AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 111–1171

ASSESSING THE REGULATORY AND ADMINISTRATIVE BURDENS ON AMERICA'S SMALL BUSINESSES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

NOVEMBER 18, 2010

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

86–770 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

ONE HUNDRED ELEVENTH CONGRESS

MARY L. LANDRIEU, Louisiana, *Chair*
OLYMPIA J. SNOWE, Maine, *Ranking Member*

JOHN F. KERRY, Massachusetts
CARL LEVIN, Michigan
TOM HARKIN, Iowa
JOSEPH I. LIEBERMAN, Connecticut
MARIA CANTWELL, Washington
EVAN BAYH, Indiana
MARK L. PRYOR, Arkansas
BENJAMIN L. CARDIN, Maryland
JEANNE SHAHEEN, New Hampshire
KAY R. HAGAN, North Carolina

CHRISTOPHER S. BOND, Missouri
DAVID VITTER, Louisiana
JOHN THUNE, South Dakota
MICHAEL B. ENZI, Wyoming
JOHNNY ISAKSON, Georgia
ROGER F. WICKER, Mississippi
JAMES E. RISCH, Idaho

DONALD R. CRAVINS, JR., *Democratic Staff Director and Chief Counsel*
WALLACE K. HSUEH, *Republican Staff Director*

C O N T E N T S

Opening Statements

	Page
Landrieu, Hon. Mary L., Chair, and a U.S. Senator from Louisiana	1
Snowe, Hon. Olympia J., a U.S. Senator from Maine	3
Hagan, Hon. Kay R., a U.S. Senator from North Carolina	7
Shaheen, Hon. Jeanne, a U.S. Senator from New Hampshire	7
Pryor, Hon. Mark L., a U.S. Senator from Arkansas	8

Witnesses

Panel 1

Sargeant, Hon. Winslow, Chief Counsel for Advocacy, U.S. Small Business Administration	8
White, James R., Director, Tax Issues, U.S. Government Accountability Office	18

Panel 2

Harris, Roger, President and COO, Padgett Business Services/SmallBizPros, Inc.	54
Nannis, Lawrence S., CPA, Chair, National Small Business Association	63
Langer, Andrew, President, The Institute for Liberty	76
Gattuso, James, Senior Research Fellow, Regulatory Policy, The Heritage Foundation	97

Alphabetical Listing and Appendix Material Submitted

Gattuso, James	
Testimony	97
Prepared statement	99
Hagan, Hon. Kay R.	
Opening statement	7
Harris, Roger	
Testimony	54
Prepared statement	57
Landrieu, Hon. Mary L.	
Opening statement	1
Langer, Andrew	
Testimony	76
Prepared statement	79
Nannis, Lawrence S.	
Testimony	63
Prepared statement	66
Pryor, Hon. Mark L.	
Opening statement	8
Sargeant, Hon. Winslow	
Testimony	8
Prepared statement	10
Shaheen, Hon. Jeanne	
Opening statement	7
Snowe, Hon. Olympia	
Opening statement	3
White, James R.	
Testimony	18

Page

—Continued
Prepared statement 20

ASSESSING THE REGULATORY AND ADMINISTRATIVE BURDENS ON AMERICA'S SMALL BUSINESSES

THURSDAY, NOVEMBER 18, 2010

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in Room 428A, Russell Senate Office Building, Hon. Mary L. Landrieu, Chairman of the Committee, presiding.

Present: Senators Landrieu, Pryor, Shaheen, Hagan, Snowe, and Risch.

Staff Present: David Gillers, Chris Lucas, and Matt Walker.

OPENING STATEMENT OF HON. MARY L. LANDRIEU, CHAIR, AND A U.S. SENATOR FROM LOUISIANA

Chair LANDRIEU. Good morning, everyone, and welcome to our hearing on Regulatory and Administrative Burdens on America's Small Business. The Small Business Meeting will come to order.

To begin, let me say that I want to be very clear that the intention of holding this hearing is not to attack the Americans With Disabilities Act and I want to thank you all for being here. I want to apologize that it was singled out among all the Acts of the Federal Government, it was not brought to my attention until a few minutes go, but I appreciate you all being here.

This hearing is about general rules and regulations of which yours may be one of hundreds that can, you know, unnecessarily, sometimes, affect the operations of very small businesses in our country. So, that is what our committee is examining today, and I want to thank you all for being here.

I also want to say that this hearing is about identifying the obstacles that small businesses face in complying with federal rules in their day-to-day operations and working to find meaningful alternatives or ways that agency rules can achieve their intended purposes, many of which are for the public good, and all of which have the intention of being for the public good, while mitigating the economic harm to small business.

Nearly two months ago, Congress passed the Small Business Jobs Act of 2010. This committee led that effort, and it provides much needed relief to small businesses through the SBA lending programs, provides immediate tax cuts, up to $12 billion for small business in America, and establishes strategic partnerships with

community banks, a first of its kind innovative approach to provide greater access to capital for small firms everywhere, and we understand that it is working as those rules are being put into place as we speak.

With that being said, our nation's smallest entrepreneurs are still facing significant obstacles when they try to grow their business. Our job here is not done, it is only beginning, and I am committed, and the members, at least on the Democratic side and I hope the Republican side as well, to reducing unnecessary administrative and regulatory burdens that small businesses face every day in their fight to get our economy back on track. That is why this past Monday I cosponsored the Bipartisan Small Business Paperwork Relief Act, which Finance Committee Chairman Max Baucus is leading, a bill that repeals the expanded Form 1099 requirement put into effect by the healthcare reform legislation signed into law last year.

For months I have heard from small businesses all over the country that the expanded Form 1099 reporting requirements just did not make sense and would unreasonably burden small business. We have responded, we are going to try to repeal that piece of the healthcare law which will not affect healthcare policy at all, which is important, it will just affect the way the money is raised to pay for that policy, and that was the wrong thing to do, as I have said, and I am glad we will have a chance to change it.

As it is now according to the testimony we will hear today, the cost of tax compliance for small business is over 300 percent greater per employee than the cost to large companies. Just yesterday in this room we had a roundtable with banks from around the country. We had a banker, Steve David sitting in that third chair, from New Roads, a small town in Louisiana, only $150 million bank. He said that his FDIC insurance had gone up over 300 percent just in the last couple of years. I am going to submit the actual dollar amount for the record, but it is just unconscionable that fees and administrative burdens for small businesses have gone up so substantially, not just in the last several years, but it has been a trend now over a decade or more.

There was a report released just last week, the Crain Report, I am going to get a copy of it in a minute, I hope that Mr. Sargeant, Dr. Sargeant, you will be speaking on that this morning and also Mr. White, that goes into greater detail about the administrative burdens on small business and we are looking forward to hearing some of that testimony today.

Today's hearing is the next step in a process that will serve to build a solid record of current regulatory obstacles small businesses face. This way we can tailor smart solutions that will maximize the public benefit, while streamlining unnecessary requirements on our nation's small businesses. We know these regulatory hurtles translate into real cost for them. Without question, federal, administrative, and regulatory burden on businesses large and small continue to grow every year.

According to a recent report, which is the one that I have called your attention to, regulations in the United States have increased more than—to $1.75 trillion. If you broke that down by cost per U.S. household, each family would be responsible for more than

$15,000 of the annual cost. However, the distribution of these regulatory costs is uneven and will disproportionately affect small business. Advocacy, which is the office before us today, estimates that the average per business was approximately $8,000 per employee in 2008.

Think about that, people stand up and cheer around here if we can find $1,000 tax cut per employee. I mean, would not that be extraordinary to provide a $1,000 tax cut per employee? But on the same time, our combination of rules and regulations is basically attaching to each employee an $8,000 burden. If we could life $500 of that or $600 of that or $1,000 of that, it would be cause for real celebration in this nation.

The regulatory cost, as I said, per employee for small business was $10,585 compared to $7,454 for medium-sized firms, and $7,755 for large firms. There is a chart that breaks that down and I think it is important to understand the burden that is falling disproportionately on small business, and the opportunity to continue, I think, to meet the goals of all of our agencies, whether it is Health or Labor or OSHA or other agencies without being disproportionately heavy to the smallest and sometimes newest businesses, that if we give them a chance to get started, would be more than happy and more than able to comply with the rules and regulations that we are requiring of them.

When Federal Government regulations do not account for the unique challenges that small business owners, and I should say entrepreneurial start-up companies, are facing, I think we all suffer. Small businesses employ approximately 50 percent of the U.S. workforce, but the start-up businesses, the new businesses, are what is going to account for the jobs created to end this recession.

So, we want to make their load as light as possible, not heavy, light, so that they can be nimble and agile and be created and grow, and that is to our benefit.

Today we will hear from our Chief Regulatory Relief Officer. That is what this office is. It is referred to today as the Office of Advocacy. The name does not exactly imply what it is. Your job, as you know Dr. Sargeant, is to advocate for regulatory relief to small businesses, it was why this office was created some years ago, its primary mission for existing, and we are looking forward to some of your either suggestions or observations today.

And Mr. White, we are happy that you are here from the Government Accounting Administrative Office that is done reports, the GAO, on this subject, any number of reports. We are looking forward to some of your observations today.

Before we get to our panel I would like to turn it over to my Ranking Member for her opening statements and thank her for joining me today——

Senator SNOWE. Thank you, Chair Landrieu.

Chair LANDRIEU [continuing]. For this very important hearing and recognize that Senator Kay Hagan is with us as well.

OPENING STATEMENT OF HON. OLYMPIA J. SNOWE, A U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Chair Landrieu. And you are absolutely right, it is a critical issue and I want to commend you for

holding this hearing because without a doubt, undeniably, the regulatory burden is disproportionate on small businesses throughout this country and it is inhibiting job creation potential and undermining their ability to compete.

I welcome our witnesses here today, most especially Dr. Sargeant, for joining us in his first appearance before this committee since becoming Chief Counsel for the Small Business Administration's Office of Advocacy, and Mr. White, thank you as well from GAO for providing such invaluable data as we make decisions in some of these critical issues and what we need to do in the future.

I do not know how to say it any clearer: excessive regulations are suffocating the entrepreneurial spirit of America's almost 30 million small businesses. The Heritage Foundation, I know, will be citing chapter and verse the number of regulations that will be promulgated, the 43 new major regulations that will be implemented in Fiscal Year 2010, imposing $26.5 billion in new regulatory compliance costs, and that is in addition, as Chair Landrieu indicated, to the $1.75 trillion in annual regulatory compliance costs that the Office of Advocacy recently reported.

This is a regulatory rampage stampeding over small businesses. So, Dr. Sargeant, as the Chief Counsel for Advocacy, you are the singular person within the entire Federal Government whose primary statutory mission is to ensure that small business economic impact is considered during the federal rulemaking process. As you well know, I and some of my colleagues here, had concerns about your nomination and subsequent recess appointment largely due to the fact that you failed to identify reducing the small business regulatory burden and administering the Regulatory Flexibility Act as the central mission of your office.

