EXTENSIONS OF REMARKS

SMALL BUSINESS TAX FLEXIBILITY ACT OF 1995

HON. E. CLAY SHAW, JR.

OF FLORIDA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, May 17, 1995

Mr. SHAW. Mr. Speaker, today I am introducing a bill that will lead to fairer tax treatment of small businesses and will help relieve the compressed workload forced on CPA's by enactment of the Tax Reform Act of 1986 [TRA '86].

Prior to passage of TRA '86, S corporations, partnerships, and personal service corporations, like today's C corporations, were allowed to pick any fiscal year they wished. Often these entities chose a year ending other than December 31 because their natural business year ended at some other time. For example, retailers could choose January 31 or July 31, after all the holiday or white sale figures were in; and suppliers of ski equipment could select May 31 after the ski season ended.

Congress abruptly halted the fiscal-year election for these entities because it needed revenue to pay for an amendment to the low-income housing credit as part of TRA '86. That law accelerated income to the U.S. Treasury by requiring fiscal year S corporations, partnerships, and personal service corporations to adopt calendar years for tax purposes thus flowing through earnings to owners at an earlier date and speeding up tax payments to the IRS.

The loss of the election for some small businesses that are formed as S corporations and partnerships has proven to be a major disruption to their business operations because the calendar year end can fall in the middle of their busiest seasons. Taking time out to comply with this arbitrary requirement hamstrings their ability to maximize production, generate revenues, and create jobs. In addition, because these businesses also adopted the calendar year for financial reporting, they had to close their books as of December 31; and their independent accountants were faced with the need to undertake year-end audits and credit compliance reviews for shareholders and creditors in the same few months as required for the preparation of tax returns. Consequently, these entities have found their accountants are least available at the time they are most needed.

As a CPA, I can personally speak to the havoc TRA '86 has caused the accounting profession. The 1986 tax law has spawned a practice management problem of major proportions, with many CPA firms, especially small and medium-sized ones, finding 65 to 75 percent of their annual workload falling between January 1 and April 15.

Furthermore, as Members of the U.S. House of Representatives this year, we learned firsthand the meaning of the phrase workload compression, as we raced to meet the 100-day deadline for voting on all 10 items in the Contract With America. I don't think any of us would describe the working conditions at the beginning of this Congress as ideal or even desirable. But they were similar to the conditions the accounting profession has faced since 1986—every year.

Congress attempted to provide some relief from the burdens of TRA '86 in 1987 when it enacted section 444 of the Internal Revenue Code, which permits electing entities to have a fiscal year ending in September, October or November. The price exacted in return was that the electing entity pay a deposit to the U.S. Government which approximated the amount of tax to be deferred through election of the fiscal year. The calculation for the deposit—of what amounted to an interest-free loan to the Government—essentially required the amount of deferred entity income to be multiplied by the top statutory tax rate applicable to individuals, plus one percentage point. In 1988, therefore, when the top individual rate was 28 percent, the deposit would have been calculated at 29 percent.

The current situation illustrates the limited value of section 444. The great majority of S corporations and partnerships on fiscal years in 1986, and those coming into existence thereafter, which would have elected fiscal years are now operating on a calendar year.

Furthermore, the 1993 increase in individual tax rates exacerbated the situation. By the administration's own projections, approximately 1.2 percent of individual taxpayers are expected to be in the 36 percent bracket and only 0.3 percent in the 39.6 percent brackets. Yet, because of the mechanics of section 444, the deposit presently payable on deferred income is at a 40.6 percent rate, even though most owners of electing entities will themselves be in the 31 or 36 percent brackets. Simple financial self-interest dictates, then, that many affected entities terminated the fiscal year election.

The stumbling block to greater relief in the past has always been revenue neutrality. The legislation I am introducing today overcomes that problem. It's designed to maintain the cash flow to the U.S. Treasury, but still be an affordable option for S corporations and partnerships. The bill also would return to S corporations and partnerships the right to elect any fiscal year and would ease the compressed workload facing the accounting profession.

A description of the bill is included below, but briefly it would ensure a steady cash flow by requiring S corporations and partnerships electing a fiscal year to pay quarterly estimated taxes to the IRS on behalf of their owners. Certain statutory rates will be required to be paid on the business's quarterly income, instead of determining an individual owner's tax bracket. The statutory rates are determined by revenue needs, but this bill provides a de minimis rule for the smallest companies. Those businesses with a tax liability of less than $5,000 on the defined income of the business will not be required to make an estimated payment. Businesses with income defined above the de minimis level but less than $250,000 per owner will be required to pay estimated tax of 34 percent. For entities with incomes above that level, where the owners are themselves likely to be in the 39.6 percent bracket, the estimated tax rate will be 39.6 percent. Owners will take credit for the entity-paid estimated tax on their income tax returns, which will eliminate the non-interest-bearing loan approach of present law.

