American Institute of CPAs
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March 31, 2015

The Honorable John Thune
Senate Committee on Finance
Tax Reform Working Group on
Business Income Tax
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Benjamin Cardin
Senate Committee on Finance
Tax Reform Working Group on
Business Income Tax
219 Dirksen Senate Office Building
Washington, DC 20510

RE: AICPA Suggestions to Tax Reform Working Group on Business Income Tax

Dear Senator Thune and Senator Cardin:

The American Institute of Certified Public Accountants (AICPA) applauds the leadership taken by the Senate Committee on Finance to spur comprehensive tax reform efforts through policy-focused working groups. We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options.

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy.[1] Our tax system must be administrable, stimulate economic growth, have minimal compliance costs, and allow taxpayers to understand their tax obligations. We believe these features of a tax system are achievable if the ten principles of good tax policy are considered in the design of the system:

- Equity and Fairness
- Convenience of Payment
- Simplicity
- Economic Growth and Efficiency
- Minimum Tax Gap
- Certainty
- Economy in Collection
- Neutrality
- Transparency and Visibility
- Appropriate Government Revenues

We, therefore, appreciate the opportunity to provide input as you begin shaping tax reform policy in the business income tax area.

In the interest of good tax policy and effective tax administration, specifically focusing on the simplification of business income tax, we respectfully submit comments on the following key issues:

1. Cash Method of Accounting
2. Tax Return Due Date Simplification
3. Alternative Minimum Tax Repeal
4. Pass-Through Business Income Taxation

[1] AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001.

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1. Cash Method of Accounting

The AICPA wholly supports the expansion of the number of taxpayers that may use the cash method of accounting. 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 income. For these same reasons, we are concerned with, and oppose, any new limitations on the use of the cash method for service businesses, including those businesses whose income is taxed directly on their owners' individual returns, such as S corporations and partnerships. Requiring these businesses to switch to the accrual method upon reaching a gross receipts threshold would unnecessarily discourage growth. A required switch to the accrual method would affect some businesses including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.

The AICPA believes that limiting the use of the cash method of accounting by businesses (e.g., sole proprietors, farmers, personal service corporations and pass-through entities) would:

1) Discourage their natural business growth;
2) Impose an undue financial burden on their individual owners;
3) Impose complexities and increase their compliance burden; and
4) Treat similarly situated taxpayers differently (because income is taxed directly on their owners' individual returns).

As the AICPA has previously stated,[2] we believe that Congress should not further restrict the use of the long-standing cash method of accounting for the thousands of U.S. businesses that currently utilize it. We believe that forcing more businesses to use the accrual method of accounting for tax purposes would increase their administrative burden, discourage business growth in the U.S. economy, and unnecessarily impose financial hardship on cash-strapped businesses.

[2] AICPA comment letter on the "Continued Availability of Cash Method of Accounting," December 5, 2013, http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/AICPA%20comments%20on%20Baucus%20cash%20method%20proposal%20FINAL%20Dated%2012052013.pdf, AICPA written statement before the House Committee on Ways And Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf, and AICPA written statement before the House Committee on Small Business, Subcommittee on Economic Growth, Tax and Capital Access, dated July 10, 2014, Hearing on "Cash Accounting: A Simpler Method for Small Firms?"; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA%20WRITTEN%20STATEMENT%20July%2010%202014%20to%20House%20Subcte%20on%20Economic%20Growth%20Tax%20and%20Capital%20Access.pdf.

2. Tax Return Due Date Simplification

Taxpayers and preparers have long struggled with problems created by the inefficient timeline and flow of information. Federal Schedules K-1 are often delivered late, sometimes within days of the due date of taxpayers' personal returns and up to a month after the due date of their business returns. Late schedules make it difficult, if not impossible, to file a timely, accurate return. The current inefficient timeline of tax return due dates is a problem for taxpayers as well as their tax practitioners.

The AICPA recommendation[3] is to require the filing of:

- The partnership Form 1065 by March 15;
- The S corporation Form 1120S by March 31; and
- The individual, trust and estate, and corporate income tax Forms 1040, 1041, and 1120 by April 15.

Extended due dates would be six months after the original due dates for all these forms except the trust and estate Form 1041, which would be extended five and half months to September 30.