I sincerely hope that you will prove us wrong, Dr. Sargeant, because we expect you, as a chief counsel, not just to be a regulatory watchdog, but to be a bulldog for small business, driving small business regulatory reform issues within the highest levels and standing up against other agencies during the rulemaking process. You must act independently from the Administration and the SBA and match, and even exceed, the $11 billion in annual regulatory compliance savings the Office of Advocacy achieved under the last chief counsel. This is not a suggestion, it is a fundamental obligation.

In my leadership capacity on this committee I have long been concerned about the mounting regulatory burden that the Federal Government is imposing on American business. Regrettably, small firms with fewer than 20 employees, and the Chair has already mentioned this, has born the disproportionate burden of complying with federal regulations with the annual regulatory costs exceeding $10,585 per employee for those firms with less than 20 employees. Those daunting figures are from 2008, as a matter of fact, so imagine where we stand today. Consider that according to the U.S. Chamber of Commerce, health reform alone mandates 41 separate rulemakings, at least 100 additional regulatory guidance documents and 129 reports.

So, we should waste no time in cutting the regulatory red tape that is strangulating America's small businesses, they are hidden

taxes, another layer of uncertainty to bottom line operating costs and is stifling job creation, hampering innovation, and postponing investment in the economy.

In my numerous, recent street tours and meetings in Maine, aside from taxes, small businesses complained the most about onerous regulations emanating from every agency, every sphere of Washington, D.C. So, Dr. Sargeant, it is absolutely critical that you take immediate action to appoint your ten regional advocates who will be your eyes and ears on the street as to what issues are most pressing to small firms, and I would like to discuss that with you further in the question and answer period as to why that has not happened.

It is absolutely critical to help you in performing the mission of your office. That is why earlier this year I joined my good friend and colleague on this committee, Senator Pryor, to introduce the Job Impact Analysis Act, and am pleased that several of those provisions were included in the recent jobs bill. It is absolutely vital that we take this step forward. I hope that you take full advantage of the additional influence this provision provides by setting a record for comments filed by the Chief Counsel for Advocacy.

There is much more that Congress can and must do. I will continue to advocate for an aggressive regulatory reform agenda that requires the Federal Government to fully consider small business economic impact during the rulemaking process. For instance, it is about time that we in Congress receive job impact statements from the nonpartisan CBO that estimates potential job creation and job loss from regulatory requirements and major legislation.

It is long overdue that we require the Federal Government to finally consider the indirect economic costs in addition to direct economic costs of Federal rules and regulations. And agencies must periodically review their existing regulations for small business impact so that agencies unnecessary and duplicative regulations can be stricken, and there has to be more than a few of those in the more than 163,000 pages of the Federal Code.

Finally, I added a requirement to the Wall Street Reform Bill that before the new Consumer Financial Protection Bureau can even publish a rule, it must convene a small business panel to scrutinize it. Dr. Sargeant, I appreciate that your office will be holding a stakeholders' panel this afternoon on the small business review panels. I expect Advocacy to play a driving role in establishing them within this bureau.

Those panels have worked exceptionally well at EPA and OSHA since 1996, so why not apply this requirement to every federal agency so small businesses are considered first, not as an afterthought, and it is a very critical point because I know that in my battle to get this done within the Financial Regulatory Reform Bill, there was one issue, everybody was saying, "well, you know, let the rules, take effect, and then if they are a problem we will fix it later." Well, no, no, no. Not in this economy. Not now. Not for small businesses.

We need to have small business effects fully examined before rules are ever promulgated, so that is why we have panels at OSHA, EPA, and now at the Consumer Financial Protection Bureau. Frankly, we should have panels at every agency.

The same is true on the 1099 issue, I know we will have further discussions, so I will not get into details in my opening statement, but I do believe you need to be front and center on this issue. I must have heard it 1,000 times on my street tours, small businesses are extremely concerned about the implications and the effects of the 1099 requirement and on their ability to comply with it.

It is going to be extremely onerous, without question, in addition to everything else that is coming their way from every other agency. So, I would hope that you would be front and center of that and I think frankly, more than just having confidential or private conversations with the IRS and Treasury, I think you should submit public comments on this very question to the Department, because it is vital. It is that crucial to the well being of small businesses throughout this country.

Finally, I am deeply troubled by OSHA's several recent actions that could undermine the collaborative approach to enforcement that has worked so well since the Clinton Administration. OSHA recently boosted penalties and reduced the penalty mitigation structure for small firms with fewer than 25 workers without first convening a small business review panel to consider the economic impact, and that is why earlier this week I joined Senator Enzi, the Ranking Member of the HELP Committee, in sending an oversight letter to the Labor Secretary probing OSHA's action and commitment to a collaborative approach that has always been the case. It concerns me that OSHA is undermining the cooperative relationship by taking these steps that are going to be additionally onerous to small business, not only increasing their penalties, but reducing the mitigation of penalties that have been in current law.

So, with that, Madam Chair, I will submit the rest of my statement but there is a lot to discuss, obviously, with respect to these issues. Thank you.

Chair LANDRIEU. Thank you. I really appreciate the leadership over many years of the ranking member. I would point out, and I am sure she is aware, that the regulatory burden of the United States could not possibly be the fault of Dr. Sargeant who just took office three months ago. Having said that, the rampage started prior to this Administration coming in, might have picked up a little bit of speed, but it started a long time ago and so I think in fairness to the witness who has just been in his job about three months.

Senator Hagan.

Senator SNOWE. Can I just make a point?

Chair LANDRIEU. Go ahead.

Senator SNOWE. Madam Chair, I was not suggesting that it was his fault. We have passed legislation that includes all that rulemaking. That is the point. Hopefully Dr. Sargeant will be an advocate to address many of these issues as they come along, because so many rules are coming down as a result of legislative enactment that will really pose a significant burden.

Chair LANDRIEU. Thank you.

Senator SNOWE. So, that is why he is going to have an enormous responsibility to address all those issues as they come to the fore-

front, because of the magnitude and dimension and breadth of all these regulations.

Chair LANDRIEU. Thank you, Senator Hagan.

OPENING STATEMENT OF HON. KAY R. HAGAN, A U.S. SENATOR FROM NORTH CAROLINA

Senator HAGAN. I just wanted to say thank you, Chairman Landrieu, for calling this hearing and to members of both of the panels joining us to discuss the regulatory burdens on small business. We have got to do something about this. I know I am not alone when I say that jobs are my number one priority and the key to a true economic recovery is enabling our nation's small businesses to expand and create jobs.

In North Carolina, too many small businesses are still struggling to make payroll, families are struggling to put food on the table and pay bills, and also, like Senator Snowe, having spent the past year and a half talking to small businesses and owners in every corner of the state, I have seen first hand the power of their determination and innovation, and what is clear to me is that North Carolina's small business owners want a fair shot to compete and to get back to work, and to help them do so, we have got to work to create a better environment for businesses to grow these jobs, and that is why it was so important that we pass the Small Business Jobs Act in September, which included critical provisions to get capital flowing to small businesses and to support the SBA's ability to support the small businesses and the lending nationwide.

Finally, it is why I think today's hearing is so important. As the witnesses have highlighted, small businesses often face a disproportionate regulatory burden and the 1099 regulatory requirement that I know we will be discussing today, is a perfect example of an unintentional consequence of legislation that truly presents significant challenges for small business, and I am committed to working with my colleagues to protect small business owners from this burden before it goes into effect in 2012, and at this point, every job is critical and it is essential that we ensure that our small businesses do not have to decide between hiring a new employee and complying with local, state, and federal regulations that present an undue burden.

So, Madam Chairman, thank you for holding this hearing and I look forward to the witnesses testimony.

Chair LANDRIEU. Thank you.

Senator Shaheen.

OPENING STATEMENT OF HON. JEANNE SHAHEEN, A U.S. SENATOR FROM NEW HAMPSHIRE

Senator SHAHEEN. I just want to thank you and the ranking member for holding the hearing this morning, and I look forward to hearing from our panelists.

Chair LANDRIEU. Senator Pryor.

OPENING STATEMENT OF HON. MARK L. PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Thank you, Madam Chairman. Thank you for having this hearing and ranking member, Snowe, thank you for your leadership on small business issues as well.

We all know that small business is the driving force in our economy so this important hearing, I am glad we are having it, and look forward to hearing from the witnesses. Thank you.

Chair LANDRIEU. Thank you. Dr. Sargeant, why do not you begin and let me just give you a very brief introduction. I know you are well known to this committee but to those that are observing. Dr. Sargeant, this past August, was appointed Chief Counsel of the Office of Advocacy by President Obama. He comes from an entrepreneurial background himself, previously working as program manager in electronics for the National Science Foundation's Small Business Innovative Research Program, and has been a cofounder of a semiconductor circuit design company.

I want to thank you for asking me to speak at the 30th Annual Regulatory Flexibility Conference that was here last September. I enjoyed meeting many of the members that were in attendance and as a result of that will be having a lunch with the former advocates and yourself later today to talk with them, both those that have served in Republican and Democratic administrations to get some good ideas from them.

Next, I want to welcome Mr. James White from the U.S. Government Accountability Office. Mr. White is the Director of Tax Issues with the GAO and has held that position since 1998. Previously he was an associate professor at Hamilton College where he taught public finance. We welcome you, Jim, this morning.

Let us start with Dr. Sargeant.

STATEMENT OF HON. WINSLOW SARGEANT, Ph.D., CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. SARGEANT. Chair Landrieu, Ranking Member Snowe, members of the committee, good morning and thank you for the opportunity to appear before you today. I am Winslow Sargeant, Chief Counsel for Advocacy at the U.S. Small Business Administration.

In the interest of time I will summarize my prepared testimony and ask that my full statement be included in the record.

The Office of Advocacy is an independent office within SBA. The views and my testimony do not necessarily reflect the views of the Administration or the SBA, this statement was not cleared by the Office of Management and Budget.

As Chief Counsel for Advocacy, it is my top priority to ensure that small businesses are not unfairly burdened by regulations. My office does this in large part through monitoring federal agencies' compliance with the Regulatory Flexibility Act, that is why I am honored to be here today.

I have been on the job for almost three months and Advocacy has been very busy during that time. Advocacy held a symposium celebrating the 30th anniversary of the passage of the RFA. I would like to personally thank Chair Landrieu for her participation. Advocacy also hosted a symposium on job creation by high impact

firms. We have held nine small business roundtables on issues including the environment, transportation, labor, safety, and health, and tax. One of those roundtables covered the expanded Form 1099 reporting requirement.