I urge my colleagues to cosponsor this bill. We have a rare opportunity to support legislation under which everyone wins.

The detailed description of the bill follows:

GENERAL PROVISION

Under current law, a partnership or S corporation, except where an election is made under present Internal Revenue Code section 444, must use a tax year which ends December 31st. As a result of making an election under new Code section 444, an entity would be able to use any fiscal year it desired. (Present section 444, which permits the use of a September, October or November tax year, would be renumbered as section 445.)

The election would be made by the 15th day of the third month of the first 12-month year using the new fiscal year end. For example, a 1995 calendar year entity wishing to change to a June 30 year in 1996 would file its election by September 15, 1996.

EFFECT ON ENTITY

Because of the nature of fiscal year pass-through entities, a deferral of tax is created on the tax returns of the owners. To alleviate the negative revenue impact of this deferral, the entity would make quarterly payments of estimated tax timed with the earning of income, the first of which would be due by the due date of the election. The entity income used in making the calculations is the amount currently reported on 1994 Schedule K, line 23(a) of the partnership return or 1994 Schedule K, line 23 of the S Corporation return. This amount is the aggregate of entity income less deductions without accounting for the character of each separately stated item on Schedule K.

Anti-abuse measures are included to prevent post-December 31 payments to partners or S Corporation shareholders to reduce the entity level tax (for example, an S corporation electing a May 31 year end, and "zeroing out" its line 23 income by salary payments in May).

In order to provide revenue neutrality, a 2-rate estimated tax system will be required. Most entities will pay estimated taxes for their owners at a flat 34% rate. However, those whose owners will, themselves, likely pay individual tax at the 39.6% top statutory rate will have to make entity-level estimated tax payments at 39.6%. These "high average income entities" are those where the prior year average entity income of owners with at least a 2-percent interest in the entity is $250,000 or more. They also include partnerships whose prior year income is at least $10,000,000.

The entity may use one of three methods to calculate the quarterly estimated tax payments. The first method is similar to that for high-income individuals, and bases the tax payments on 110% of the prior year income. That income is multiplied by the statutory estimated tax rate, then multiplied by

110%, then divided by 4 to obtain a quarterly estimated payment amount.

The second method allows the entity to calculate estimated tax based on the current year income. Estimated current year income is multiplied by the same 34% or 39.6% statutory tax rate and divided into four quarterly estimated payments.

The third method uses similar calculations to calculate its payments based upon annualized current year quarterly income, similar to the rules presently applicable to individuals or C corporations.

The payments of tax are due on the 15th day of the 3rd, 5th, 8th, and 12th months of the taxable year of the entity.

In addition, the entity makes a one-time payment with its fiscal year election that applies to the short period created (if any) by moving from a calendar year to a fiscal year. This payment is at the same statutory rate and is based on short period income.

The election terminates if the owners of more than half the entity's equity consent to such revocation, or when the entity itself terminates. (''Inadvertent terminations'' of an S corporation however, will not terminate the election.) Subsequent re-elections may not be made by that same entity for 5 tax years unless the entity obtains consent from the Internal Revenue Service. Rules will also be provided under regulations for successor entities.

A penalty for underpayment will be due from the entity if it does not make the required level of estimated tax payments. The penalty is based on the amount of underpayment and continues until appropriate payment is made or until the April 15th that the owners report their share of entity income. At that point, the owners become liable for the tax and any existing underpayment penalties that may be imposed. An exception to the entity level penalty is provided which parallels the analogous exception for individual taxpayers (casualty, unusual circumstances, etc.)

EFFECT ON OWNER

The quarterly estimated payments made by the entity are ''passed through'' to the owners of the entity as a credit on their individual tax returns. Since the entity is making these payments on behalf of the owners, they may reduce their quarterly estimated payments for their shares of the entity level payment. When they receive an annual information report from the entity (Schedule K–1), it will list their share of fiscal year income as well as their annual share of the credit. The amount of the credit allocated to each owner is based upon his or her share of the entity income (no special allocations of the credit are allowed). The credit is reported on an owner's individual income tax return as if it were estimated taxes paid by the owner.

In making their own quarterly estimated payments, the owners may rely on amounts reported by the entity as paid, even if errors occur or payments are not made, so that penalties accrue only at the entity level. If payments are overpaid or underpaid compared with those reported to the owners, such amounts are treated as any other tax due or overpaid under Subtitle A of the Internal Revenue Code.

TIERED STRUCTURES

No election may be made by an entity that is part of a tiered structure under this proposal. Additionally, if an entity becomes part of a tiered structure the election is terminated. The tiered structure rules do not apply, however, if all of the owners are partnerships and S corporations that elect the same fiscal year.