Our recommendation would alleviate the problems mentioned above by establishing a logical set of due dates, focused on promoting a chronologically-correct flow of information between pass-through entities and their owners. It would promote the early filing of more business and personal returns and relieve workload compression surrounding the September 15 business return deadline.

The AICPA supports[4] the proposal to change due dates for tax returns of partnerships, S corporations and C corporations because it would:

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[3] See AICPA Summary Chart of Proposed Due Dates and 2013, 2014 and 2015 Proposals; http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Summary_Original_and_Extended_Due_Dates_for_bills_and_proposals_3_12_2014.doc.

[4] We are pleased that this due dates proposal has wide bipartisan support and has been included in proposed legislation introduced by Senator Enzi and Representative Jenkins, including in 2013 (S. 420 and H.R. 901) and in 2011 (S.845 and H.R. 2382). It was also included in the March 21, 2013, Senate Finance Committee Tax Reform Options paper on Simplifying the Tax System for Families and Businesses. It was also in the November 20, 2013, Senate Finance Committee staff discussion draft on tax reform of tax administration provisions. We are also pleased that this proposal has been included in the February 26, 2014, House Ways and Means Committee Chairman comprehensive tax reform discussion draft "Tax Reform Act of 2014." This proposal is also supported by the President and was in both the March 2014 and March 2015, Administration's 2015 and 2016 Fiscal Year Revenue Proposals.

- Senate Finance Committee Tax Reform Options paper on Simplifying the Tax System for Families and Businesses, Part II. Filing Process, 1. Enable the IRS to Verify Information on Taxpayer Returns Against Third-Party Information as Returns are Processed, a. Establish a System of Filing Deadlines that Ensures Timely Receipt of Reliable Third-Party Information by Taxpayers and the IRS, for Example by Changing Due Dates for Returns, dated March 21, 2013; http://www.finance.senate.gov/issue/?id=b1ae1ce3-c25c-43c3-82da-6d33378e62bf.

- Improve the accuracy of tax and information returns by allowing corporations and individuals to file using current data from flow-through returns that have already been filed rather than relying on estimates;
- Better facilitate the flow of information between taxpayers (i.e., corporations, partnerships, and individuals);
- Reduce the need for extended and amended corporate and individual tax returns; and
- Simplify tax administration for the government, taxpayers, and practitioners.

3. Alternative Minimum Tax Repeal

The AICPA supports repeal of the alternative minimum tax (AMT).[5] We believe that the current system's requirement for taxpayers to compute their income for purposes of both the regular income tax and the AMT is a far-reaching complexity of the Internal Revenue Code (IRC or "Code"). Small businesses, including those businesses operating through pass-through entities, are increasingly at risk of being subject to AMT.

This tax was created to ensure that all taxpayers pay a minimum amount of tax on their economic income. However, small businesses suffer a heavy burden because they often do not know whether they are affected or subject to the tax until they file their taxes and complete the complex tax computation. Therefore, they must constantly maintain a reserve for possible AMT, which takes away from resources that can be allocated to business needs such as hiring, expanding, and giving raises to workers.

The AMT is a separate and distinct tax regime from the "regular" income tax. Code sections 56 and 57 create AMT adjustments and preferences that require taxpayers to make a second, separate computation of their income, expenses, allowable deductions, and credits under the AMT system. This separate calculation must be done on all components of income including business income for sole proprietors, partners in partnerships and shareholders in S corporations. Small businesses must maintain annual supplementary schedules used to compute these necessary adjustments and preferences for many years to calculate the treatment of future AMT

- Senate Finance Committee staff discussion draft on tax reform of tax administration provisions, dated November 20, 2013; http://www.finance.senate.gov/newsroom/chairman/release/?id=a4f8205c-d286-4a41-a61d-753d1abd23d3.
- House Ways and Means Committee, Tax Reform Act of 2014, dated February 26, 2014; http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=370987.
- Budget of the United States Government, Fiscal Year 2016, dated February 2, 2015; https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf.

[5] AICPA written testimony before the House Committee on Ways And Means, Subcommittee on Select Revenue Measures, dated March 03, 2011, "Hearing on Small Businesses and Tax Reform," http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/FINALTESTIMONYFORTHOMPSONMarch32011.pdf; and AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

items and, occasionally, receive a credit for them in future years. Calculations governing AMT credit carryovers are complex and contain traps for unwary taxpayers.