During my short time at Advocacy, I have signed 13 public regulatory comment letters including ones in environmental, education, and medical privacy and Medicare rules. At the recent RFA symposium, we released a new study authored by Dr. Mark Crain on the cost of federal regulatory burden on small businesses. Dr. Crain found that the total regulatory burden on small firms is larger than ever. As indicated on this chart, the smallest business, those with fewer than 20 employees, pay $10,585 per employee, on average, to comply with federal regulations. The federal regulatory burden is 36 percent greater on these small firms than on their large counterpart creating a staggering competitive disadvantage.

Compliance with IRS tax regulations is one area where small business is at a severe cost disadvantage to large firms. The Crain study also found that the cost to small businesses of tax compliance is over 300 percent greater per employee than the cost to large companies. In September, Advocacy held a roundtable on the IRS Form 1099 expanded reporting requirement where we heard directly from over 30 small business owners and representatives. Participants spoke to the significant paperwork burden of the requirement as well as the internal data controls that would need to be implemented. The small business owners and representatives called for a legislative fix.

Advocacy commends Senator Baucus, Senator Landrieu, and Senator Shaheen, on the introduction of the Small Business Paperwork Relief Act that would repeal the expanded Form 1099 reporting requirement.

As Chief Counsel for Advocacy, I fully support the repeal of this reporting requirement.

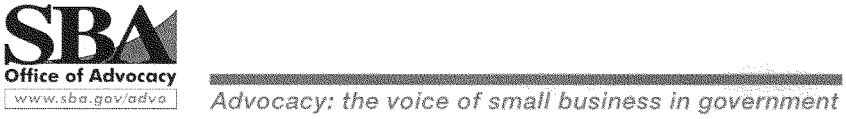
Small businesses are also greatly concerned about the impact of regulations in the environmental area. Advocacy is currently working closely on EPA's Small Business Advocacy Review panels, on wood heaters, stone mortar discharge, and emissions from small electric utilities. An additional area I am focused on is the newly created Consumer Financial Protection Bureau, CFPB. We are working to help the bureau build compliance with the RFA, and especially the SBREFA panel process.

I met earlier this week with the leadership of the CFPB to discuss implementation of the SBREFA panel process into their rulemaking plans. This afternoon, Advocacy will host a roundtable that will bring together small businesses from the banking and finance sector to discuss the SBREFA process at this new agency.

I commend this committee on your commitment to my office and reducing the regulatory burden on small businesses. Addressing these concerns will help foster an atmosphere of certainty and fairness for small business, allowing America's greatest engine of economic growth and job creation to drive our economy forward.

I look forward to continue to closely with you. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Sargeant follows:]



Testimony of

Dr. Winslow Sargeant
Chief Counsel for Advocacy
U.S. Small Business Administration

U.S. Senate
Committee on Small Business and Entrepreneurship

Date:	November 18, 2010
Time:	10:00 A.M.
Location:	Room 428-A Russell Senate Office Building Washington, D.C.
Topic:	Next Steps for Main Street: Reducing the Regulatory and Administrative Burdens on America's Small Businesses

Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. The Chief Counsel for Advocacy, who is appointed by the President and confirmed by the U.S. Senate, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Issues are identified through economic research, policy analyses, and small business outreach. The Chief Counsel's efforts are supported by offices in Washington, D.C., and by Regional Advocates. For more information about the Office of Advocacy, visit ***http://www.sba.gov/advo****, or call (202) 205-6533.*

Chair Landrieu, Ranking Member Snowe, Members of the Committee, good morning and thank you for the opportunity to appear before you today to discuss regulatory and administrative burdens on small businesses. As Chief Counsel for Advocacy, it is my top priority to ensure that small businesses are not unfairly burdened by regulations, which my office does in large part through monitoring federal agencies' compliance with the Regulatory Flexibility Act (RFA). The Office of Advocacy is an independent office within the U.S. Small Business Administration (SBA). The views in my testimony do not necessarily reflect the views of the Administration or the SBA and this statement was not circulated to the Office of Management and Budget (OMB) for clearance.

I have had the honor of serving as Chief Counsel for almost three months and Advocacy has been very busy during that time. The Office of Advocacy held a symposium celebrating the thirtieth anniversary of passage of the RFA. Advocacy also hosted a symposium on Capitol Hill on job creation by high-impact firms. We have held nine small business roundtables, on issues including the environment, transportation, labor, safety and health, and tax. One of those tax roundtables covered the expanded Form 1099 reporting requirement, which I will discuss in greater detail shortly. I have signed thirteen public regulatory comment letters, including ones on environmental, education, medical privacy, and Medicare rules. I am monitoring ongoing EPA Small Business Advocacy Review (SBAR) panels on wood heaters, hazardous air pollutants from small electric utilities, and stormwater discharge. As we do every day, we have been hard at work making certain that small business does not get unnecessarily burdened by federal regulatory requirements. This is possible because Advocacy has a team of dedicated and talented lawyers, economists and other highly trained professionals that I am lucky to work with every day. Soon, that team will grow further as we hire Regional Advocates that will give me the necessary eyes and ears on the ground to help us communicate with and assist small businesses in every part of the country.

It is difficult to overstate the important role that small businesses play in our nation's economy. There are over 27 million small businesses in the U.S. which is 99.7 percent of all businesses in America. These businesses are the most dynamic, fast-changing part of the economy, employing about half of the American workforce and creating 64 percent of net new jobs. Many people believe that technology and innovation are solely the products of big businesses with massive R&D budgets, but in fact, small businesses in high tech fields tend to be more innovative than their large counterparts, producing 16 times as many patents per employee as larger firms. Not only that, but these firms are on the cutting edge of new technologies, as confirmed by the fact that the patents they produce are twice as likely to be in the top one percent of patent citations.

How do small businesses accomplish this? Well, my personal experience in starting my first business is a prime example: I left a big company to help found a small business in order to innovate and grow a company the way I thought was best. In doing so, we created new technologies and new jobs. Small businesses cannot accomplish these things if they are overburdened by federal government regulations.

As I mentioned, we recently celebrated the thirtieth anniversary of the Regulatory Flexibility Act. As part of the Office of Advocacy symposium, we released a new study authored by Dr. Mark Crain on the costs of the federal regulatory burden to small businesses. The results of the

study were eye-opening. Dr. Crain found that the total regulatory burden on small firms is larger than ever, with the smallest businesses, those with fewer than 20 employees, paying $10,585 per employee on average to comply with federal regulations. The regulatory burden is 36 percent greater in these small firms than in their large counterparts, creating a staggering competitive disadvantage (see Appendix).

Even more stark is the contrast between the burden of environmental regulation on large and small firms in the manufacturing industry. Small manufacturers spent over $22,000 per employee to comply with regulations from the U.S. Environmental Protection Agency (EPA), while large manufacturers spent less than $5,000 per employee. It simply is not possible to expect small manufacturers to remain competitive with their larger domestic and international counterparts when their cost of complying with environmental regulations is 464 percent greater.

On my first day in office as Chief Counsel of Advocacy, August 23rd of this year, I sent a public comment letter to the EPA on their proposed rule on packaging hazardous air pollutants from industrial, commercial, and institutional boilers. EPA had conducted an SBAR panel on two rules regarding Major Source and Area Source boilers, which affected literally millions of small businesses. Through the panel process, EPA reduced the scope of the Area Source rule on smaller boilers and, almost by definition, smaller businesses, leading to over $20 billion in burden reduction in the rule that was eventually proposed. This is an example of how the SBREFA panel process should work, informing agencies of small business concerns and the agency incorporating this information into the rulemaking process to design better standards.

The Major Source rule that EPA proposed, however, was problematic in that EPA did not adopt the majority of the panel's recommendations for more flexible compliance options. Advocacy believes that EPA had the authority and should have done more to reduce the burden of the rule on over 150 small manufacturers, municipal power plants, and other facilities that fall into the Major Source category. The rule will cost some small businesses millions of dollars to bring their facilities into compliance. Both the panel report and my letter recommended that EPA (1) adopt less stringent emissions standards that could be met without extremely costly capital investments; (2) reduce monitoring and recordkeeping requirements; and (3) incorporate special subcategories for boilers that are only infrequently used or vary in significant ways from the ones EPA used to determine the emissions standards. The point of my letter was simple: that EPA should craft emissions standards that small businesses can actually meet, rather than ones that, in some instances, will be hard for even the largest firms to achieve without redesigning entire facilities. As with all regulatory matters, we will continue to work with EPA on this issue.

Compliance with Internal Revenue Service (IRS) tax regulations is another area where small business is at a severe cost disadvantage to large firms. The cost to small businesses of tax compliance is over 300 percent greater per employee than the cost to large companies. Fixed costs like this make it that much harder for small firms to hire new employees and help the economy grow. The disproportionate burden of tax compliance costs is precisely why small businesses are so uniformly opposed to expanding the scope of tax reporting through Form 1099. As I will describe in detail, the Form 1099 provision would greatly increase the reporting and recordkeeping burdens on small businesses. Because of this, Advocacy commends Senator Baucus and Senator Landrieu on the introduction of the "Small Business Paperwork Relief Act"

that would repeal the expanded Form 1099 reporting requirement. Advocacy fully supports their call for a repeal of this reporting requirement.

Advocacy has been involved with this issue from the beginning. Following an IRS-issued notice requesting public comments for ways to reduce the burden of reporting and record keeping required with Form 1099,[1] Advocacy hosted a roundtable on September 22, 2010. The roundtable gave small businesses an opportunity to comment on how they anticipated that the expanded reporting requirements would impact them and what suggestions they could offer to reduce the burdens of the expanded reporting requirement.

Over 30 small business owners and representatives attended the roundtable or participated by phone. Participants said that the expanded Form 1099 reporting requirement would increase burdens on small businesses in two ways. First, the expanded reporting requirement would result in a significantly greater paperwork burden. As an example, one roundtable participant said that the expanded Form 1099 requirement would result in his business increasing its tax year filings from ten 1099 forms to three hundred and sixty. Second, and more significantly, roundtable participants focused on the all-new internal data controls that would need to be implemented to address the expanded reporting requirements.

The information reported on a Form 1099, such as the Tax Identification Number (TIN) of a vendor, is different from the information usually maintained and tracked by businesses. As a result, all-new internal controls will need to be implemented to determine if the expanded Form 1099 requirement is triggered and this information will need to be saved. Most small businesses do not have specific personnel available to create and manage such a system, and the costs of compliance will be daunting.

Ultimately, at the roundtable, small business owners and representatives called for legislative action to address the burdens caused by the expanded Form 1099 reporting requirement. I agree with this assessment and support the repeal of the expanded Form 1099 reporting requirement.

