would impose a major, unjustified tax increase on small businesses; the Joint Committee on Taxation estimates that last year's House proposal, which closely parallels Section 51 of the Senate draft bill, would generate \$23.6 billion in new revenue over 10 years. Second, the proposals would impede economic growth by discouraging law firms and other professional service providers from expanding or merging because once a firm exceeds \$10 million in annual gross receipts, it would be forced to switch from cash to accrual accounting, thereby accelerating its tax payments. Third, the proposals would harm clients by pressuring firms to collect their fees immediately after legal services are provided, discouraging the use of alternative or flexible fee arrangements, and making it more difficult for firms to provide essential pro bono legal services to the poor.

To avoid these harmful consequences, the NJSBA urges you and the Business Income Tax Working Group to help preserve the ability of law firms and other personal service businesses to use the simple cash method of accounting. In addition, we urge you and the Working Group not to support any tax reform proposals that would require these businesses to switch from the cash method of accounting to the more complex and costly accrual method.

Thank you for considering our views on this issue, which is of critical importance to lawyers, law firms, and many other types of personal service businesses throughout New Jersey and around the country.

Sincerely,



PARIS P. ELIADES
President, New Jersey State Bar Association