Financial Executives International
Committee on Private Company Policy
Tax Reform Recommendations
October 19, 2017

Financial Executives International (FEI) is a professional association 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 and Canada. FEI represents both the providers and users of financial information. Nearly 60% of FEI members represent private companies, and the Committee on Private Company Policy focuses on these members' policy concerns. The following summarizes the Committee's recommendations with respect to the unified tax reform framework released by the House Ways & Means Committee on September 27, 2017. This paper represents the views of the Committee on Private Company Policy.

Tax Rate Reform for Small Businesses Structured as Pass-through Entities

Small and family-owned businesses play a critical role in the U.S. economy, serving as a key source of jobs, tax revenue and private sector employment. Tax reform is needed to drive the U.S. economy and grow jobs provided by small businesses and we fully support proposals put forth by the House Blueprint in June 24, 2016 and the Unified Framework for Fixing the Broken Tax Code released on September 27, 2017 that would limit the maximum rate applied to business income of small pass-through entities. The current tax system puts privately-held businesses that operate as pass-throughs at a huge competitive disadvantage by applying higher rates and limiting their ability to create jobs and invest in their local communities. The FEI Committee on Private Company Policy believes there should be parity in how business income is taxed between businesses that operate in corporate form and those that are formed as pass-through entities. We appreciate efforts to stimulate and provide opportunities for growth of small businesses and respectfully submit specific the following recommendations to consider as the Senate Committee on Finance develops comprehensive tax reform.

- Tax Rate To be Imposed on Pass-Through Entities
  Currently business income of pass-throughs is taxed as personal income and is subject to a maximum marginal rate of 39.6%. [1] Both the Blueprint and the Framework recommend that a tax rate of 25% be imposed on pass-through business income. We are in full support of a reduced rate of tax on such income. We believe that the tax imposed on pass-through business

[1] https://taxfoundation.org/2017-tax-brackets

income be equivalent to the highest corporate rate to level the economic outcomes of tax policy, restore fairness to the tax code and position pass-throughs to create jobs and increase investment.

- Qualifying Small Business Income
  In order to achieve sustainable tax reform, we understand the need for specific parameters and rules. However, the current definition of qualified small business for tax purposes changes depending on the section of the IRS tax code in question. Even the definition of small business, as utilized by the Small Business Administration, is dependent on the industry, and is currently undergoing a review for standardization. The most common determinations of a small business is based upon annual revenue, assets, and/or number of employees. Due to the disparity of rules and difficulty in defining small businesses specifically for determination of a preferential tax rate, we reiterate our recommendation that there should be an equivalent rate applied both to corporate entities, as well as small businesses that operate as pass-throughs. The size of a pass-through enterprise should not put it at an economic disadvantage to corporate entities as it relates to tax policy.

- Suggestions for Anti-Abuse Rules
  We do not advocate a specific safe harbor rule to bifurcate business income subject to the business rate and compensation to owner-employees since each business is so unique and it would be completely arbitrary to do so. We recognize that there are concerns about abuse and we would be happy to provide suggestions on how fair and effective anti-abuse rules can be structured.

Territorial Tax System Access/Deemed Repatriation
Private companies are significant exporters. 8 of the top 25 US exporters are private companies. [2] Increasingly, large and medium-sized pass-throughs are expanding their businesses by exporting and establishing offshore operations as business requirements and opportunities dictate. Broadly, tax reform legislation should create a territorial system that puts all U.S. businesses on an even footing with their US and foreign competition, removing disincentives for capital mobility and earnings repatriation from overseas, aligning U.S. tax policy with other developed countries, eliminating complexity in organization structure driven by the current foreign tax credit regime, and providing consistent tax treatment for all US businesses.

Since 2013, pass-throughs have been subjected to a higher marginal tax rate on business income than C-corporations. Currently, the top tax rate on individuals is 39.6% while the top corporate tax rate is 35%. The disparity puts privately-held and family-owned businesses which operate as pass-throughs at

[2] Marsha Salisbury, Research Editor, "Mergers and acquisitions reshape top US exporter ranking", The Journal of Commerce, June 9, 2016

a huge competitive disadvantage, limiting their ability to create jobs and invest in their businesses. Some of these disadvantages are:

- Current territorial tax proposals are limited to C-Corps. Congress should grant pass-throughs access to any new territorial tax regime.

- Absent consistent treatment of US corporations and pass-through entities, the tax rate paid by pass-through entities on foreign source earnings would be almost 50% higher than C corporations, putting US pass-through entities at a competitive disadvantage with their US corporate and foreign competitors when operating in foreign jurisdictions.

- Pass-throughs have very complex international structures because they don't qualify for the Section 902 indirect credits even though they have exposure to Subpart F income. Some have CFCs for offshore deferral, but most use a combination of check the box and hybrid entities to manage tax exposure. A territorial system could reduce the need for this complexity.

Potential International Strategies to Drive Successful Tax Reform

We outline specific ideas below that would achieve a more simple and competitive solution for the taxation of U.S. businesses operating abroad, while minimizing the impact of adverse issues stated above, and assist with efforts in meeting budgetary requirements.

- Under a territorial system, pass-throughs could establish specified accumulated adjustment accounts (AAA) for offshore earnings and the entity could make distributions comprised of proportionate shares of foreign and domestic earnings as reported on Schedule K-1.

- Transition to a territorial system by providing a toll charge applicable to prior period accumulated untaxed foreign earnings that would be payable 50% in year 1 and the balance over a period of 5 to 8 years. The toll charge applicable to prior period accumulated untaxed foreign earnings would be assessed at an effective date of 1/1/2017. A few options to consider for the toll charge are to use the Trump Administration’s proposed 10% tax rate for untaxed offshore earnings. A slight modification to the Trump proposal using a rate of 20% consistent with the C-corporation new proposed tax rate allowing for a foreign tax credit limited to 50% of the new C-corporation tax rate (i.e. 10%) may reduce the controversy over the toll charge tax rate. The House Blue Print proposed two toll charge tax rates including a higher rate of 8.75% for untaxed offshore earnings in cash and a 3.5% rate for reinvested earnings which may create an unintended incentive to reinvest untaxed offshore earnings to obtain the lower tax rate.

- An opportunity to use the deemed toll charge on untaxed offshore earnings to provide funds for the Trump Administration infrastructure (re)build America plan may provide an interesting opportunity for bipartisan support for tax reform.

The Committee on Private Company Policy appreciates your efforts on tax reform and looks forward to working with you to advance tax reform legislation that advances our goals. We welcome the opportunity to discuss these issues further with you and your staff.

Also, we would be pleased to discuss other related topics such as tax simplification, financial reporting consequences of tax reform, including deemed toll charge options under consideration, or any other topics you desire.

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