Sole proprietors who are also owners in pass-through entities must combine the AMT information from all their activities in order to calculate AMT. Including adjustments and preferences from pass-through entities contributes to AMT complexity. The computations are extremely difficult for business taxpayers preparing their own returns and the complexity affects the Internal Revenue Service's (IRS's or "Service's") ability to meaningfully track compliance with the AMT.

AICPA supports repealing the AMT for corporations and individuals altogether. As AMT complexities increase, so do the tax regime's impact on unintended taxpayers[6] and related compliance problems.

4. Pass-Through Business Income Taxation

We suggest that as part of pass-through business income tax reform, Congress should:

A. Allow Subchapters K and S to Remain as Separate Subchapters

B. Retain the Flexibility of the Subchapter K Model (Including Special Allocations and Outside Basis for Partnership Level Debt)

C. Retain the Check-the-Box Rules

D. Obtain Tax Rate Parity Between Pass-Through Business Entities and C Corporations

E. Repeal Section 1372: Partnership Rules to Apply for Fringe Benefit Purposes for S Corporations

F. Make Permanent the Reduced Recognition Period for Built-In Gains for S Corporations

G. Allow Full Consideration of Net Realized Built-In Loss for S Corporations

H. Increase the Passive Income Percentage to 60% and Eliminate the Three Year Termination for S Corporations

[6] Although most sophisticated taxpayers are aware of the AMT and that they may be subject to its provisions, the majority of middle-class taxpayers has never heard of the AMT and is unaware that the tax may apply to them. Unfortunately, the number of taxpayers facing potential AMT liability is expanding exponentially due to: (1) "bracket creep;" (2) classifying as "tax preferences" the commonly used personal and dependency exemptions, standard deductions, and itemized deductions for taxes paid, some medical costs, and miscellaneous expenses; and (3) the inability to use many tax credits to offset AMT.

I. Simplify Partnership Audits and Adjustments

J. Repeal Partnership Technical Termination Rule

K. Make Remedial Allocations Mandatory for Partnerships with Greater than 5% Nonresident Alien Individuals as Partners

L. Eliminate the Section 751(b) Calculation on Disproportionate Distributions

M. Oppose Any Proposal for Tax Treatment of "Large" Partnerships as Corporations

N. Require Mandatory Adjustments to Basis of Partnership Property in Case of Transfer of Partnership Interests and Mandatory Adjustments to Basis of Undistributed Partnership Property

O. Allow Accumulated Earnings and Profits Withdrawal from S Corporations with Certainty

P. Reduce Realized Built-In Gains of S Corporations by the Amount of Accrued State Income Tax

Q. Allow Incentive Deductions Permitted by the Internal Revenue Code to Flow Through to Taxpayers Without Basis Limitations

R. Repeal the Prohibition of Section 179(d)(4) for Estates/Trusts; Alternatively, Allow Pass-Through Entity Allocation and Amortization at the Estate /Trust Level

A. Allow Subchapters K and S to Remain as Separate Subchapters

Taxpayers want, and should have the option, to choose between taxation for their pass-through business under a Subchapter K (or "partnership") or Subchapter S (or "corporation") model.[7] Melding Subchapters K and S may result in structural simplification of the Code. However, the melding of these two entity models is not the simplification that American taxpayers truly need. People want practical day-to-day simplification of their tax planning and compliance processes. Allowing taxpayers to choose between two effective pass-through tax regimes gives them the ability to match which pass-through regime best fits their varied business needs.

[7] AICPA submitted letters and written statements on Option 1 and Option 2 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Business_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf, and Option 2 comments, dated July 30, 2013; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf.

B. Retain the Flexibility of the Subchapter K Model (Including Special Allocations and Outside Basis for Partnership Level Debt)

The AICPA recommends[8] that the Subchapter K model retain its flexibility. We note that there are well-developed Subchapter K regulations filled with many anti-abuse rules designed to limit taxpayers from taking undue advantage of the Code, and we suggest that these anti-abuse rules remain in the Code as counter-weights to the desired flexibility of the partnership model. Limiting the flexibility of the Subchapter K model could impede many business transactions and make certain transactions impossible to execute. In the modern business world, partnerships are often the most effective and efficient entity vehicle for the varying, and increasingly complex, economic interests of the parties.

