fei committee on private companies

December 1, 2021

The Honorable Charles Schumer
Senate Majority Leader
United States Senate
Washington, DC 20510

The Honorable Mitch McConnell
Senate Minority Leader
United States Senate
Washington, DC 20510

Dear Leaders Schumer and McConnell:

Financial Executives International (FEI) is made up of over 10,000 Chief Financial Officers, Vice Presidents of Finance, Corporate Treasurers,Controllers, and other senior financial executives from 74 chapters across the United States. Nearly 60% of our members work for private companies, and FEI's Committee on Private Companies (CPC) focuses on these members' policy concerns.

Our members' companies are located throughout the country and represent a variety of manufacturing and service businesses, and in operate both corporate and pass-through form. According to a study from the Small Business Administration, private businesses are the lifeblood of the U.S. economy: they createtwo-thirds of net new jobs and drive U.S. innovation and competitiveness.

The FEI Committee on Private Companies ("CPC") urges the Senate to include tax provisions in Build Back Better (BBB) legislation that will fairly distribute the tax burden included in the proposed bill for all business income subject to tax regardless of the form of ownership of the business activity. This would help privately owned companies that survived the COVID-19 crisis, to keep capital and jobs in the U.S., hire employees and compete in both domestic and foreign markets and remain competitive with larger public competitors here and abroad. FEI's CPC therefore requests that Federal legislation concentrates on the need to level the playing field for private companies that will aid the economic recovery process and the rebuilding of our businesses. Specifically, we ask that Congress:

- **Reject changes to the Net Investment interest tax (NIIT) that would impose the 3.8% tax on earnings from trusts or estates, regardless of whether the income is from passive or nonpassive activity. (Section 13201 of the *Build Back Better* legislation introduced 10/28/21)**
  When the NIIT was created under the Obama administration, the intent was to impose the tax on individual investment or trust passive income only; active business income, whether earned by corporations or pass-through entities, was not intended to be subjected to this tax. Many family businesses are operating through trusts, such as farms and small businesses, for non-tax purposes. These structures have been in place for many years. The bill, as currently drafted, does not impose a proportional tax burden on income earned by businesses in corporate form. Imposing the NIIT tax on trusts or estates is discriminatory – it unfairly taxes businesses that are in trust or estate form, even if they generate active business or trade income. Further, the bill provides no transition period or method for structures to be reevaluated or changed in response to the change in income tax rules.

We urge you to reject this provision that would unfairly put family-owned businesses in a non-competitive position. An alternative to the draconian rule of imposing NIIT on all trust/estate income, could retain an exception to income or gain from a trade or business conducted as a sole proprietor, partnership, or S corporation, if the individual taxpayer materially participates in the trade or business activity. That follows a long-standing accepted concept of active versus passive investment activity.

- **Reject the imposition of the current limits on the new Surcharge on High Income Individuals, Estates and Trusts. (Section 13203 of the *Build Back Better* legislation introduced 10/28/21)** As discussed above, many companies are operated within trust or estate entities for purposes of succession planning for family businesses. It is important for the transfer of the business to be clearly laid out for the successor generations. We note that businesses utilize trusts and estates facilitate the transfer of the business to the next generation and to avoid liquidity requirements that can disrupt continuity of the business. We urge you to reject this provision. While the limits for the 3% and 5% surtax for individuals are $10 million and $25 million (for married filing joint filers), respectively, the proposed limits for businesses operating in trust or estate form are only $200,000 and $500,000. These extremely low limits will cause even very small businesses to be unfairly burdened with the new surcharge tax.

  We urge you to reject the surtax provisions on trusts and estates, which are exceedingly unfair to family businesses utilizing a trust or estate for nontax purposes. If revenue raising is the main motivation, an equitable alternative may be imposing a proportional rate increase on incomes at high levels for all entities as the only equitable way – i.e., raise all business income 3% or 8%.

- **Retain the Qualified Business Income (QBI under §199A), in the *Build Back Better* legislation**. The QBI deduction was included in the Tax Cuts and Jobs Act to partially level the playing field for pass-through entities with their corporate counterparts. The provision was thoughtfully designed to apply to commercial enterprises in which income shifting between earned income and business income was not an issue and that had sufficient employment to use the deduction. For companies that can take advantage of the provision their business income was taxed at 28% versus 21% for corporations. In the current proposed BBB bill the effective rate on most business that used this provision would increase to over 50% while the tax on corporate income remained at 21%. While not only unfair to closely held businesses, this rate differential would cause many companies to change form of ownership resulting in far less revenue than even under the current regime. We encourage you to retain this necessary provision and urge you to consider making this a permanent deduction to maintain parity for companies operating in pass- through form.

