

The Honorable Orrin Hatch  
Chairman  
Committee on Finance  
United States Senate  
219 Dirksen Senate Office Building  
Washington, D.C. 20510

The Honorable Kevin Brady  
Chairman  
Committee on Ways and Means  
United States House of Representatives  
1102 Longworth House Office Building  
Washington, D.C. 20515

The Honorable Ron Wyden  
Ranking Member  
Committee on Finance  
United States Senate  
219 Dirksen Senate Office Building  
Washington, D.C. 20510

The Honorable Sander Levin  
Ranking Member  
Committee on Ways and Means  
United States House of Representatives  
1102 Longworth House Office Building  
Washington, D.C. 20515

October 27, 2017

Dear Chairmen and Ranking Members:

As trade associations representing millions of Main Street businesses, we strongly support the tax framework's goal of promoting investment and job creation by all businesses – C corporations, S corporations, partnerships, and sole proprietorships alike.

The new, lower tax rate on pass-through business income is critical to meeting this goal. Pass-through businesses create the majority of jobs in the United States, and this new rate will be imposed on businesses employing tens of millions of workers. The new rate therefore needs to be broad and apply to all pass-through businesses and all active pass-through business income, just as all active business income earned by C corporations would qualify for the new, lower corporate rate.

Just as critically, the lower rate should be accompanied by strong rules to ensure it applies to real business profits only, and not disguised wages. This is one of the more difficult challenges Congress will face in tax reform. A poorly designed "guardrail" has the potential to completely undo the value of the lower pass-through business rate, rendering the whole exercise meaningless and harming closely-held family businesses in the process.

To ensure the pass-through business rate is successful, we recommend Congress adopt enforcement provisions that conform to the following principles.

First, the guardrails used to enforce the new pass-through business rate must preserve its value for real profits. "One-size fits all" rules like 70/30 and other fixed ratios would inevitably exclude legitimate business profits from the lower rate. Blanket rules excluding certain industries would do the same. Coupled with the

extensive base broadening envisioned in the framework, these rules would result in significant tax hikes for many pass-through businesses. For these reasons, they should be rejected.

Second, since the essential enforcement challenge is to distinguish returns on an owner's labor from returns on their investment, inactive owners who do not materially participate in the operation of the business should have the new lower rate apply to all of their profits. Since inactive owners do not work in the business, there is no confusion over what should be considered wages and what should be considered profits.

Third, businesses with a mix of active and inactive owners and pro-rata distribution rules, such as the S corporation single class of stock rule, should also be excluded from the new enforcement rules. Businesses with such competitive ownership structures and a requirement to divide profits strictly according to their ownership shares simply are not in a position to game the new rates.

And, finally, a general test should be devised that takes an owner's investment in employees and capital into account when distinguishing an owner's wages from profits. The higher an owner's level of investment in workers and capital, the more profits they should be able to claim. Such a rule would inevitably produce a rough justice result, but it is infinitely more equitable than a fixed ratio or other rules that ignore the actual attributes of the affected business.

America's pass through businesses are a large and vital part of the economy and the new lower pass-through business tax rate needs to reflect their importance by being broadly applied and effectively enforced. The undersigned trade groups support the lower pass through tax rate called for in the framework and look forward to working with Congress to ensure it is structured properly.

Sincerely,

American Business Conference  
American Council of Engineering Companies  
American Foundry Society  
American International Automobile Dealers Association  
American Rental Association  
American Subcontractors Association, Inc.  
American Supply Association  
American Veterinary Distributors Association (AVDA)  
Associated Builders and Contractors  
Associated Builders and Contractors Florida East Coast Chapter, Inc.  
Associated Equipment Distributors  
Associated General Contractors of America  
Association for Manufacturing Technology  
Auto Care Association  
Design Professionals Coalition  
DHI - Door Security + Safety Professionals  
Glass Packaging Institute (GPI)  
Heating, Air-conditioning & Refrigeration Distributors International (HARDI)

Independent Community Bankers of America  
International Cemetery, Cremation and Funeral Association  
International Council of Shopping Centers  
Independent Lubricant Manufacturers Association  
International Foodservice Distributors Association  
International Franchise Association  
International Housewares Association  
International Warehouse Logistics Association  
Irrigation Association  
ISSA, The Worldwide Cleaning Industry Association  
Metals Service Center Institute  
National Apartment Association  
National Association of Realtors  
National Association of Electrical Distributors  
National Association of Wholesaler-Distributors  
National Automobile Dealers Association  
National Beer Wholesalers Association  
National Electrical Contractors Association  
National Grocers Association  
National Lumber and Building Material Dealers Association  
National Marine Distributors Association (NMDA)  
National Marine Manufacturers Association (NMMA)  
National Multifamily Housing Council  
National Roofing Contractors Association  
National Small Business Association  
National Tooling and Machining Association  
North American Association of Food Equipment Manufacturers (NAFEM)  
Outdoor Power Equipment and Engine Service Association (OPEESA)  
Pet Industry Distributors Association  
Petroleum Marketers Association of America (PMAA)  
Policy and Taxation Group  
Precision Machined Products Association  
Precision Metalforming Association  
Printing Industries of America  
The Real Estate Roundtable  
S Corporation Association  
Secondary Materials and Recycled Textiles Association (SMART)  
Small Business & Entrepreneurship Council  
Water and Sewer Distributors of America (WASDA)  
Wholesalers Association of the Northeast (WANE)