C. Retain the Check-the-Box Rules

The AICPA recommends the retention of the check-the-box rules in their current form in any tax reform regime.

The entity classification ("check-the-box") rules of section 7701 have been in place since 1997. These rules allow for the electing entity, if eligible, to choose whether it will be treated as a corporation or a partnership (or as a disregarded entity, if appropriate) under U.S. tax law.

The check-the-box regulations simplify the issue of entity classification by providing a bright-line test for how an organization is treated for tax purposes. These regulations also eliminate the historical and complex facts and circumstances analysis, or the "multi-factor test," that was previously required in some cases. The check-the-box rules provide the necessary flexibility that organizations need to properly plan and structure both domestic and international operations while preventing unintended consequences, such as double taxation. Additionally, these rules provide a means for international investors to benefit from the U.S. long-term capital gains tax rates. In many cases, without the check-the-box rules, many foreign investors are prevented from taking advantage of investments in U.S. businesses.

D. Obtain Tax Rate Parity between Pass-Through Business Entities and C Corporations

The Code should integrate the tax rate of corporations, pass-through entities and individuals. What is essential to any tax reform is parity in marginal tax rates on corporate taxable income and pass-through taxable income (without regard to the double taxation of dividends). The single level of tax enjoyed by pass-through entities is good for our economy and encourages the development and growth of many small businesses and entrepreneurs. The formation of pass-

[8] AICPA submitted comments on Option 2 of Chairman Camp's Small Business Tax Reform Draft, dated July 30, 2013; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf.

through entities should not be discouraged by subjecting their owners to a higher marginal tax rate than corporations.

E. Repeal Section 1372: Partnership Rules to Apply for Fringe Benefit Purposes for S Corporations

The AICPA recommends[9] the repeal of IRC section 1372 which treats most S corporation shareholders as partners for fringe benefit purposes while treating the same people as regular employees for all other payroll reporting purposes. The rule under this provision has created confusion and significant compliance burdens since its enactment by the Subchapter S Revision Act of 1982. There are no proposed or finalized regulations under this provision. The only published guidance in regards to this rule is limited to the treatment of premiums paid for health insurance by S corporations on behalf of 2% shareholders, contributions to health savings accounts, and certain fringe benefits described in IRC section 132. Additionally, published guidance does not identify what the IRS considers included within the scope of the term "fringe benefit" for purposes of this provision.

The post-1982 enactment of predecessor versions of section 162(l), governing the deduction for health insurance by "self-employed individuals" which includes 2% shareholders, and the subsequent expansion of those provisions have all but eliminated any disparity in the treatment of self-employed individuals, partners, 2% shareholders, and other employees with respect to employer-provided medical insurance. Elimination of IRC section 1372 would also allow the simplification of section 162(l) with its seemingly duplicitous and confusing treatment of health insurance for 2% shareholders. The repeal would eliminate one of the most prevalent errors — the failure to report health insurance for 2% shareholders that occurs annually in payroll reporting.

Developments in other provisions of the Code since the enactment of section 1372 in 1982 have caused this provision to be narrow (albeit uncertain) in scope. Our recommendation to repeal section 1372 will help simplify the compliance burden of small business taxpayers and their tax preparers without significantly affecting tax revenues.

F. Make Permanent the Reduced Recognition Period for Built-In Gains for S Corporations

The AICPA continues[10] to support the provision that would permanently reduce the built-in-gains (BIG) tax recognition period to five years from ten years. In addition, we recommend[11]

[9] AICPA written testimony before the House Committee on Ways And Means, Subcommittee on Select Revenue Measures, Hearing on "Miscellaneous Revenue Issues," dated June 22, 1993; http://services.taxanalysts.com/taxbase/archive/tnt1993.nsf/SearchIndex/0153C15365B640508525600F004A95FD?OpenDocument&highlight=0,AICPA,repeal,section,1372.

[10] AICPA written statement before the House Committee on Ways and Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft;

making permanent the rule that installment sales are governed by the provision applicable in the tax year in which the sale was made.