  Furthermore, the current policy is bad for jobs and the economy. It does not distinguish between an individual's earned income and business sourced income. The proposed policy imposes a material burden on the business income of closely held businesses to pay for BBB while letting corporations enjoy materially lower taxes on their income. Frankly, this is discriminatory tax policy. We have long advocated and continue to advocate that business sourced income be taxed on parity with corporations. Maintaining and extending the QBI regime coupled with parity on international sourced income and full deductibility of business sourced SALT, while not perfect,

would create reasonable parity on the taxation of business sourced income. This does not preclude policy makers from imposing changes in tax policy on non-business sourced income of individuals in any income bracket to fund BBB.

- **Provide Pass-through State and Local Income Tax ("SALT") deduction parity with C-Corps**
  We recommend that Federal law should be changed to allow a SALT deduction for pass-throughs at the entity level, rather than imposing the SALT cap at the individual level. Many states have already adopted legislation to impose the SALT on the pass-through entity, to permit such entity to deduct the SALT for federal tax purposes. We also recommend that lawmakers consider raising the SALT limit to at least $50,000, proportionally applied to higher taxable income levels.

- **Provide international tax parity to allow for pass-through entities to remain competitive with C Corp on a global basis and maintain export incentives**. There are several ways this can be accomplished:

1) **Allow Dividend Received Deduction for Pass-through entities.** To create some parity in the international tax playing field for pass-through entities versus C Corps, is it important to obtain a dividend received deduction and tax basis for deemed income inclusions like GILTI, Subpart F, and investment in US property inclusions for previously taxed-inclusion dividends. Also, it is also important to maintain existing or expand export incentives (IC-DISC export incentives along with reduced qualified dividend tax rate and FDII) to compete with zero-rated export VAT refunds in the EU and other countries.

2) **Extend the alternate territorial system to international earnings of pass-through businesses.** Under the TCJA, a pass-through's foreign earnings remained subject to U.S. tax on a worldwide basis, while C-corporations were provided an alternate territorial tax system under a narrow tax base using the domestic only territorial system. This disparate treatment provides a disincentive for pass-throughs to reinvest capital in the US on foreign earnings to create U.S. jobs and presents an additional disparity and inequity for the private business owner. Pass-through businesses should be included in the territorial tax system established by the TCJA using the 100% dividends received deduction available to C-corporations under the Section 245A mechanism for a territorial participation exemption.

3) **Potential solution: Annual Pass-Through Business Election to Be Taxed as a C-Corporation under Section 962 (inadvertently overlooked).** A combined solution for pass-through transition to C-corporation and international earnings is to annually elect to be taxed as a C-corporation for international and domestic earnings under Section 962. This potential solution is to allow a pass-through to annually elect to be taxed as a C-corporation under the existing Section 962 rules to achieve parity for retained capital that would be subject to the second level of C-corporation dividend tax when distributed to the owners. The Election to Be Taxed as a C-Corporation under Section 962 would include both the tax incentives (carrots), minimum taxes and anti-tax abuse rules (sticks) highlighted below:

- 100% dividends received deduction
- 50% deduction under current rules of global intangible low taxed income (GILTI) amounts,
- 37.5% deduction under the current rules of "foreign-derived intangible income",
- foreign branch income at C-corporation rates,
- Minimum tax rules
- Base Erosion Anti-Abuse Tax
- Previously taxed earnings and Profits (PTEP) rules C-Corporation rules for actual distributions of previously reported gross-income treated as return of basis.

We appreciate the ability to provide our recommendations from our members and thank you for your consideration. We would be happy to provide additional information, as well real-life examples of the tax and economic impact of proposed legislation to our member companies. CPC members would be pleased to meet with you or your staff to further discuss our recommendations and explain the impact the Build Back Better Act will have on private companies and job creation in the U.S.

Committee on Private Companies
Financial Executives International

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Cc: Senator Ron Wyden, Chairman,
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