Economic regulations are another area of significant cost burden for small businesses, as illustrated by Dr. Crain's report. These include regulations that affect the banking and financial services sectors. It is especially crucial at present that we do everything possible to ensure that small businesses in need of capital are not hampered, including by regulatory barriers that make lending more costly than necessary. My staff and I have been working closely with the newly created Consumer Financial Protection Bureau (CFPB) to help them build compliance with the RFA, and especially the SBAR panel process, into their rulemaking processes from the beginning.

I met earlier this week with the leadership of the CFPB to discuss implementation of the SBREFA panel process into CFPB's rulemaking plans. I also attended a meeting at the White

[1] http://www.irs.gov/pub/irs-drop/n-10-51.pdf. In the notice, the IRS provided one example of reducing the burden of the expanded requirement by observing that the IRS has "already issued a proposed regulation that would allow a broad exemption from [Internal Revenue Code] section 6041 information reporting for payment card transactions that would otherwise be reportable [on Forms 1099]." The IRS Notice sought public comments on similar methods to reduce the burdens associated with the expanded 1099 reporting requirement.

House on Tuesday where Elizabeth Warren briefed trade associations on her plans to begin implementing the CFPB's mandate. Finally, this afternoon, the Office of Advocacy will be hosting a small business roundtable that will allow small firms in the banking and finance sector to discuss future regulatory action and the SBREFA process with the CFPB and other federal financial regulatory agencies. We believe that building the SBAR process into these future rulemakings earlier rather than later will best serve the interests of small business and ensure that rules made under this process will be stronger and more effective.

I would like to thank you once again for inviting me to speak to you today. Advocacy stands ready to voice the concerns of small business throughout the process, from legislative actions to rule finalization. It is critical that Advocacy communicate the concerns of small businesses to help foster an atmosphere of certainty and fairness for small businesses. Being able to plan ahead and to compete on a level playing field encourages small businesses to have confidence. When this happens, small business is an engine for the economy and a major source of job creation. I commend the Committee on your commitment to reducing the regulatory burden on small business.

Appendix

Annual Cost of Federal Regulations by Firm Size

Type of Regulation	Cost per Employee for All Firms	Cost per Employee for Firms with:		
		Fewer than 20 Employees	20–499 Employees	500 or More Employees
All Federal Regulations	$8,086	$10,585	$7,454	$7,755
Economic	5,153	4,120	4,750	5,835
Environmental	1,523	4,101	1,294	883
Tax Compliance	800	1,584	760	517
Occupational Safety and Health and Homeland Security	610	781	650	520

Source: *The Impact of Regulatory Costs on Small Firms*, by Nicole Crain and Mark Crain, 2010. U.S. Small Business Administration, Office of Advocacy (www.sba.gov/advo/research/rs371tot.pdf).

Winslow Sargeant, Ph.D.
Chief Counsel for Advocacy
U.S. Small Business Administration

Dr. Winslow Sargeant is the sixth chief counsel for advocacy of the U.S. Small Business Administration's Office of Advocacy, appointed by President Obama August 19, 2010. The Office of Advocacy is an independent voice for small business within the federal government with a mission of encouraging policies that support small business startup, growth, and development.

As chief counsel, Dr. Sargeant directs Advocacy's operations, which include conducting research on the U.S. small business sector, advocating for small businesses within the federal government's agencies and rulemaking processes, reaching out to regional and state small business advocates and policymakers, and fostering public awareness of small business contributions and concerns.

Dr. Sargeant sees the entrepreneurial spirit as uniquely American and as a path to wealth and job creation—a thread that runs through his life story. Most recently, he served as managing director of Venture Investors, LLC, in Madison, Wisconsin. The firm provided seed and early-stage money to high-potential health care and IT companies. There, he specialized in computer software, hardware, and materials, and worked with technology transfer offices.

The chief counsel brings to his advocacy role years of experience as a federal partner to small firms. From 2001 to 2005, he was program manager in electronics for the National Science Foundation's Small Business Innovation Research (SBIR) Program, while also serving as adjunct professor at the University of Pennsylvania. The NSF is one of the federal agencies with the largest extramural research and development budgets that are required in the SBIR program to dedicate a portion of their awards to small firms.

And Dr. Sargeant knows the challenges of starting and building a small firm. He enrolled in a PhD. Program at the University of Wisconsin, Madison, in 1988 and left in 1992 to work at IBM in Rochester, Minnesota. He received his Ph.D in electrical engineering in 1995, and worked at ATT/Bell Labs in Allentown, Pennsylvania. In 1997, Dr. Sargeant and partners cofounded Aanetcom, a "fabless" semiconductor integrated circuit design company. The company designed state-of the-art computer circuits for telecom and broadband applications. In March 2000, Aanetcom was acquired by PMC-Sierra, a publicly traded company.

Dr. Sargeant met his wife, Ikanyeng, during his graduate studies at the University of Wisconsin. Winslow and Ikanyeng have three children, Kgosi, Lorato, and Marang.

Chair LANDRIEU. Thank you so much.
Mr. White.

STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WHITE. Madam Chair and members of the committee, I am pleased to be here to discuss the burden on small businesses of filing third party information returns with IRS about certain payments they make. The payments are labeled miscellaneous income and reported on Form 1099 MISC. You can see the form on page four of my statement.

As the form shows, there are many categories of miscellaneous income, most relevant for today is non-employee compensation in box seven where businesses must currently report payments over $600 for services provided by contractors who are not incorporated. The Patient Protection and Affordable Care Act expands this reporting to include both payments to corporations and payments for goods. IRS uses third party reporting of payments to verify that the payment recipients include them on their tax returns.

I want to make three points. First, third party information is a powerful tool for ensuring taxpayers pay the tax they owe. Second, reporting such information imposes a cost on the third parties. Third, options are available to Congress and IRS that could mitigate those costs.

Regarding the benefits, third party information reporting increases voluntary tax compliance because taxpayers know that IRS knows their income. The process is shown on page six of my statement where a kite shop hires a contractor for $600. Both are small businesses. The kite shop files a 1099 MISC reporting the payment to IRS and the contractor gets a copy. IRS then matches the 1099 with the contractor's tax return to make sure the payments are included in income.

The chart on page seven shows that where there is information reporting and/or withholding, taxpayers' compliance rates are high. For example, for wages and salaries, taxpayers misreported about one percent of their income. By contrast, sole proprietors, whose income is often not subject to information reporting, misreported 54 percent of their income. Information reporting has other benefits. It reduces the cost and intrusiveness of IRS's compliance efforts because computer-matching substitutes for audits of taxpayers. It may also reduce small businesses costs of preparing their returns because they get summaries of payments received.

My second point is that third parties incur costs to file information returns. It is difficult to estimate how large these costs are because businesses do not track them separately. In nine case studies we conducted in 2007, filers of information returns told us the costs were relatively low, but not zero, for example, one organization with a few thousand employees said filing a couple hundred information forms was a minimal additional cost. A small business told us that spending three to five hours per year preparing information returns manually. Two venders charge between 80 cents and $10 per form depending on the number of forms. We did not study the costs on third parties of expanding reporting to include payments for goods.

My third point is that businesses trying to file 1099 MISC forms face impediments. For example, some businesses are not aware that they have a filing requirement. Better IRS guidance is one obvious solution, but it ignores the fact that many small businesses pay tax preparers or accountants to do their taxes and never look at IRS guidance. More effective, perhaps, would be requiring preparers to ask whether 1099s have been filed, or waiving penalties for late submission by first-time filers. Another impediment is that some businesses are confused about the 1099 requirements. Options here include standardizing the dollar threshold for reporting or increasing the dollar threshold to limit the number of small businesses having to report.

Another impediment is determining whether the payee is incorporated. We were told that some businesses routinely file 1099 MISCs for all their contractors rather than going to the effort of determining who is incorporated. We have suggested that reporting be extended to incorporated payees, but not payments for goods.

IRS has already taken one step to reduce the costs of reporting by exempting payments paid by credit card. Other options include grandfathering existing business relationships, and exempting certain types of payments or businesses.

Finally, the 1099 MISC filing process is not convenient. Payers must get tax I.D. numbers from payees, paper submissions must be on specially printed forms, and IRS does not have an online portal for electronic filing. Solutions include guidance to new companies about providing tax I.D. numbers on invoices, allowing submission of downloaded forms, and building an online portal.

In summary, our tax system shifts some of the costs of tax administration to third parties in order to increase compliance, however, those costs could be reduced and still maintain the compliance benefits. This concludes my statement, I would be happy to answer questions.

[The prepared statement of Mr. White follows:]

United States Government Accountability Office

GAO

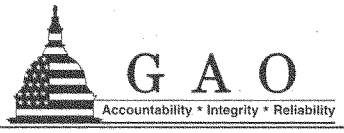
Testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EST
Thursday, November 18, 2010

SMALL BUSINESSES

Tax Compliance Benefits and Opportunities to Mitigate Costs on Third Parties of Miscellaneous Income Reporting Requirements

Statement of James R. White, Director
Strategic Issues



GAO-11-218T

GAO
Accountability • Integrity • Reliability
Highlights

Highlights of GAO-11-218T, a testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

November 18, 2010

SMALL BUSINESSES

Tax Compliance Benefits and Opportunities to Mitigate Costs on Third Parties of Miscellaneous Income Reporting Requirements

Why GAO Did This Study

Third parties, often businesses, reported more than $6 trillion in miscellaneous income payments to the Internal Revenue Service (IRS) in tax year 2006 on Form 1099-MISC. Payees are to report this income on their tax returns. It has been long known that if these payments are not reported on 1099-MISCs, it is less likely that they will be reported on payee tax returns. In 2010, the reporting requirements were expanded to cover payments for goods and payments to corporations, both previously exempt, beginning in 2012.

This testimony summarizes recent GAO reports and provides information on (1) benefits of the current requirements in terms of improved compliance by taxpayers and reduced taxpayer recordkeeping, (2) costs to the third-party businesses of the current 1099-MISC reporting requirement, and (3) options for mitigating the reporting burden for third-party businesses. GAO has not assessed the expansion of 1099-MISC reporting to payments for goods.

What GAO Recommends

GAO is not making new recommendations in this testimony. In 2009, GAO suggested that Congress consider requiring payers to report service payments to corporations. GAO did not study reporting of payments for goods. Other prior GAO recommendations included ways for IRS to improve its use of 1099-MISC information received. IRS agreed with six of eight recommendations and is taking action to address them.

View GAO-11-218T or key components. For more information, contact James R. White, at (202) 512-9110 or whitej@gao.gov.