We believe that the proposed change would provide more clarity and continuity for taxpayers affected by the BIG tax. This provision is consistent with the legislation passed by Congress over the past few years, including multiple pieces of legislation to temporarily reduce the recognition period in an effort to provide tax incentives to many S corporations.[12]

G. Allow Full Consideration of Net Realized Built-In Loss for S Corporations

The AICPA recommends the amendment of section 1374 to allow the full consideration of a net realized built-in loss via the carryback and carryforward of a net realized built-in loss during the recognition period. The BIG tax imposed by section 1374 has an absolute cap and is imposed on built-in gains, net of built-in losses, recognized during the recognition period. The amount subject to taxation is the total net built-in gain actually recognized during the recognition period. However, if a certain year during the recognition period results in a net built-in loss, the taxpayer cannot carryforward or carryback this loss to offset net built-in gains recognized in the years during earlier or later years. Our recommendation would result in total BIG tax being limited to the tax on actual net built-in gain recognized during the recognition period. We recommend this change is implemented using rules similar to the elective carryback rules for net operating losses under section 172. Carrybacks should be restricted to the recognition period.

H. Increase the Passive Income Percentage to 60% and Eliminate the Three Year Termination for S Corporations

The AICPA recommends[13] increasing to 60% (from 25%) the portion of an S corporation's income that is considered passive without incurring an entity-level tax, and eliminate the current rule that terminates an S corporation's pass-through status if the S corporation has excess passive income for three consecutive years.[14]

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http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf.

[11] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[12] The American Recovery and Reinvestment Tax Act of 2009 reduced the recognition period from ten years to seven years for 2009 and 2010. The Small Business Jobs Act of 2010 temporarily reduced the recognition period to five years for 2011. The American Taxpayer Relief Act of 2012 maintained the five-year recognition period for 2012 and 2013.

[13] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[14] AICPA submitted letters and written statements on Option 1 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013;

Currently, if an S corporation has excess passive income for three consecutive years, even though a corporate-level tax may not be incurred due to the taxable income limitation, the S election is subject to termination, creating uncertainty in S corporation operations. Under current law, if the S corporation unknowingly has $1.00 of accumulated earnings and profits, the S election is terminated if the S corporation has excess passive investment income for three consecutive years. The IRS routinely grants waivers of the involuntary termination under section 1362(d)(3). S corporations without C corporation earnings and profits may receive an unlimited amount of passive investment income and are not subject to the S election termination.

Finally, the BIG tax operates to limit the ability of a C corporation to elect S status and avoid corporate-level taxation.

I. Simplify Partnership Audits and Adjustments

Currently, partnerships are subject to three different audit regimes. Despite the multiple alternatives, adjustments with respect to certain partnerships are cumbersome and difficult to administer (e.g., partnerships with a large number of partners subject to the TEFRA[15] regime).

AICPA's recommendations[16] are as follows:

- Allow partnerships with more than 100 partners to pay taxes due on some adjustments, up to a certain specified total amount;[17]
- Allow refunds of taxes to include interest, with respect to a decrease in taxable income; and
- Require netting of adjustments for all years under exam when computing the tax due.[18]

Our recommendations are fair, allow the partnership to analyze the facts as they exist at the time of the exam, and hold the appropriate partners liable for the period in which they were a partner. Additionally, our recommendations prevent the shift of one set of complexities for another and avoid a transfer of the burden on the Department of the Treasury ("Treasury") to shift onto partnerships and their partners.

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http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Business_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf.

[15] The Tax Equity and Fiscal Responsibility Act of 1982; http://history.nih.gov/research/downloads/PL97-248.pdf.

[16] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[17] For example, if the specified total amount was $1 million, a publicly traded partnership with 5,000 partners could pay any amount due that is less than $1 million because it is not cost effective or efficient to individually collect $200 from each of the 5,000 partners.

[18] A common example is a repair that requires capitalization as a result of an exam which would result in depreciation in the next year. The proposal would require a payment with respect to the first year and an adjustment to taxable income with respect to the second year.

J. Repeal Partnership Technical Termination Rule

The AICPA recommends[19] the repeal of section 708(b)(1)(B) regarding the technical termination of a partnership.[20]

Under current law, when a partnership is technically terminated, the legal entity continues, but for tax purposes, the partnership is treated as a newly formed entity. The current law requires the partnership to select new accounting methods and periods, restart depreciation lives, and make other adjustments. Furthermore, under the current law, the final tax return of the "old" partnership is due the 15th day of the fourth month after the month-end in which the partnership underwent a technical termination.[21]

A technical termination most often occurs when, during a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. Because this 12-month time frame can span a year-end, the partnership may not realize that a 30% change (a minority interest) in one year followed by a 25% change in another year, but within 12 months of the first, has caused the partnership to terminate.

