fei financial executives international

COMMITTEE ON PRIVATE COMPANY POLICY

November 28, 2017

The Honorable Orrin Hatch
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Chairman Hatch:

Financial Executives International's (FEI) Committee on Private Company Policy (CPC-P) applauds your efforts to draft comprehensive tax reform legislation that fosters growth and increases competitiveness among all U.S. businesses. It is particularly important that this legislation levels the playing field for America's pass-through businesses so that they can reinvest in their businesses, create jobs and compete with their C-corporation counterparts. The Committee on Private Company Policy The CPC-P's recommendations on how to accomplish this are outlined below.

FEI is a professional association representing the interests of more than 10,000 chief financial officers, treasurers, controllers, chief tax officers, and other senior financial executives from over 8,000 major companies throughout the United States, Canada, and Japan. FEI represents both the providers and users of financial information. FEI's Committee on Private Company Policy formulates tax policy for FEI in line with the views of the membership. This letter represents the views of the Committee on Private Company Policy.

1. Tax rate parity is critical if pass-through businesses are to compete with their C-corporation competition. The current tax rate differential between pass-throughs and C-corps is 4.6% (39.6% v. 35%). HR 1 would widen that differential by lowering the corporate rate to 20% while imposing an effective rate of about 35% on pass-through income while the Senate bill would tax pass-throughs at an effective rate of about 32%. Instead of moving closer to parity with C-corps, pass-throughs will see the rate differential increase by 12-15% if the current legislation isn't amended.

2. Pass-throughs should be treated the same for SALT deduction. Currently pass-throughs cannot deduct SALT deductions in the Senate bill and only $10K in real estate tax at individual level under the House bill. C-corps get the SALT deduction in both the House and Senate bills.

3. Pass-throughs should be treated the same under a territorial system as C-corps. Currently pass-throughs are subject to a worldwide tax system under the bill.

4. Pass-throughs and C-corps should be able to continue to use the export incentives to manufacture in the U.S. to maintain and create U.S. jobs. The IC-DISC is the export incentive that has been in the law since 1972 and not challenged by the WTO used by small business, agriculture and U.S. based manufacturers.

The CPC-P is strongly opposed to proposed tax legislation that would encourage pass-through entities to convert to C-corporation status for the following tax and financial reporting consequences and reasons:

1. **Limitations on Electing** - Current law prohibits companies from changing their elected status for 5 years. Thus, many pass-throughs that have made an election within the prior 5 years would be ineligible to change its status. Further, it would be patently unfair to force companies to go through the legal and structural changes to analyze and convert to a C-corp for each separate entity based on newly enacted tax law that is set to either sunset, or can be changed again in future years. At a minimum, any newly enacted tax legislation should provide safe harbor relief to permit a company to revert back to a pass-through without restriction due to the uncertainty posed by the tax proposals.

2. **Tax Accounting for Financial Purposes -** Conversion of a pass-through entity to a C-corp will create onerous results with respect to additional tax accounting required by U.S. GAAP. Currently pass-throughs are not required to include complex tax computations and disclosures in their financial statements, since they are not taxable entities. Under the ASC 740 rules, C-corps have extensive requirements to report current and deferred taxes, as well as foreign tax liabilities, which would be extremely burdensome for privately owned small companies and pass-throughs.

3. **Conflicts with other tax rules including foreign/state tax disparity** - Foreign and state tax consequences need to be addressed since many states and most foreign jurisdictions do not recognize a U.S. federal check-the-box election for onshore or offshore entities. A pass-through entity may have ownership constraints for trust and estate planning that may preclude a conversion to C-corp status, such as some a grantor retained annuity trusts (GRAT), which is commonly used with S-Corps for family transition planning. Onerous International outbound tax consequences and deemed toll charges under the tax code for a pass-through conversion to C-corporation for non-U.S. entities would potentially pose a significant hurdle to a conversion.

4. **Structural, Ownership, and Complexity Limitations** - Pass-throughs have limited ownership; generally, the intent is to maintain ownership of the entity within a limited group of owners. An S corporation with an LLC structure can benefit from reduced level of corporate complexity compliance/formalities (e.g. required meetings). A pass-through structure is less complex, allowing more active participation in business level decisions and eliminates the need for complex capital structures between the shareholders and company. The pass-through structure allows an owner to net the business income/loss and compensation income in computing the total tax liability of the business and the shareholder; this is important for private companies to manage cash flow as the owners are the source of capital (i.e. whether equity or debt).

It is a myth that a pass-through can simply check-the-box and become a C-corporation without significant tax and financial considerations.

FEI's private company members welcome the opportunity to discuss the impact of the Senate tax reform legislation's pass-through provisions with you.

Thank you for your consideration of our views.

Sincerely,

Committee on Private Company Policy
Financial Executives International

For Additional Information please contact:

Brian Cove
Managing Director, Technical Activities
Financial Executives International
(973) 765-1092
bcove@financialexecutives.org