What GAO Found

Information reporting is a powerful tool for encouraging voluntary compliance by payees and helping IRS detect underreported income. Also, information reporting may sometimes reduce taxpayers' costs of preparing their tax returns, although by how much is not known. IRS estimated that $68 billion of the annual $345 billion gross tax gap for 2001, the most current available estimate, was caused by sole proprietors underreporting their net business income. A key reason for this noncompliance was that sole proprietors were not subject to tax withholding and only a portion of their net business income was reported to IRS by third parties. The benefits from information reporting are affected by payers' compliance with reporting requirements and IRS's ability to use the information in its process that matches third-party data with tax returns. However, IRS does not have estimates of the number or characteristics of payers that fail to submit 1099-MISCs as required. To improve its use of 1099-MISC information, IRS has collected data to help identify ways to refine its matching process and select the most productive cases for review, as GAO recommended in 2009.

Current 1099-MISC requirements impose costs on the third parties required to file them. The magnitude of these costs is not easily estimated because payers generally do not track these costs separate from other accounting costs. In nongeneralizable case studies conducted in 2007 with four payers and five vendors that file information returns on behalf of their clients, GAO was told that existing information return costs were relatively low. One small business employing under five people told GAO of possibly spending 3 to 5 hours per year filing Form 1099 information returns manually, using an accounting package to gather the information. Two vendors reported prices for preparing and filing Forms 1099 of about $10 per form for 5 forms to about $2 per form for 100 forms, with one charging about $0.80 per form for 100,000 forms. However, these prices did not include clients' recordkeeping costs. Payers face a variety of impediments preparing and submitting 1099-MISC forms, including complex rules and an inconvenient submission process. For example, payers must determine whether payees are incorporated, must get the payees' taxpayer identification number, and must use special forms if filing on paper.

A variety of options exist for mitigating the costs of filing Form 1099-MISC. Most have pros and cons. IRS has already exempted payments, including those paid by credit card, which will be reported to IRS by other means. Other options include improving IRS guidance and education; adding a check-the-box question to business tax forms that would force return preparers to ask their clients whether they have complied with 1099-MISC reporting requirements; waiving late submission penalties for first-time payers; raising the payment reporting threshold; initially limiting the types of payments covered; having IRS develop an online filing capability; and allowing paper filers to submit computer-generated black and white 1099-MISCs rather than IRS's printed forms.

Madam Chairwoman and Members of the Committee:

I am pleased to be here today to discuss the effects on small businesses of filing third-party information returns with the Internal Revenue Service (IRS) reporting various payments. Payees are responsible for reporting payments they received from the third-party payers as income on their tax returns. This income is labeled miscellaneous income and reported by the third parties on Form 1099-MISC. IRS matches the third-party information returns with payees' tax returns to ensure that payees are accurately reporting their income and paying any tax. Third parties reported more than $6 trillion in payments for tax year 2006 on Forms 1099-MISC.

Information reporting by third parties is a proven approach for improving taxpayer compliance with the tax laws and for minimizing taxpayers' costs of complying. However, such reporting imposes a cost on the third parties. Consequently, there is a trade-off. Our tax system shifts some of the costs of tax administration to the third parties and gains improved compliance and reduced compliance costs for taxpayers.

This trade-off is illustrated by the requirement for additional reporting of miscellaneous income. Section 9006 of the Patient Protection and Affordable Care Act[1] requires expanded information reporting to include payments to corporations and payments of amounts in consideration of property and gross proceeds. For payments after December 31, 2011, every person engaged in a trade or business would be required to file a Form 1099-MISC reporting aggregate annual payments of more than $600 to any individual or corporate payee for the purchase of goods or services.[2] Currently, information reporting is only required for payments for services and only to payees who are not incorporated. Concerns have been expressed about the costs that the additional reporting will impose on businesses. The Joint Committee on Taxation estimates that eliminating the new requirement would result in revenue loss of approximately $19 billion from 2012 to 2020 from increased taxpayer noncompliance.

[1]Pub. L. No. 111-148, Title IX, Subtitle A, 124 Stat. 119 (Mar. 23, 2010).

[2]Section 9006 expanded information reporting to include payments of amounts in consideration for property and payments of gross proceeds. In its July 19, 2010 Notice 2010-51 requesting public comment on these amendments to information reporting, IRS specifically asked the public to comment on the appropriate scope of the terms and how to interpret the terms in a manner that minimizes the reporting burden and avoids duplicative reporting.

In 2009, we suggested that Congress consider requiring payers to report service payments to corporations on the Form 1099-MISC, but we have not assessed or recommended expanding 1099-MISC reporting to payments for goods.[3] As early as 1991, we determined that the benefits in terms of increased tax revenue and voluntary taxpayer compliance would exceed the costs of extending 1099-MISC reporting to corporate payments.[4] IRS agreed that the benefits of eliminating the corporate exemption for service payments outweigh the costs, and the Bush Administration had proposed legislation extending the reporting requirements to service payments to corporations. The Obama Administration had similar proposals in its fiscal year 2010 and 2011 budget requests.[5]

Because of the debate about the cost imposed by the new requirement, you asked us to summarize our prior reports on what is known about the costs and compliance benefits of information reporting, particularly 1099-MISC reporting.[6] More specifically, our objectives are to describe (1) what is known about the benefits of the current requirements in terms of both improved compliance by taxpayers and reduced taxpayer recordkeeping and other costs, (2) what is known about the costs to the third-party businesses of the current 1099-MISC reporting requirement, and (3) what opportunities are available to mitigate the reporting burden for third-party businesses. The reports we summarize in this statement did not assess the expansion of 1099-MISC reporting to payments for goods.

My testimony today is based on three reports on information reporting by third parties. We used multiple methodologies to develop our findings for

[3]GAO, *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, GAO-09-238 (Washington, D.C.: Jan. 28, 2009). In this report, we made eight recommendations to IRS, six of which IRS agreed with and is taking action to address.

[4]GAO, *Tax Administration: Benefits of a Corporate Document Matching Program Exceed the Costs*, GAO/GGD-91-118 (Washington, D.C.: Sept. 27, 1991).

[5]According to the Department of the Treasury's estimates, the Obama Administration's fiscal year 2011 proposal for reporting payments to corporations would have generated an estimated $9.2 billion from 2011 through 2020, in part because of increased voluntary compliance. However, the Joint Committee on Taxation estimated that the Administration's 2011 proposal would have generated about $3.4 billion for the same period.

[6]GAO-09-238; *Tax Administration: Costs and Uses of Third-Party Information Returns*, GAO-08-266 (Washington, D.C.: Nov. 20, 2007); and *Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance*, GAO-07-1014 (Washington, D.C.: July 13, 2007).

these reports. We conducted structured interviews with four organizations volunteered through International Accounts Payable Professionals or the National Federation of Independent Businesses, an organization of small businesses that was on record as finding the information reporting proposals we studied to be troublesome to small businesses. We also selected five companies from lists of vendors, IRS-approved electronic filers, and Information Reporting Program Advisory Committee members, enough to include representatives of software vendors, service bureaus, and return preparers and cover a sizable percentage of all information returns. These nine case studies provide examples of costs related to 1099s, including 1099-MISCs, but are not representative of the general population of payers and are not to be generalized. We interviewed IRS officials and members of IRS advisory groups, tax professionals, and tax software and information return filing vendors to identify impediments facing payers in preparing and submitting 1099-MISCs. In addition, we reviewed IRS documents and compliance data. We conducted our work for these three reports in accordance with generally accepted government auditing standards. A more detailed discussion of scope and methodology is available in each of the three reports.

Background

As we reported in 2009, more than 5 million third parties submitted more than 82 million miscellaneous income information forms (Form 1099-MISC) to the IRS reporting more than $6 trillion in payments for tax year 2006. Third-party payers are businesses, governmental units, and other organizations that make payments to other businesses or individuals. Payers must submit payment information on 1099-MISCs to IRS when they make a variety of payments labeled miscellaneous income. Payees, or those being compensated, are required to report the payments on their income tax returns.

The types of payments reportable on a Form 1099-MISC—shown in figure 1—and their reporting thresholds vary widely. Under existing law, information reporting is required for payments by persons engaged in a trade or business to nonemployees for services of $600 or more (called nonemployee compensation), royalty payments of $10 or more, and medical and health care payments made to physicians or other suppliers (including payments by insurers) of $600 or more. However, personal payments, such as a payment by a homeowner to a contractor to paint his or her personal residence, are not required to be reported because these payments are not made in the course of a payer's trade or business. Existing regulations also exempt certain payments to a corporation, payments for merchandise, wages paid to employees, and payments of

rent to real estate agents.[7] The expansion of information reporting to payments to corporations and for merchandise will apply to payments made after December 31, 2011.

Figure 1: Form 1099-MISC, Tax Year 2010

9595 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $	OMB No. 1545-0115 2010 Form 1099-MISC	Miscellaneous Income
	2 Royalties $		
	3 Other income $	4 Federal income tax withheld $	Copy A For Internal Revenue Service Center
PAYER'S federal identification number / RECIPIENT'S identification number	5 Fishing boat proceeds $	6 Medical and health care payments $	File with Form 1096.
RECIPIENT'S name	7 Nonemployee compensation $	8 Substitute payments in lieu of dividends or interest $	For Privacy Act and Paperwork Reduction Act Notice, see the 2010 General Instructions for Certain Information Returns.
Street address (including apt. no.)	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐	10 Crop insurance proceeds $	
City, state, and ZIP code	11	12	
Account number (see instructions) / 2nd TIN not. ☐	13 Excess golden parachute payments $	14 Gross proceeds paid to an attorney $	
15a Section 409A deferrals $ / 15b Section 409A income $	16 State tax withheld $ $	17 State/Payer's state no.	18 State income $ $

Form 1099-MISC Cat. No. 14425J Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Source: IRS.

Note: The 2010 form reflects current law in effect and does not include reporting on payments for goods.

[7]Treasury Regulations §1.6041-3. See GAO, *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, GAO-08-956 (Washington, D.C.: Aug. 28, 2008).

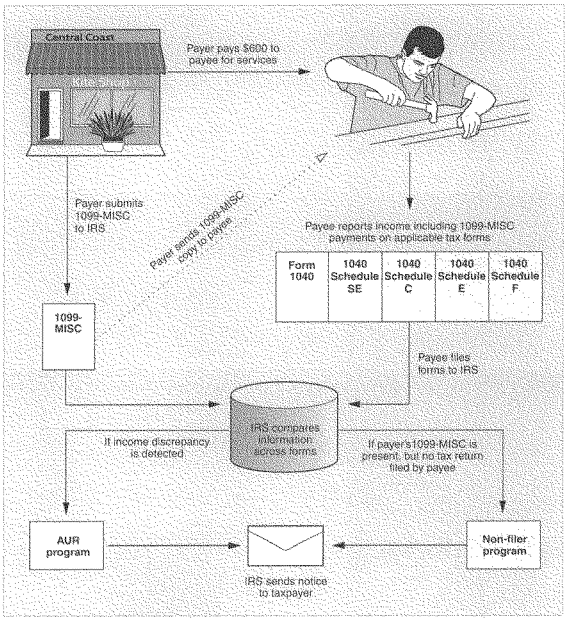
Payers must provide 1099-MISC statements to payees by the end of January. Payers submitting fewer than 250 1099-MISCs may submit paper forms, which are due to IRS by the end of February. Payers submitting paper 1099-MISCs are required to use IRS's official forms or substitute forms with special red ink readable by IRS's scanning equipment.[8] Photocopies and copies of the 1099-MISC form downloaded from the Internet or generated from software packages in black ink do not conform to IRS processing specifications. Payers submitting 250 or more 1099-MISCs are required by IRS to submit the forms electronically.[9] Most 1099-MISCs for tax year 2006 were submitted electronically. However, most payers submitted small numbers of 1099-MISCs, and most payers submitted paper 1099-MISCs.