In practice, this earlier required filing of the old partnership's tax return often goes unnoticed because the company is unaware of the accelerated deadline due to of the equity transfer. Penalties are often assessed upon the business as a result of the missed deadline. Although ignorance is not an acceptable excuse, this technical termination area is often misunderstood and misapplied. The acceleration of the filing of the tax return, to reset depreciation lives and to select new accounting methods, serves little purpose in terms of abuse prevention and serves more as a trap for the unwary. Therefore, we believe that the repeal of technical termination promotes simplicity.

K. Make Remedial Allocations Mandatory for Partnerships with Greater than 5% Nonresident Alien Individuals as Partners

[19] AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf.

[20] AICPA submitted letters and written statements on Option 1 and Option 2 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Business_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf, and Option 2 comments, dated July 30, 2013; http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf.

[21] For example, a partnership that technically terminated on April 30 of the current year due to a transfer of 80% of the capital and profits interests in the partnership must file its tax return for that final tax year on or before August 15 of the current year.

The AICPA recommends making remedial allocations mandatory for partnerships with greater than 5% nonresident aliens as partners. The current rules regarding remedial allocations for nonresident partners lack clarity due to the associated remedial methods that are elective and generally only used when phantom deductions flow through to a taxable partner and the phantom income flows through to a tax-advantaged partner, such as a nonresident alien individual.[22]

L. Eliminate the Section 751(b) Calculation on Disproportionate Distributions

The AICPA recommends the modification of section 751(b) in order to allow Treasury to issue regulations that will result in the reporting of the correct ordinary income that arises in connection with partnership distributions without the cumbersome complexity of the current rules and regulations.

We applaud the IRS for its work towards improving and simplifying the section 751(b) regulations by issuing new proposed regulations.[23] However, the IRS is restrained by the language in section 751(b) that requires treatment "as a sale or exchange of such property between the distributee and the partnership…." This wording should be deleted from section 751(b) and replaced by language that authorizes the further simplification of the calculation for determining ordinary income resulting from disproportionate distributions.

M. Oppose Any Proposal for Tax Treatment of "Large" Partnerships as Corporations

Currently, section 7704 provides that certain publicly traded partnerships are treated as corporations. Any expansion of the taxation of partnerships as corporations should be in the context of limiting the exceptions to section 7704. The AICPA opposes any proposal that recommends tax treatment of all "large" partnerships as corporations.

N. Require Mandatory Adjustments to Basis of Partnership Property in Case of Transfer of Partnership Interests and Mandatory Adjustments to Basis of Undistributed Partnership Property

The AICPA recommends requiring mandatory adjustments of partnership property when a partner transfers his or her interest in a partnership, or a partnership distributes property to a partner. We believe that the aggregate property rules would apply to securitization and electing investment partnerships. Additionally, simplification rules are needed for tiered partnerships.

[22] For example, if a U.S. corporation contributes an asset with a value of $100 million but zero basis to a foreign partnership, and a foreign corporation contributes $100 million dollars, the remedial allocation method for section 704(c) would not be elected. However, if this situation is reversed with the U.S. contributing money and the foreign entity contributing the appreciated property, the remedial method would be elected and this election can result in notional deductions to the U.S. partner and notional income to the foreign partner that is not taxed in the U.S. If remedial allocations are made mandatory, the results will be more reasonable over time because sometimes the U.S. will benefit and other times the foreign.

[23] Internal Revenue Service, Notice of Proposed Rulemaking, "Certain Distributions Treated as Sales or Exchanges," dated November 17, 2014; http://www.irs.gov/irb/2014-47_IRB/ar15.html.

We propose these rules be made mandatory for "large" partnerships and elective for all other partnerships. We propose that the definition of large partnerships includes partnerships with more than $100 million of gross receipts per year or book assets.

