

Dear Senate Finance Committee,

Attached is a letter from the Small Business Exporters Association of the United States to the Committee regarding S. 4026, the Tax Technical Corrections Act of 2006.

We would appreciate your consideration of the issues raised in the letter.

For your convenience, we are attaching the letter in both Word and PDF formats.

If you have any questions, or would like any clarifications, our contact information is provided below.

Regards,

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Hon. Charles Grassley
Chairman
Committee on Finance
United State Senate
Washington, DC 20510

27 October 2006

Re: S. 4026, the "Tax Technical Corrections Act of 2006"

Dear Chairman Grassley,

On behalf of the more than 22,000 small and mid-sized exporting companies that belong to the Small Business Exporters Association of the United States and its affiliated nonprofit organization, the National Small Business association, SBEA would like to comment on S. 4026, the *Tax Technical Corrections Act of 2006*.

We appreciate the conscientious work that went into this legislation, as well as its companion bill H.R. 6424, by the members and staff of the Senate Finance Committee, the House Ways and Means Committee, and the Joint Committee on Taxation. We know that many provisions of the bill will help clarify the tax code for taxpayers, tax practioners, and Congress itself.

However, we do wish to draw the attention of the Ways and Means Committee to one section of the bill that we believe requires a more extensive analysis and more public input than it is likely to receive in this bill.

Section 7 of the bill would significantly change the tax treatment of Interest Charge Domestic International Sales Corporations (IC-DISC's). We believe these changes would unnecessarily harm small U.S. exporters, notably those who manufacture their products.

Change would disrupt businesses. The IC-DISC form of business organization is best suited for privately-held companies with few shareholders, such as smaller C corporations and pass-through entities like S Corporations. Consequently, nearly all of the companies utilizing the IC-DISC are small. Our members who use IC-DISC's tell us that they spent tens of thousands of dollars, and considerable amounts of time, structuring their companies so as to utilize the IC-DISC format, on the basis of assurances from attorneys and CPA's that this form of organization was approved by Congress and the World Trade Organization.

Not only would a change in the tax treatment of IC-DISC's expose these companies to much greater than anticipated federal taxes, but it would require them to yet again restructure their companies, yet again spend tens of thousands of dollars on attorneys and accountants, and yet again divert precious management time to all of this.

For a larger company, spending tens of thousands of dollars and many hours of management time is not inconsequential, but it can at least be spread over tens or hundreds of millions of dollars in sales and dozens of managers. Not so a smaller company. For them, this would be a real blow.

The sudden decision by the tax-writing Committees, in the closing hours of the last session of Congress, to focus on this provision means that almost none of these affected companies are prepared for this change. Indeed, the American Institute of Certified Public Accountants has just finished holding two programs, in Chicago and San Francisco, advising accountants and companies on how to structure IC-DISC's. (Two more such programs are planned soon.)

Legal under the WTO. The IC-DISC is qualitatively different from other forms of business organization by exporters that have been invalidated by WTO decisions. In the first place, IC-DISC shareholders pay interest on any deferred taxes. Secondly, the type of taxation and the tax rates levied on IC-DISC income (dividend income taxation and rates) are available not only to exporters, but to a broad swath of U.S. taxpayers. Thus, the IC-DISC has never been challenged, and indeed the WTO has specifically exempted it from its earlier decisions affecting DISC's and FSC-ETI. So we see no external reason to tamper with it.

Would increase taxes. An upward revision in the tax rates on IC-DISC revenue would affect, at a bare minimum, many hundreds of companies and many millions of dollars in revenues. This is a tax increase; there is no other way to view it. Historically, and as a matter of fairness, Congress has allowed those affected by tax increases ample opportunity to express their views to their elected representatives. That process has included the commissioning of economic studies and the debating of alternatives. It has also included allowing ample lead time for those affected to plan and adapt.

None of that has occurred in this situation. With no advanced warning or publicity, a significant tax increase has been proposed for a whole swath of taxpayers -- in the closing moments of a Congressional session just before an election. It is further proposed that Congress approve this tax increase a week or two after the election, in a "lame duck" session that may last only a few days. Most of those affected are small companies who aren't "plugged in" to Washington and have no idea what could be coming their way. This isn't right or fair.

A substantive change. Sometimes, what seems like a modest tweak to analysts who concentrate closely on the tax code will seem far more sweeping to those who experience the change. We can understand how the IC-DISC proposal might seem small to some, and therefore end up in a "Technical Corrections" bill. IC-DISC's have grown quietly over a period of years, and those outside the manufacturing and exporting communities are probably not that familiar with them. But perhaps more than any other provision in the "Tax Technical Corrections" bill, this one has far-reaching ramifications. It is truly a substantive change. It deserves careful deliberation. We ask the Committees to refrain from acting on this provision until that more careful deliberation has occurred.

Trade policy considerations. Changing IC-DISC's is not simply a matter of tax policy. It is also a matter of trade policy. How can the U.S. best deal with a trade deficit that is rapidly ascending to \$1 trillion a year? What needs more emphasis -- and less emphasis? Engaging American small and mid-sized enterprises in

international trade would seem to be a crucial piece of the puzzle. Virtually all of our country's largest companies are fully globalized, but fewer than 10% of U.S. companies that have less than one hundred employees export. How can we address the cost of entry hurdles that keep smaller companies out of the international marketplace?

How, too, can we address the global price advantage that border-adjustable taxes give to countries that offer them? Shall we wait years or decades for an overhaul of the U.S. tax system – as trade deficits continue rising unimpeded – or shall we do something sooner?

SBEA urges the Committee to take the time to explore these issues before acting on the IC-DISC proposal.

Regards,

James Morrison
President

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SBEA is the nation's oldest and largest nonprofit organization exclusively representing small and mid-size companies in international trade. SBEA is proud to serve as the international trade council of the National Small Business Association, the nation's oldest nonprofit advocacy organization for small business.