By matching 1099-MISCs received from payers with what payees report on their tax returns, IRS can detect underreporting of income including failure to file a tax return. Figure 2 shows the automated process IRS uses to detect mismatches between nonemployee compensation and other payments reported on 1099-MISCs and payees' income tax returns. The Nonfiler program handles cases where no income tax return was filed by a 1099-MISC payee. The Automated Underreporter (AUR) program handles cases where a payee filed a tax return but underreported 1099-MISC payments. AUR's case inventory includes payee mismatches over a certain threshold, and IRS has a methodology using historical data to select cases for review. AUR reviewers manually screen the selected cases to determine whether the discrepancy can be resolved without taxpayer contact. For the remaining cases selected, IRS sends notices asking the payee to explain discrepancies or pay any additional taxes assessed.

[8]IRS uses the Service Center Recognition Image Processing System (SCRIPS) to capture printed or handwritten information from paper forms and convert the information into machine-readable format for computer processing.

[9]26 U.S.C. § 6011(e)(2)(A).

Figure 2: Matching 1099-MISC Reportable Nonemployee Compensation Information with Individual Tax Returns

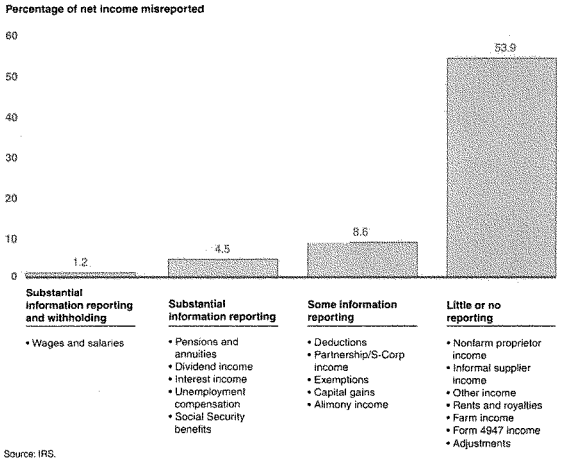


Source: GAO analysis of IRS information.

1099-MISC Information Reporting Increases Voluntary Taxpayer Compliance, Reduces the Cost and Intrusiveness of IRS Compliance Programs, and May Reduce Payees' Costs of Preparing Their Tax Returns

Third-party information reporting is widely acknowledged to increase voluntary tax compliance in part because taxpayers know that IRS is aware of their income. As shown in figure 3, voluntary reporting compliance is substantially higher for income subject to withholding or information reporting than for other income. For example, for wages and salaries, which are subject to withholding and substantial information reporting, taxpayers have consistently misreported an estimated 1 percent of their income. For income with little or no information reporting, the tax year 2001 estimated percentage was about 54 percent. IRS has long recognized that if payments made to businesses are not reported on 1099-MISCs, it is less likely that they will be reported on payee tax returns.

Figure 3: Individual Net Income Misreporting Categorized by the Extent of Income Subject to Withholding and Information Reporting, Tax Year 2001



Source: IRS.

In a 2007 report we highlighted the connection between a lack of information reporting and the contribution of sole proprietors, a significant portion of the small business community, to the tax gap.[10] IRS estimated the gross tax gap—the difference between what taxpayers actually paid and what they should have paid on a timely basis—to be $345 billion for tax year 2001, the most recent estimate made. IRS also estimated that it will collect $55 billion, leaving a net tax gap of $290 billion. IRS estimated that a large portion of the gross tax gap, $197 billion, was caused by the underreporting of income on individual tax returns. Of this, IRS estimated that $68 billion was caused by sole proprietors underreporting their net business income. The $68 billion does not include other sole proprietor contributions to the tax gap, including not paying because of failing to file a tax return, underpaying the tax due on income that was correctly reported, and underpaying employment taxes. Nor does it include tax noncompliance by other types of businesses such as partnerships and S corporations. In the report, we noted that a key reason for this noncompliance was that sole proprietors were not subject to tax withholding, and only a portion of their net business income was reported to IRS by third parties. Tax noncompliance by some small businesses is unfair to businesses and other taxpayers that pay their taxes—tax rates must be higher to collect the same amount of revenue.

The 1099-MISCs are a powerful tool through which IRS can encourage voluntary compliance by payees and detect underreported income of payees that do not voluntarily comply. Increasing the numbers of 1099-MISCs IRS receives from payers in turn would increase information available for use in IRS's automated matching programs to detect tax underreporting, including failure to file a tax return. For tax year 2004 (the last full year available for our 2009 report), the AUR program assessed $972 million in additional taxes for payee underreporting detected using 1099-MISC information.[11] To help IRS improve its use of 1099-MISC information, we recommended in 2009 that IRS collect data to help refine its matching process and select the most productive cases for review. In response to our recommendation, IRS reviewed a sample of AUR cases and plans to modify its tax year 2010 matching criteria for 1099-MISC information.

[10] GAO-07-1014.

[11] GAO-09-238.

Information reporting has allowed IRS to use its computerized matching programs as an alternative to audits to address some issues. The matching programs generally require less contact with taxpayers and thus are less intrusive and involve less taxpayer time.

In addition, information reporting may reduce taxpayers' costs of preparing their tax returns. In a 2006 report we described how additional information reporting on the basis of securities transactions could reduce taxpayers' need to track the basis of securities they sold.[12] The extent to which 1099-MISC reporting reduces taxpayer recordkeeping costs is not known, but to the extent it reduces the need to track receipts by year from each payer it could have some effect on those costs.

IRS does not know the magnitude of 1099-MISC payer noncompliance or the characteristics of payers that fail to comply with the reporting requirements. Without an estimate of payer noncompliance, IRS has no way of determining to what extent 1099-MISC payer noncompliance creates a window of opportunity for payees to underreport their business income and go undetected by IRS. Research would be key for IRS in developing a cost-effective strategy to identify payers that never submit 1099-MISCs. In 2009, we recommended that IRS study the extent of 1099-MISC payer noncompliance and its contribution to the tax gap, as well as the nature and characteristics of those payers who do not comply.[13] In response to our recommendations, IRS plans to study payer noncompliance through its National Research Program studies with results estimated to be available in December 2015.

[12]GAO, *Capital Gains Tax Gap: Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed*, GAO-06-603 (Washington, D.C.: June 13, 2006).

[13]GAO-09-238.

Third Parties Incur Costs to File 1099-MISCs, but Case Study Entities Reported That the Costs of Complying with Current Requirements Were Relatively Low

Existing information reporting requirements impose costs on the third-party businesses required to file Form 1099-MISC. The expanded reporting requirements will impose new costs. To comply with information reporting requirements, third parties incur costs internally or pay external parties. In-house costs may involve additional recordkeeping costs beyond normal recordkeeping costs related to running a business, as well as the costs of preparing and filing the information returns themselves. If the third parties go outside their organizations for help, they would incur out-of-pocket costs to buy software or pay for others to prepare and file their returns.

Data on the magnitude of these information reporting costs are not readily available because taxpayers generally do not keep records of the time and money spent complying with the tax system. A major difficulty in measuring tax compliance costs, including the costs of filing information returns, is disentangling accounting and recordkeeping costs due to taxes from the costs that would have been incurred in the absence of the federal tax system. Data on compliance costs are typically collected by contacting a sample of taxpayers, through surveys or interviews, and asking them for their best recollection of the total time and money they spent on particular compliance activities. The quality of the resulting data depends on the ability of taxpayers to accurately recall the amount of time and money they spent.

In the nine case studies we conducted in 2007, filers of information returns told us that existing information return costs, both in-house and for external payments, were relatively low. While these nine case studies are not to be generalized to the entire population, they do provide examples of costs and insights from the perspective of organizations of different sizes and from different industries and of organizations filing their own information returns and those filing on behalf of others.[14] In-house compliance costs include the costs of getting taxpayer identification numbers (TIN), buying software, tracking reportable payments, filing returns with IRS, and mailing copies to taxpayers.

- One organization with employees numbering in the low thousands estimated that its costs of preparing and filing a couple hundred Forms 1099, which include recordkeeping and distinguishing goods from services, were a minimal addition to its normal business costs.

[14]For additional details on our case studies, see GAO-08-266.

- One small business employing under five people told us of possibly spending 3 to 5 hours per year filing Form 1099 information returns manually, using an accounting package to gather the information.

- An organization with more than 10,000 employees estimated spending less than .005 percent of its yearly staff time on preparing and filing Forms 1099, including recordkeeping.

- Unit prices for services provided to payers by selected software vendors, service bureaus, and return preparers decreased as the number of forms handled increased. Two external parties selling services reported prices for preparing and filing Forms 1099 with IRS of about $10 per form for 5 forms to about $2 per form for 100 forms, with one of them charging about $0.80 per form for 100,000 forms. These prices do not include the payers' recordkeeping costs.

This relationship of price to size for entities we studied is consistent with what studies that we have seen show about the role of fixed costs and economies of scale in complying with the tax code; we are familiar with no similar studies of information returns.[15]

Although our case study organizations indicated that 1099 recordkeeping and reporting costs are relatively low, costs may not be as low as they could be. According to IRS, advisory group members, and others we interviewed for our 2009 report, payers are confronted with a variety of impediments to preparing and submitting 1099-MISC forms.[16] Some payers that do not submit their 1099-MISCs as required may be unaware of their 1099-MISC reporting responsibilities. Other payers may be confused about whether payments are reportable because of different dollar reporting thresholds and the general exemption for payments to corporations under current law. Some payers misreport or neglect to report payee taxpayer identification numbers (TIN) and could be subject to penalty and required

[15]According to Slemrod and Bakija, studies consistently found that the smaller the firm, the larger the cost of complying with the tax system per dollar of various measures of the size of the firm. (See Joel Slemrod and Jon Bakija, *Taxing Ourselves: A Citizen's Guide to the Debate over Taxes*, 3rd ed. (Cambridge, Mass.: The MIT Press, 2004.)