O. Allow Accumulated Earnings and Profits Withdrawal from S Corporations with Certainty

The AICPA recommends increased certainty for S corporations and their shareholders who wish to make a formal election to pay out accumulated earnings and profits (AEP). An S corporation would be required to make a good faith estimate of AEP to accompany this election. Additionally, upon making this election, the corporation would be considered to have distributed all AEP for purposes of the distribution layering rules of section 1368 and the passive income related issues of section 1375.[24] The S corporation and all shareholders would be required to agree to report their ratable shares of AEP over a period of ten years in a manner similar to an installment sale. The Service would have 18 months from filing of the election to audit and adjust the "good faith" amount of AEP reported, after which the amount of AEP would be considered final as filed by the taxpayer or adjusted by the Service. The sale or exchange of stock would accelerate the taxation period.

Furthermore, we recommend that present law be followed if distributions in excess of the accumulated adjustments account occur. These excess distributions would continue to be considered payment of AEP and accelerate taxation to the extent in excess of amounts previously reported. Taxpayers could elect to accelerate payment at any time. We recommend giving Treasury the authority to issue appropriate anti-abuse rules via regulations as needed and directing the process to make it expeditious. This proposal would provide an S corporation with the certainty it needs to deplete its AEP while allowing the government to collect additional tax revenue.

P. Reduce Realized Built-In Gains of S Corporations by the Amount of Accrued State Income Tax

The AICPA recommends that the computation for federal tax on realized built-in gains include consideration of any state income tax liability related to a realized and recognized BIG. This amendment would clarify that state income taxes actually payable as a result of realized and recognized BIG are taken into account in the calculation of the federal BIG tax payable for a given year.

Q. Allow Incentive Deductions Permitted by the Internal Revenue Code to Flow Through to Taxpayers Without Basis Limitations

[24] Reference here to the passive income rules of section 1375 includes the early termination rule of 1362(d)(3). Neither would apply once this election was made.

When Congress adds incentive provisions to the Code, Subchapter S basis limitation rules can significantly limit corporations from receiving the intended benefits of provisions that do not require actual expenditures. Examples of these barriers include the energy incentives of section 179D and the portion of the charitable deduction in excess of cost. Therefore, the AICPA recommends an amendment that would automatically permit incentive provisions to flow through to the individual taxpayer level regardless of tax basis in the S corporation, unless specifically limited by Congress.

R. Repeal the Prohibition of Section 179(d)(4) for Estates/Trusts; Alternatively, Allow Pass-Through Entity Allocation and Amortization at the Estate /Trust Level

Section 179 is a very important capital recovery provision available only to small businesses. This deduction is not allowed to an estate, trust, nor can it be allocated to an estate or trust which is a partner or S corporation shareholder. Treasury Reg. § 1.179-1(f)(3)[25] permits the entity to depreciate the portion of the asset allocated to the estate or trust. However, S corporations currently are not allowed to make special allocations of depreciation to estates or trusts. The conflict between these two rules discourages S corporations with an estate or trust as a shareholder from taking the section 179 deduction. If section 179(d)(4) is not repealed outright, then an amendment should clarify that the section 179 deduction, allocable to an estate or trust which is a partner or S corporation shareholder, can pass through to the estate or trust to depreciate in the same manner currently provided for in Treas. Reg. § 1.179-1(f)(3).

* * * * *

We understand the challenges that Congress faces as it tackles the complex issues inherent in drafting tax legislation, and note that both taxpayers and tax practitioners are interested in, and need, tax simplification. Compliance burdens for individual taxpayers are too heavy, both in terms of time required and out-of-pocket cost. Likewise, complexity increases the "Tax Gap" and may impair the efficiency of tax administration.[26] While there are costs associated with simplification reforms, it is also important to recognize the elimination of significant compliance burdens by such reforms.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. 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.

[25] See IRC section 179(d)(4).
[26] AICPA written testimony before the House Committee on Ways And Means, Hearing on "How the Tax Code's Burdens on Individuals and Families demonstrate the need for Comprehensive Tax Reform," dated April 13, 2011; http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/FINAL_TESTIMONY_FOR_NELLEN_April_13,_2011.pdf.

We welcome the opportunity to discuss these comments or to answer any questions that you may have. I can be reached at (801) 523-1051 or tlewis@sisna.com; or you may contact Kevin Walsh, Chair of the Pass-Through Tax Reform Task Force, at (907) 456-2222 or kwalsh@wkscpa.com; or Amy Wang, AICPA Technical Manager, at (202) 434-9264, or awang@aicpa.org.

