

The Honorable Harry Reid  
Majority Leader  
United States Senate  
S-221 Capitol Building  
Washington, DC 20150

The Honorable Mitch McConnell  
Minority Leader  
United States Senate  
S-230 Capitol Building  
Washington, DC 20150

May 3, 2012

Dear Senators Reid and McConnell:

As organizations representing millions of employers, we strongly oppose the provision in S. 2343 to increase payroll taxes on S corporations and partnerships by \$9 billion.

While we are sympathetic with efforts to ensure that taxpayers, including business owners, fully comply with the tax law, we are concerned that the new rules envisioned by S. 2343 are less clear and less enforceable than current law and will do little to increase compliance.

On the other hand, they could increase the payroll tax burden on business owners who are already fully complying with the law. For those businesses, this provision represents a tax increase rather than a clarification of existing tax burdens. Businesses engaged in service professions have employees and capital investments. S. 2343 would apply payroll taxes to the income attributable to both, thus blurring the line between payroll taxes imposed on wages and salary, and income taxes applied to other forms of income.

While the authors describe the targets of this provision as lobby shops and law firms, the application of the "Professional Service Business" definition included in the bill is much broader and could embrace a significant portion of the American economy. Closely-held businesses engaged in health, real estate, engineering, architecture, consulting, financial services, billing, and other fields could be affected. Moreover, once the line between earnings from labor and capital is removed, we are concerned that this provision could be expanded to include other, more capital intensive industries.

Under S. 2343, the active shareholders of service sector S corporations would be required to pay payroll taxes on all their income from the business -- wage and business earnings alike -- if the S corporation is a partner in a professional service business *or* if 75 percent or more of the gross income of the S corporation is attributable to the service of three or fewer shareholders.

This new approach, particularly the "principal rainmaker" test, is neither clear nor more enforceable than existing rules. These rules have been in effect for over half a century, and the IRS has repeatedly and successfully used them to ensure that active S corporation shareholders pay themselves a reasonable wage, most recently in *Watson v. US (2011)*.

Legislation similar to the payroll tax provision in S. 2343 failed to move through the Senate in 2010. Like S. 2343, that provision was made public at the last minute and brought directly to the Senate floor. It was not considered by the full Finance Committee, nor was it subject to an open amending process the

Senate floor. Now, two years later, we are presented with a similar policy to be debated in a similar, truncated manner.

Finally, we are concerned that the permanent payroll tax increase in S. 2343 would be used to fund a temporary program -- however worthy -- outside of the Medicare or Social Security programs. Moving forward, we would argue that payroll tax collections should be reserved for Medicare and Social Security and not diverted to offset unrelated federal spending.

Thank you for your consideration of our concerns.

Sincerely,

**Air Conditioning Contractors of America**  
**American Bankers Association**  
**American Council of Engineering Companies**  
**The American Institute of Architects**  
**American Rental Association**  
**American Supply Association**  
**Associated Builders and Contractors**  
**Associated Equipment Distributors**  
**Associated General Contractors of America**  
**Automotive Aftermarket Industry Association**  
**Financial Executives International's Committee on Private Company Policy**  
**Financial Planning Association**  
**Financial Services Institute, Inc.**  
**Independent Community Bankers of America**  
**Independent Insurance Agents & Brokers of America**  
**International Foodservice Distributors Association**  
**International Franchise Association**  
**National Apartment Association**  
**The National Association for the Self-Employed**  
**National Association of Convenience Stores**  
**National Association of Wholesaler-Distributors**  
**National Electrical Contractors Association**  
**National Federation of Independent Businesses**  
**National Funeral Directors Association**  
**National Grocers Association**  
**National Multi Housing Council**  
**National Restaurant Association**  
**National Roofing Contractors Association**  
**National Small Business Association**  
**National Utility Contractors Association**  
**Printing Industries of America**  
**Professional Beauty Association**  
**The S Corporation Association**  
**Truck Renting & Leasing Association**  
**U.S. Business and Industry Council**  
**U.S. Chamber of Commerce**  
**Wine & Spirits Wholesalers of America**