[16]IRS advisory groups include the Electronic Tax Administration Advisory Committee (ETAAC), the Information Reporting Program Advisory Committee (IRPAC), and the Internal Revenue Service Advisory Council (IRSAC). We also interviewed tax professionals, tax software vendors, paid preparers, and other business and professional association representatives knowledgeable about 1099-MISC payer reporting attending the IRS National Public Liaisons (NPL) fall 2007 meeting.

to do backup withholding on 1099-MISC payments to payees with bad TINs. For the large number of payers each submitting a few 1099-MISCs, IRS does not offer a fillable form on its Web site and requires payers to submit scannable red ink forms, but some payers submit black and white 1099-MISCs anyway.

Opportunities Exist to Mitigate the Burden and Promote Reporting Compliance for Third Parties Submitting 1099-MISC Information Returns

Although businesses will face additional costs for each additional Form 1099, some options for modifying the 1099-MISC reporting requirements could help mitigate the burden and promote payer reporting compliance. Table 1 highlights options we previously reported. We noted those options that were proposed by IRS, IRS advisory groups, and the National Taxpayer Advocate.[17] Our list of 1099-MISC impediments and options is not exhaustive, nor is the list of pros and cons associated with the options. Improved IRS guidance and education are relatively low-cost options, but most taxpayers use either tax preparers or tax software to prepare their tax returns and may not read IRS instructions and guidance. While taxpayer service options may improve compliance for those that are inadvertently noncompliant, they are not likely to affect those that are intentionally noncompliant.[18] Some options to change 1099-MISC reporting requirements require congressional action, and other options would be costly for IRS to implement. Where the option involves particular issues, such as cost or taxpayer burden, we note them in our table.

[17]The table notes options specifically recommended by IRS's advisory groups or by IRS in its budgets and tax gap plans at the time of our 2009 report on reporting miscellaneous income.

[18]GAO, *Highlights of the Joint Forum on Tax Compliance: Options for Improvement and Their Budgetary Potential*, GAO-08-703SP (Washington, D.C.: June 2008).

Table 1: Impediments to 1099-MISC Payer Reporting Compliance and Options for Increasing Voluntary 1099-MISC Compliance

Impediments facing 1099-MISC payers	Options for increasing voluntary compliance and related actions, pros, and cons
Some payers are unaware of their 1099-MISC reporting responsibilities	

1. Some payers are unaware of their 1099-MISC reporting responsibilities.	• Revise business tax form instructions to remind taxpayers of 1099-MISC reporting requirements for specific expense types.
	  • IRS added a 1099-MISC reminder to the 2007 Schedule C instructions for contract labor expenses, and such reminders can be added for other 1099-MISC reportable expenses such as rent and legal and professional services.
	• Target 1099-MISC related education and outreach activities to specific payer groups (IRSAC, 2005; IRS Oversight Board, 2008).[a]
	  • IRS has initiated such outreach to federal, state, local, and tribal governments, but more research is needed to determine which business payer groups to target.
	In response to our 2009 recommendation, IRS added a general reminder to the 2009 *Publication 535 Business Expenses* to highlight 1099-MISC reporting responsibilities.
	All of the above may be of limited efficacy if taxpayers rely on paid preparers and tax preparation software and do not look at IRS instructions or guidance, or if taxpayers are willfully misreporting. Providing additional guidance could be helpful if tax return preparation software is based on the guidance.
	• Increase outreach to paid preparers and tax software vendors to promote awareness of 1099-MISC reporting responsibilities (IRSAC, 2005).
	  • Providing 1099-MISC training outreach through IRS's phone forums or Nationwide Tax Forums can reach large numbers of paid preparers. At the 2010 Tax Forums, IRS discussed ways to properly report 1099-MISC payment information.
	  • Many payers rely on paid preparers and tax software to help them comply with their reporting responsibilities.
	• Add check-the-box question to business tax forms requiring taxpayers to attest whether they submitted 1099-MISCs related to their reported expenses (IRSAC, 2005; National Taxpayer Advocate, 2005).
	  • Would force tax preparers and tax software to query taxpayers about their expenses, and taxpayers would have to respond to the checkbox under penalty of perjury.
	  • According to the National Taxpayer Advocate, the burden associated with a checkbox asking taxpayers to verify that they have complied with existing legal requirements is inherently small.
	  • Impact may be on increasing voluntary compliance, with little utility as an IRS enforcement tool.
	  • California has a similar checkbox on state corporation and S-corporation income tax returns, which serves as a reminder to taxpayers. California has not evaluated how this reporting feature affects payer reporting compliance.
	• Add a chart in the business income tax instructions to help payers determine if they have a potential 1099-MISC reporting requirement and need to review the 1099-MISC instructions. IRS frequently provides charts and worksheets to help taxpayers understand their filing obligations.[b]

2.	Some payers first learn about 1099-MISC reporting responsibilities from their tax preparers after 1099-MISC due dates have passed.	• Add IRS's "Information Returns Processing" hyperlink to its "Starting a Business" and "Small Business and Self-Employed Tax Center" sites to make information reporting a more prominent aspect of business responsibilities.
		• Provide a general notice about 1099-MISC reporting responsibilities to new small business owners when they apply for an employer identification number (EIN).
		  • IRS currently encourages online application and provides EINs immediately after validation which makes this a low cost option.
		• Provide a notice about 1099-MISC reporting responsibilities, key requirements, and due dates to small businesses each fall. Notices could be sent to some businesses, such as Schedule C filers reporting contract labor expenses for the first time, or all small businesses.
		  • Potentially costly mailing. May not be cost-effective if large numbers of businesses do not have 1099-MISC reportable payments.
		• Have single due date for 1099-MISC submission to IRS.
		  • Change paper submission due date to IRS from February 28 to March 31 to encourage taxpayers and tax preparers to prepare any 1099-MISCs that may have been overlooked without fear of penalty (IRSAC, 2005).
		  • Change electronic submission due date to IRS from March 31 to February 28 to allow IRS more time to process 1099-MISC for computer matching (Electronic Tax Administration Advisory Committee (ETAAC), 2006).
		  • Changing due dates for submitting 1099-MISC to IRS affects due dates for other information return series, but does not change the January due date to payees.
		• Waive late submission penalties for first-time payers.
		  • Some payers who realize they are late in submitting 1099-MISCs may choose not to file rather than run the risk of incurring late penalties. IRS already reduces the late penalty for 1099-MISCs submitted before August 1 to encourage voluntary submissions.
		  • Hard for IRS to distinguish first-time payers that may have reasonable cause for being late from payers that have willfully neglected to submit 1099-MISCs. Thus, this option may require legislative action to grant IRS authority to automatically waive the late penalty for 1099-MISC payers reporting for the first time.

Some payers are confused about 1099-MISC requirements	
3. Under existing guidance, payers must navigate through 8 pages of singled-spaced instructions to determine what to report in the 14 boxes on the 1099-MISC.	• Add a chart in the 1099-MISC instructions for distinguishing 1099-MISC reportable from non-reportable payments and for calculating whether reportable payments reached reporting threshold. For example, IRS General Instructions for Forms 1099, 1098, 5498 and W-2g contain a chart highlighting what payments and amounts to report for various information returns, including Form 1099-MISC. • Clarify guidance to address common misreporting errors. • IRS does not have research identifying the reasons for payer reporting problems.
4. Some payers overlook reporting payments for non-routine or sporadic one-time transactions.	• Revise business tax form instructions to remind taxpayers of 1099-MISC reporting requirements for specific expense types.

5. Payers must determine whether payments are reportable due to different reporting thresholds. Some payers may underreport miscellaneous income types, such as royalties, with thresholds lower than $600.	• Add a chart in the 1099-MISC instructions for distinguishing 1099-MISC reportable from non-reportable payments and for identifying whether reportable payments reached reporting threshold. Similarly, adding a chart in the business income tax instructions could help payers determine if they have a potential 1099-MISC submission requirement and need to review the full instructions.
	• Standardize or eliminate dollar threshold for reporting payments (NTA, 2005; IRPAC, 2006).[c]
	  • Lower uniform amount (National Taxpayer Advocate, 2005).
	  • Increased payer burden to submit more 1099-MISCs.
	  • Increased number of 1099-MISCs to IRS for detecting payee income underreporting.
	  • Higher uniform amount.
	  • Decreased payer burden.
	  • Decreased number of 1099-MISCs to IRS for detecting payee income underreporting.
	  • Some options to change the dollar reporting threshold require legislative action.

6. Under current law, payers must determine whether payee is a corporation that is exempt from 1099-MISC reporting.	• Amend legislation—as was achieved under the broader reporting requirements enacted in 2010—to extend reporting requirements to include service payments to corporations. We previously reported that the benefits in terms of increased revenue and taxpayer compliance exceed costs for reporting service payments to corporations. In 1991, we suggested that Congress needed to enact legislation to require reporting on payments to corporations and in 2009 formally recommended that matter for congressional consideration.[4] IRS agrees that the benefits of this option in addressing the tax gap outweigh the costs. The Bush Administration requested legislative action in its fiscal year 2008 and 2009 budgets and the Obama Administration in its fiscal year 2011 budget. According to Treasury estimates, extending the reporting to payments to corporations would generate revenue due in part to increased voluntary compliance and IRS's ability to detect underreported payments received by businesses.
	• The burden of determining the payee's status would be simplified. Some payers already submit 1099-MISC for all corporate payees rather than determine payee status. (IRSAC, 2005). However, other payers fail to submit 1099-MISCs currently required because they mistake small business payees as corporations exempt from reporting.
	• Payers need to submit more 1099-MISCs (IRPAC, 2007). Various phase-in options could minimize the burden and disruption for payers.[6] Some options listed below could add complexity for payers to determine whether the payee is exempt or the payment is reportable.
	  • Exempting transactions paid by merchant payment cards, such as credit cards. In August 2010, IRS issued a rule exempting payments reported under the new payment-card reporting requirements from 1099-MISC reporting.
	  • Delaying the effective date.
	  • Grandfathering ongoing relationships or specifying a lead time for collecting information on them.
	  • Issuing guidance to require that for business relationships just starting, TIN and information about services versus goods be provided immediately, for example on the invoice.
	  • Initially covering only specific payment types, such as rent payments to corporations.
	  • Extending existing exemptions for payments like freight, effectively exempting certain categories of corporations.
	  • Requiring reporting only for payments to some corporations, such as those privately held or below a certain size, for instance, smaller than the Fortune 500; exempt corporations could show their exemption on their invoices.[7]
	  • Raising the $600 floor for reporting (discussed above).
	  • Exempting small payer businesses from reporting based on their revenues or other factors; this option risks allowing noncompliance by some payees and gaming of the system. For example, a business may receive payments totaling $1 million with $200,000 of that reported to IRS by the nonexempt payers. If the business chooses to report only the $200,000 on its tax return, the IRS matching program would not be able to detect the $800,000 underreported.

Some payers find 1099-MISC submission burdensome/inconvenient.	

