COMMITTEE ON PRIVATE COMPANY POLICY

December 8, 2017

The Honorable Kevin Brady
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Brady:

Financial Executives International's (FEI) Committee on Private Company Policy (CPC-P) applauds the House and Senate for their work on The Tax Cuts and Jobs Act (HR 1). The goal of the bill is to foster growth and increase competitiveness among all U.S. businesses and 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. As the House and Senate meet to reconcile the differences between each chamber's version of HR 1, the Committee on Private Company Policy urges conferees to consider our recommendations as 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.

While the House and Senate versions of the Tax Cuts and Jobs Act take different approaches to provide tax relief to pass-through entities; our committee strongly recommends that the conferees adopt the following suggestions. This is notwithstanding that we believe the House approach of setting a maximum rate on business rate is a straight-forward method to achieve tax cuts for pass-throughs.

1. **The Senate version limits imposed on Qualified Business Income ("QBI") eligible for the deduction.**
   The W-2 wage cap (provided in Proposed Section 199A(b)(2)) needs to be eliminated. The statute already provides a guardrail for pass-through entities that are owner-operated in its requirement to reduce QBI for "reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business" In Proposed Section 199A(c)(4). Further, the W-2 wage cap would not eliminate the gap for those businesses with relatively low labor costs compared to output, nor those which utilize the use of consultants in lieu of employees.

2. **Specified Service Trade or Business**
   We do not agree with the limited definition of Qualified Trade or Business provided in the Senate bill. Specifically the definition of Specified Trade or Business by reference to existing Internal Revenue Code section 1202(e)(3)(A), as prescribed in Proposed Sec. 199A(d) is extremely broad and would preclude almost all businesses that are not retail-based or manufacturing from utilizing the provision meant for small business. The Specified Service Trade or Business exclusion effectively eliminates a large portion of small businesses since the current U.S. economy has a significant service sector. The reference to IRS Code Section 1202 contained in the Senate bill creates additional complexity and is too restrictive, since it includes a carve-out for particular industries, regardless of whether they are investing in equipment, an enhanced workforce, or other capital expenditures. Professional service firms invest heavily in capital by hiring non-partners, make leasing

commitments for office space and making significant capital expenditures in technology, computers, software, and specialized equipment such as medical apparatuses. In addition, some pass-throughs have partners that are running the business, in addition to those that just invest capital. Further, farm and other businesses that are also capital-intensive businesses would be penalized for choosing to work in a pass-through structure. Taxes should not be focused on the nature of a profession or a business. Thus, we strongly recommend that the exclusions for pass-through entities be less restrictive.

3. **Deductibility of State and Local Taxes**
   The treatment of state and local taxes for pass-throughs and C corporations should be the similar. The Senate bill precludes pass-through entities from deducting state and local taxes, which are a necessary and ordinary business expense, while allowing entities operating as a C corporation to fully deduct such taxes, which would cause disparity in the tax treatment since the tax base is broader of a business solely based upon their tax status. While we believe that pass-throughs should also be able to deduct state and local taxes, we would strongly support a more equitable solution by reducing the C-corporation's ability to deduct such taxes, in order to achieve a higher level of parity, as well as create a method to fund the tax cuts envisioned in the bill.

4. **Territorial Tax System**
   Pass-throughs should be treated the same under a territorial system as C-corporations. Under the proposed legislation in both the Senate and House bills, pass-throughs would be subject to a worldwide tax system under the bill, while C corporations are provided an alternate territorial tax system under a narrow tax base using the domestic only territorial system. Not only would this provide a disincentive for pass-throughs to reinvest capital in the US on foreign earnings, but would also present an additional disparity and inequity for the private business owner.

5. **Trusts and Estate Taxes**
   Trusts and estates should also be eligible for the deduction that the Senate bill provides for Qualified Business Income to create parity with other owners including after-tax net liquidity. Taxpayers operating businesses that employ people, make capital investments and contribute to the American economy should not be penalized due to the fact that they are organized as trusts or estates. Trusts and estates are used to achieve long-term business goals including orderly ownership transition between generations and to the extent that they generate qualified business income they should be treated the same as other owners, partnerships and S Corporations under the tax law.

A comparison that is simply about tax rates ignores the timing of the tax payments, the tax base for pass-through is broader and the fact that corporations do not pay taxes up-front for their undistributed earnings. Cash flow is essential to the operation of a business and pass-throughs suffer the loss of crucial dollars to pay taxes on income earned, whether or not distributed, while corporations are allowed to defer taxes on undistributed earnings. For pass-throughs that reinvest their profits in the business, as many do, both the Senate and House bills cost the pass-through additional taxes, which is indisputably unfair.

FEI's private company members would be pleased to discuss potential solutions for the lack of parity between pass-throughs and C-corporations for tax rates, the timing of the tax payments, and the broader tax base for pass-throughs. We hope that you consider our recommendations outlined above as the conference committee works toward a final version of HR 1.

Thank you for your consideration of our views.

Sincerely,
Committee on Private Company Policy
Financial Executives International

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