

Congress of the United States
Washington, DC 20510

March 27, 2006

The Honorable Charles Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Grassley:

As you begin your work on the Tax Relief Act of 2005 (H.R. 4297) in conference, we urge you to include Section 302, an important Senate-passed provision which provides relief from the onerous "sting tax" on excess passive income held by S corporations. This is an important provision that will relieve many small and family-owned businesses from a double tax which can reach a combined federal and state rate of over 50 percent.

The heavy burden of the sting tax imposed by the passive income rules unfairly penalizes and heavily taxes businesses organized as S corporations, and places their S corporation status at an ongoing risk from factors often beyond their control. This causes these taxpayers to make business decisions based on their tax bill, rather than the best economic use of their capital. Ironically, Subchapter S tax rules were written by Congress in 1958 with the intent to encourage the creation of small and entrepreneurial businesses and to remove tax considerations from small business owners' decisions to incorporate.

Section 302 of H.R. 4297 eliminates the rule that would terminate a company's Subchapter S tax status if it has excess passive income for three consecutive taxable years. It also increases the threshold for taxing excess passive income from 25 percent to 60 percent. Further, Section 402 removes gains from the sales or exchanges of stock or securities from the definition of passive investment income. The Joint Committee on Taxation included similar provisions in its 2001 study and recommendations on tax simplification. There has also been bicameral and bipartisan support for these provisions, which have been introduced as part of the S Corporation Modernization Act in both Houses of Congress, and in the Small Business and Farm Economic Recovery Act of 2002.

The sting tax inhibits the proper use of capital for small businesses and is a surprise tax on those taxpayers that are least aware of the hidden traps of the tax code. Given this, we need your help to ensure the sting is taken out of the sting tax – and relieve these mostly small and family-owned businesses of this pernicious tax.

Thank you for your continued commitment in working to improve the tax code for family-owned and small businesses. We respectfully request your support for Section 302 throughout the House-Senate Conference and strongly encourage you to retain this important provision.

Sincerely,



Senator Orrin Hatch



Senator Gordon H. Smith



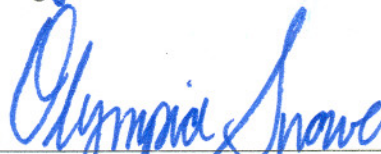
Senator Blanche L. Lincoln



Congressman Jim Ramstad



Congressman Phil English



Senator Olympia Snowe



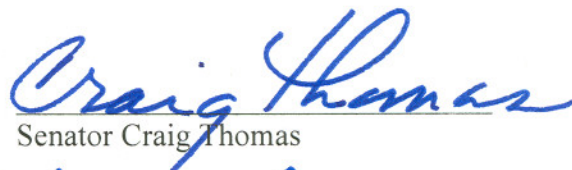
Senator Mark Pryor



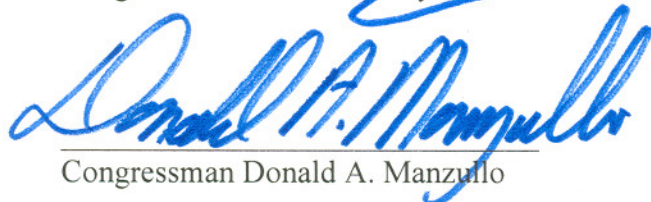
Senator Mike Enzi



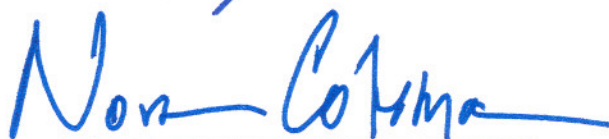
Congressman Mark Kennedy



Senator Craig Thomas



Congressman Donald A. Manzullo



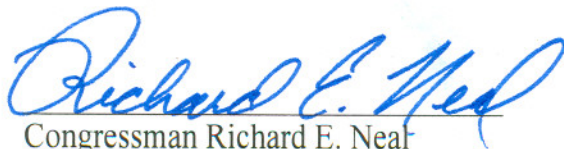
Senator Norm Coleman



Senator Pete V. Domenici



Senator Wayne Allard



Congressman Richard E. Neal