ALTERNATIVE TAX YEARS

Nothing in this provision will affect an entity's right to a fiscal year that exists under current law; for example, under the natural business year tests. The provision also allows for retention of fiscal years by any entities that currently use a fiscal year under Rev. Proc. 87–32.

OLD SECTION 444

The new provision would preclude any new elections under the old section 444. However, existing 444 elections would be allowed to continue if the entity so desired. Alternatively, an entity with an existing section 444 election, may elect instead under this new provision thereby entitling it to a refund of its current 444 required payments, or a credit of such required payments toward its new estimated tax payment requirements.

DE MINIMIS AND REASONABLE CAUSE EXCEPTION

The provision provides for an exception to payment of any entity level tax if such tax would be below $5,000. The provision also provides for the relief of section 7519 penalties if reasonable cause can be shown.

THE RIGHT ROAD

HON. RON PACKARD

OF CALIFORNIA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, May 17, 1995

Mr. PACKARD. Mr. Speaker, today we begin an historic journey. For the first time in a generation, we will lay out a road map toward a balanced budget. Americans understand this is a trip we all must take. If we fail in this mission, frankly, this country is through. I mean we are headed the way of Mexico into economic collapse.

The Nation is currently $5 trillion in debt spiraling toward a debt of $8 trillion by 2010. We spend almost half of our budget on interest alone—half. Soon we will spend more on the interest on the debt than anything else—including entitlements and defense combined. The American dream is starting to evolve into the American nightmare.

For a nation that prides itself on leaving a better country for our children, we are instead leaving a legacy of fiscal and moral bankruptcy. Some of you may know that I have a relatively large family—seven children and, as of a couple of weeks ago, 31 grandchildren.

Since I began my service in Congress, I have always measured everything I do by one standard—what legacy am I leaving to them and to our Nation's children and grandchildren?

Washington's lack of discipline is crushing our opportunity and leaving our children with a devastating debt. We cannot continue down this destructive path.

In fact, my new grandchild, born just a couple of weeks ago, will pay nearly $200,000 over her lifetime. I cannot leave this legacy to her, and I am sure most Americans do not want to leave this legacy to their children and grandchildren. People outside Washington know this and have asked us to lead them down a new road—toward a balanced budget. I say, let's get going.

GREAT LAKES INITIATIVE STATEMENT

HON. DAVID E. BONIOR

OF MICHIGAN

IN THE HOUSE OF REPRESENTATIVES

Wednesday, May 17, 1995

Mr. BONIOR. Mr. Speaker, I rise today to express my strong concern over any attempts to further weaken the Great Lakes Initiative. I understand there are those who would still like to make States' participation voluntary. That would completely undermine one of the key initiatives that has been taken to improve water quality in the Great Lakes region. I would strongly oppose those efforts.

The Transportation and Infrastructure Committee worked out a compromise on this issue. Like every compromise, it doesn't make everybody happy. I believe it is still too ambiguous. It's an open invitation to lawsuits. And will ultimately weaken the GLI. But it is a true compromise.

Further efforts to weaken the GLI would go too far. It would turn the clock back. For those of us who live in the region, the Great Lakes have a profound effect on who we are as a people and how we live our lives.

The Great Lakes provide our drinking water, they provide our largest recreational resource, they are tremendously important to our economy, and they shape our quality of life. They are our Yellowstone, our Grand Canyon, our Everglades. The Great Lakes ought to be protected like the national treasure they are. Unfortunately, a handful of polluter interests seem to have a burning desire to weaken the landmark Great Lakes Initiative, which will provide uniform water quality standards for all of the Great Lakes States. For that reason alone, I would oppose the current clean water bill.

Beyond the GLI, however, events in Lake St. Clair taught many of us in Michigan how important our environment is for our quality of life and for our economy. In Michigan, clean water is jobs. Without clean water, we lose thousands of jobs in our State.

Sport fishing in that lake alone is estimated at $140 million annually. Nonfishing boaters and beachgoers spend more than $1 billion each year on boats, accessories, marina slips, gas, restaurants and other items. Last year's ban on swimming cost the most popular beach in the Detroit area $500,000. This wasn't just a quality of life problem—our economic benefits of the lake were destroyed last year.

During most of the summer, profits at local marinas were down. Many local businesses were devastated. In just 2 months time, losses to local businesses ran into the millions of dollars. Our biggest concern is that it could happen again. In fact, with this type of legislation here before us today, it could happen anywhere and everywhere.

In this bill, written by lobbyists for some of this country's most notorious polluters, we say to Americans—we don't care about the water you drink, we don't care about the pollution of your beaches, and we don't care about one of the most important recreational and economic resources you have.

That's not common sense. We must protect our water—not polluter interests. We should be strengthening our standards—not weakening them. We should be debating ways to emulate model regulatory programs like the GLI—not gutting them.