[Paul Mitchell and Aveda logos]

Honorable Thad Cochran
Chairman
Committee on Appropriations

113 Dirksen Senate Office Building

Washington, D.C. 20510

Honorable Barbara Mikulski
Ranking Member
Committee on Appropriations

503 Hart Senate Office Building

Washington, D.C. 20510

Honorable Lamar Alexander
Chairman
Committee on Health, Education, Labor and Pensions
428 Dirksen Senate Office Building
Washington, D.C. 20510

Honorable Patty Murray
Ranking Member
Committee on Health, Education, Labor and Pensions
648 Dirksen Senate Office Building
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Honorable Orrin Hatch
Chairman
Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

Honorable Ron Wyden
Ranking Member
Committee on Finance
[219] Dirksen Senate Office Building
Washington, D.C. 20510

Re: Underreporting of income in the salon and spa industry and its gainful employment rule implications for the cosmetology industry—the need for a solution

Dear Senate Appropriations, Education, and Finance Committee Leadership:

As soon as November 2016, the Department of Education’s gainful employment regulation applicable to educational programs offered by cosmetology schools will likely begin to force the closure of many institutions preparing future salon and spa industry professionals despite strong, consumer-driven demand for health and wellness services. We at Aveda Institutes and Paul Mitchell School Groups agree with the critically important purpose of the gainful employment rule in addressing the serious problem of unmanageable student debt relative to income, but we have significant concerns about the unintended consequences of the rule on cosmetology programs that provide skilled workers to the thriving salon and spa industry in the United States.

Specifically, our primary concern stems from the Aggregate Earnings data utilized by the Department to calculate the debt to income rates (D/E rates) that determine whether an educational program passes or fails the new rule. The problem for cosmetology schools, as acknowledged by both the Department and IRS - but not addressed in the rule at all - is that there is a significant “tax gap” in the salon and spa industry. In other words, much like in other cash based industries, graduates of cosmetology programs enter an industry where some workers do not fully report tip and other wage income on their tax returns, impacting state, local and federal tax revenues. That tax gap can, in some cases, mean a 30% or more difference between reported and actual income for some graduates, a meaningful difference not only to tax revenues, but to the reported earnings of graduates as reported to the Department for purposes of determining consequences of the new rule.

While underreporting of income occurs in many industries, it is exacerbated in the salon and spa industry by the ever growing “gray market[[1]](#footnote-1)” of salons and spas. Both the IRS and the Department are aware that misreported or underreported earnings (including wage and tip income) are, unfortunately, prevalent in the salon and spa industry. The IRS has, for example, engaged with the cosmetology industry in the past through sector specific education campaigns and voluntary compliance efforts intended to increase awareness of salon and spa industry employers’ and workers’ federal tax obligations,[[2]](#footnote-2) but those efforts have waned over the years, and there is evidence much more needs to be done. According to the Professional Beauty Industry “gray market” salons and spas, in fact, are thriving.[[3]](#footnote-3)

Employer based salons and spas, like the Aveda salon network that hires many Aveda Institute graduates, meet their employer-based tax obligations and are concerned about the growing “gray market” salon and spa sector, not only for the competitive disadvantage those entities pose to compliant salon and spa businesses, but also because misreporting or underreporting wages and tips by some graduates could impact good cosmetology schools like the Aveda Institutes that train workers demanded by Aveda salons.

We have met with both the Department of Education and IRS to discuss the “tax gap” issue and the need to adjust the rule to reasonably account for the estimated tax gap. In return, we offered our commitment to establishing cosmetology student tax education programs, free graduate tax clinics, incentives for graduates to work with employers or establishments that can demonstrate appropriate classification under IRS tax laws, and leadership on a national educational campaign at the state level by working with state cosmetology boards to inform all state licensed cosmetologists and state licensed salon/spa establishments of their tax obligations. This public-private partnership cannot work, however, unless the Department recognizes this problem in the rule.

Given the lack of response by the Department and IRS to our meetings and request to address this issue, and the impending consequences of the D/E rate metrics on cosmetology school programs, we ask for your leadership at this time to address this issue in the Fiscal Year 2017 Labor/HHS/Education Appropriations bill through statutory or report language. Proposed language is attached and we stand ready to discuss these and other proposals with your staff at any time**.**

We firmly believe that Congress, the Department of Education, the IRS, salon and spa industry leaders, and cosmetology schools have a strong alignment of interests to pursue a voluntary tax compliance program that will protect the integrity of the new federal rule, prevent unnecessary school closures and job loss, and raise significant federal, state and local tax revenues in the process. We urge your serious consideration of this issue.

Sincerely,

Aveda Institutes Coalition Paul Mitchell School Groups

1. “Gray market” salons and spas are those operated by individuals not accurately classifying workers as employees under IRS criteria (with concurrent wage and tip reporting obligations for employees) or operating as independent contractors but skirting their obligations to report all cash based wage and tip income. In contrast, employer-based salons and spas compensate employees either based on salary and/or commission alone, or allow but have a system in place for tracking and reporting tip income of employees. [↑](#footnote-ref-1)
2. See https://www.irs.gov/pub/irs-pdf/p4902.pdf (Tax Tips for the Cosmetology and Barber Industry, IRS 2011); see also https://www.irs.gov/pub/irs-utl/hairtrac.pdf (Tip Reporting Alternative Commitment, IRS 2004). [↑](#footnote-ref-2)
3. See Professional Beauty Association, Economic Snapshot of the Salon and Spa Industry (March 2015). [↑](#footnote-ref-3)