We enclose a legislative proposal to amend the tax on net earnings from self-employment. It is directed at the need to accommodate the emergence of limited liability companies as a preferred form of business operation and intended to eliminate widespread uncertainty and unfairness. The previous attempt at a solution, by regulation in 1997, failed when in 1997 Congress enacted a moratorium on the finalization of regulations.

We have worked closely with the Tax Division of the AICPA in developing this legislative proposal, which would treat members of limited liability companies that are taxed as partnerships in the same manner as partners of partnerships generally. In the interest of fairness, income attributable to capital would be excluded from net earnings from self-employment. Simplicity would be served by the addition of two safe harbors for determining income attributable to capital, one an interest-based return on capital, the other an exclusion for amounts in excess of reasonable compensation for services rendered, a familiar concept in measuring business expense deductions.

These views are presented on behalf of the Section of Taxation of the American Bar Association. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing policy of the Association.
Principal responsibility for the Section of Taxation of the American Bar Association was exercised by Steven G. Frost, Chapman and Cutler, Chicago, IL, Chair of the Section’s Task Force on Limited Liability Companies. Substantive contributions were made by Jonathan Axelrad, Wilson Sonsini Goodrich & Rosati, Palo Alto, CA; Sheldon I. Banoff, Katten Muchin & Zavis, Chicago, IL; Allan G. Donn, Willcox & Savage, Norfolk, VA; Bruce P. Ely, Tanner & Guin, Tuscaloosa, AL; Michael Grace of Powell, Goldstein, Frlexer & Murphy, Washington, DC; C. Wells Hall, III, Moore & Van Allen, Charlotte, NC; Robert R. Keatinge, Holland & Hart, Denver, CO; Timothy Larason, Andrews Davis Legg Bixler Milsten & Price, Oklahoma City, OK; Stuart Levine of Baltimore, MD; William B. Prugh, Shughart Thomson & Kilroy, Kansas City, MO; and Richard A. Shapack, Shapack McCullough & Kanter, Bloomfield Hills, MI. The proposal was reviewed by Richard M. Lipton, Sonnenschein, Nath & Rosenthal, Chicago, IL, for the Section’s Committee on Government Submissions, and by Charles H. Egerton, of Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth, Orlando, FL; Council Director for the Committee on Partnerships.

We view this as a constructive, collaborative effort to provide overdue and sensible guidance to many affected taxpayers. Your consideration is respectfully requested.

If we can be of any assistance in your consideration of this proposal, please do not hesitate to let us know.

Sincerely,

Paul J. Sax

Chair-Elect, Section of Taxation