Sincerely,



Troy K. Lewis, CPA
Chair, Tax Executive Committee

cc: The Honorable Orrin G. Hatch, Chairman of the Senate Committee on Finance
The Honorable Ronald L. Wyden, Ranking Member of the Senate Committee on Finance
Members of the Senate Committee on Finance

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Addendum

AICPA is a Resource on Tax Reform

The American Institute of Certified Public Accountants (AICPA) looks forward to working with the 114th Congress and the tax-writing committees as you address tax reform. The proliferation of new income tax provisions since the 1986 tax reform effort has led to compliance hurdles for taxpayers, administrative complexity, and enforcement challenges for the Internal Revenue Service. We encourage you to examine all aspects of the tax code to improve the current rules. We stand for a code that is simple, practical, and administrable. The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will significantly reduce taxpayers' compliance costs and encourage voluntary compliance through an understanding of the rules.

We are available to Members of Congress and staff as a resource. For example, we are available to:

- Offer suggestions from an administrative standpoint;
- Identify potential pitfalls of a particular provision;
- Discuss the "small business" perspective;
- Provide informal feedback on legislative language; and
- Support legislative provisions which are officially approved by our Tax Executive Committee.

AICPA Positions on Tax Reform Issues

The AICPA actively is pursuing or has published positions on a number of tax reform issues, has developed a 10-principle framework for analyzing proposals, and is available as a resource to assist you as you consider various proposals and options.

Specifically, we would like to highlight some of our tax reform proposals and resources for your consideration:

A. AICPA Compendium of Legislative Proposals ("Compendium") [1] – These recommendations promote simplification, efficient and effective administration, and fairness; are technical in nature; and are generally noncontroversial.

[1] AICPA's Compendium of Legislative Proposals is available at: http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA_Compendium_of_Legislative_Proposals-2015.pdf.

B. The AICPA has developed 10 guiding principles of good tax policy[2] – Congress should consider these principles to analyze and compare proposals to change a tax rule. Proposals for changes to the tax law should strive to incorporate all 10 principles to yield a simpler, more equitable, and transparent tax system. The AICPA guiding principles for good tax policy are:

1. *Equity and Fairness*. Similarly situated taxpayers should be taxed similarly.
2. *Certainty*. The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. *Convenience of Payment*. A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. *Economy in Collection*. The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. *Simplicity*. The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. *Neutrality*. The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. *Economic Growth and Efficiency*. The tax system should not impede or reduce the productive capacity of the economy.
8. *Transparency and Visibility*. Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. *Minimum Tax Gap*. A tax should be structured to minimize noncompliance.
10. *Appropriate Government Revenues*. The tax system should enable the government to determine how much tax revenue will likely be collected and when.

C. The AICPA has developed a number of proposals that we have shared with the tax-writing committees regarding such important matters as:

- Due dates of tax returns;
- 9100 relief for missed elections;
- Simplification of the *Kiddie Tax*;
- Disaster relief legislation;
- Consolidation and simplification of retirement plans; and
- Harmonization of education incentives.

[2] AICPA's Tax Policy Concept Statement No. 1: Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, issued March 2001, is available at: http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Tax_Policy_Concept_Statement_No.1.doc. Note that the AICPA principles of good tax policy are equal in importance; the numbered order of the principles is for reference only and should not be taken as an indication of the order of importance of these principles. A more detailed explanation of each of the 10 principles is provided in the AICPA's Tax Policy Concept Statement No. 1. The statement also notes some of the challenges that exist in achieving each of the 10 principles.

The AICPA also has testified and commented on legislative proposals concerning:

- The 113th Congress House Ways and Means Chairman Camp's February 2014 discussion draft tax reform proposals;
- The continued availability of the cash method of accounting;
- Tax return identity theft;
- Repeal of the alternative minimum tax (AMT);
- Penalty reform;
- Small business tax reform; and
- Retirement savings for small employers.

* * * * *

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If you would like to discuss any of our legislative proposals or principles of good tax policy in more depth or have any questions or would like more information, please contact Troy Lewis, Chair, AICPA Tax Executive Committee, at (801) 523-1051, or tlewis@sisna.com; you may contact Jeffrey Porter, Chair of the Tax Reform Task Force, at (304) 522-2553 or jporter@portercpa.com; or Melissa Labant, AICPA Director of Tax Advocacy, at (202) 434-9234, or mlabant@aicpa.org.