7. Some payers misreport or neglect to report payee taxpayer identification numbers (TINs) and could be subject to penalty and required to do backup withholding on 1099-MISC payments to payees with bad TINS.
Some payers misreport 1099-MISCs using the payee's partnership's name and TIN rather than the individual payee's Social Security Number (SSN).
	• Provide education and outreach activities to
	  • Remind payers to secure TINs from payees for 1099-MISC reporting to avoid backup withholding for missing or incorrect TINs.[g]
	  • Remind payers of IRS's voluntary TIN Matching program that allows authorized payers the opportunity to match payee TIN and name with IRS records free of charge before submitting the 1099-MISC.[h]
	  • Increase awareness of IRS policy on waiving incorrect or missing TIN information penalties and how a payer can establish reasonable cause.
	• Issue guidance to require that for business relationships just starting, TIN information be provided immediately, for example on the invoice.
	• Require payers to validate payee TINs (IRS, 2007).[i]
	  • Increase reporting burden for payers.
	  • Decrease number of 1099-MISCs unmatchable to payees for IRS's automated enforcement programs.

8. Payers submitting paper 1099-MISCs are required to use forms printed with special red ink scannable by IRS. IRS does not offer a fillable form for downloading on its Web site, and forms computer generated from accounting or tax software are not acceptable formats. Some payers submit black and white 1099-MISCs anyway.	• Provide an online portal for electronic submission similar to the Social Security Administration's portal for W-2s (ETAAC, 2007, 2008).[j]
	  • Potentially affects a majority of payers as 90 percent of payers used paper forms and 64 percent of all payers submitted one to four forms in 2006.
	  • Facilitate more accurate 1099-MISC entry and processing for IRS.
	  • Implementation has costs, and IRS currently has no plans for a 1099-MISC portal.
	• Allow payers to submit computer generated black and white 1099-MISCs (IRSAC, 2005).
	  • IRS currently has no plans to upgrade its scanning technology to eliminate the special red ink requirement and process computer-generated black and white 1099-MISCs.
	  • IRS submission processing officials said some black and white computer-generated forms are currently scanned but require additional work to ensure information was correctly scanned. These officials predicted that relaxing the red ink requirement would overwhelm the current scanning operation. In 2009, we reported that IRS had not conducted any research to determine the extent to which computer-generated black and white forms slows 1099-MISC processing.
	  • Lowering the 250 threshold for electronic submission would reduce the total number of paper submissions and might ameliorate such slowdown (ETAAC, 2007). Lowering the threshold would require legislative action.
	• Promote awareness of any offers for free electronic 1099-MISC submission services available through IRS's authorized e-file partners. (IRS)
	  • A few vendors in the past offered free online preparation and submission for small numbers of 1099-MISCs for businesses.[k]

9. Payers using IRS's Filing Information Returns System (FIRE) must register and buy software to format 1099-MISC data transmission, or pay a vendor to submit their forms electronically.	• Provide an online portal (discussed above). • Online portal likely to require registration with IRS and may be convenient for payers submitting a few forms, but not likely convenient for payers submitting 250 or more forms.

Source: GAO analysis, including that done in GAO-09-238 and GAO-06-266.

Notes:

[4]IRSAC, *Internal Revenue Service Advisory Council Public Meeting*, November 17, 2005 (Washington, D.C.: Nov. 17, 2005) and IRS, IRS Oversight Board, Annual Report 2007, (Washington, D.C.: March 2008).

[5]For example, the Form 1040 tax return instructions to help individuals determine whether they are required to file an income return. Also, the Schedule SE highlights who must file the schedule for self-employment tax and includes a chart to help individuals determine whether to file the short or long Schedule SE.

[6]In 2005 testimony, the National Taxpayer Advocate recommended reducing or eliminating the $600 threshold. In 2006, IRPAC recommended increasing the medical payment threshold to $5,000 to reduce payer reporting burden.

[8]GAO/GGD-91-118. In 1992, we recommended federal agencies issue information returns on payments to corporations (GAO/GGD-92-130). In 2004, we reported that revenues from extending reporting requirements to corporate payments could increase by billions of dollars (GAO-04-649). See GAO, *Tax Administration: Costs and Uses of Third Party Information Returns*, GAO-08-266 (Washington, D.C.: Nov. 20, 2007) for a list of how the additional costs payers would incur could be mitigated. GAO-09-238 included the matter for congressional consideration.

[9]The options are based on our previous analysis of 1099-MISC reporting requirements; we have not analyzed the costs and benefits of reporting payments for goods.

[10]To minimize burden on small businesses, the National Taxpayer Advocate recommended expanding 1099-MISC reporting to include corporations only if IRS's National Research Program (NRP) found significant levels of noncompliance among small corporations. *National Taxpayer Advocate, 2007 Annual Report to Congress, Vol. 1, Section Two—Key Legislative Recommendations*, (Washington, D.C.: Jan. 9, 2008). This phase-in approach does not simplify the need to track the payee's status.

[11]IRS Form W-9 can be used to obtain and certify the payee's tax identification number (TIN). IRS uses the combination of the payee name and TIN to match the information reported on a 1099-MISC with information reported by the payee on income tax returns.

[12]Currently TIN matching is only available to authorized payers that filed information returns with IRS in at least one of the two past tax years.

[13]Internal Revenue Service, *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance*, (Washington, D.C.: Aug. 2, 2007).

[14]The Social Security Administration offers free online submission of W-2s for payers submitting 20 or fewer forms.

[15]In 2007, we reported that, according to vendors we interviewed, prices for preparing and submitting 1099-MISCs were relatively low, ranging from about $10 per form for 5 forms to about $2 per form for 100 forms, with one of them charging about $0.80 per form for 100,000 forms. See GAO, Tax Administration: Costs and Uses of Third-Party Information Returns, GAO-08-266 (Washington, D.C.: Nov. 20, 2007).

As we reported in 2009, multiple approaches could help IRS to mitigate the reporting costs and promote payer compliance with 1099-MISC reporting requirements.[19] For example, the evidence shows that the benefits outweigh the costs for information reporting for payments to corporations. For other options, it is not clear whether the benefits outweigh the associated costs, and additional research by IRS could help to evaluate the feasibility of more costly options, such as allowing black and white paper 1099-MISCs. Action to move forward on options to target outreach to specific payer groups or clarify guidance to reduce common

[19]GAO-09-238.

reporting mistakes would hinge on IRS first conducting research to understand the magnitude of and reasons for payer noncompliance.

In 2009, we recommended two actions that IRS could take to help payers understand their 1099-MISC reporting responsibilities:[20]

- Provide payers with a chart to identify reportable payments. IRS disagreed with our recommendation and stated that the Form 1099-MISC instructions already list which payments are reportable and explain the rules for specific payment types. We believe that a chart would provide taxpayers with a quick guide for navigating the Form 1099-MISC instructions, already eight pages long under the current reporting requirements.

- Evaluate adding a new checkbox on business tax returns for payers to attest whether they submitted their 1099-MISCs as required. IRS also disagreed with this recommendation and stated that a similar question was removed from the corporate tax return after the Paperwork Reduction Act of 1980 was enacted. We believe results from the evaluation we recommend would be useful in weighing the benefits and burdens associated with a checkbox option.

To reduce the submission burden facing many payers submitting small numbers of 1099-MISCs, we also recommended that IRS evaluate the cost-effectiveness of eliminating or relaxing the red ink requirement to allow payers to submit computer-generated black and white 1099-MISCs. In April 2009, IRS conducted a test to determine the labor to process a sample of 4,027 red-ink 1099-MISCs versus the same documents photocopied. IRS told us that, using the same scanning equipment and employees, the red-ink sample took 2 hours and 9 minutes to process versus 28 hours and 44 minutes to process and manually key the photocopy sample. Based on the test results, IRS decided to maintain the red ink requirement to minimize labor costs. We have not reviewed the results of the IRS test.

Our prior work did not assess requiring 1099-MISC reporting on payments for goods. Some of our findings and recommendations may be relevant, but we do not know the extent of relevance.

[20]IRS has taken action to implement a third recommendation—to add a 1099-MISC reporting reminder to *Publication 535 Business Expenses*.

Madame Chairman, this concludes my statement. I would be pleased to respond to any questions you or other Members of the Committee may have.

GAO Contacts and Acknowledgments

For questions about this statement, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals who made key contributions to this testimony include Amy Bowser, Bertha Dong, Lawrence Korb, MaryLynn Sergent, and Cheri Truett.

Related GAO Products

Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements. GAO-09-238. Washington, D.C.: January 28, 2009.

Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance. GAO-08-956. Washington, D.C.: August 28, 2008.

Highlights of the Joint Forum on Tax Compliance: Options for Improvement and Their Budgetary Potential. GAO-08-703SP. Washington, D.C.: June 2008.

Tax Administration: Costs and Uses of Third-Party Information Returns. GAO-08-266. Washington, D.C.: November 20, 2007.

Business Tax Reform: Simplification and Increased Uniformity of Taxation Would Yield Benefits. GAO-06-1113T. Washington, D.C.: September 20, 2006.

Capital Gains Tax Gap: Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed. GAO-06-603. Washington, D.C.: June 13, 2006.

Tax Policy: Summary of Estimates of the Costs of the Federal Tax System. GAO-05-878. Washington, D.C.: August 26, 2005.

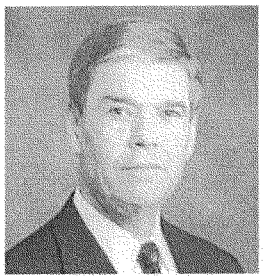
Tax Administration: IRS Should Continue to Expand Reporting on Its Enforcement Efforts. GAO-03-378. Washington, D.C.: January 31, 2003.

Tax Administration: Benefits of a Corporate Document Matching Program Exceed the Costs. GAO/GGD-91-118. Washington, D.C.: September 27, 1991.

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission	The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.
Obtaining Copies of GAO Reports and Testimony	The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."
Order by Phone	The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, http://www.gao.gov/ordering.htm. Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537. Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.
To Report Fraud, Waste, and Abuse in Federal Programs	Contact: Web site: www.gao.gov/fraudnet/fraudnet.htm E-mail: fraudnet@gao.gov Automated answering system: (800) 424-5454 or (202) 512-7470
Congressional Relations	Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400 U.S. Government Accountability Office, 441 G Street NW, Room 7125 Washington, DC 20548
Public Affairs	Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800 U.S. Government Accountability Office, 441 G Street NW, Room 7149 Washington, DC 20548

Please Print on Recycled Paper



James R. (Jim) White

Director, Tax Issues
U.S. Government Accountability Office

Mr. White is a Director at GAO responsible for work on IRS, tax administration and tax policy. He has held this position since July 1998. Previous positions at GAO include Associate Director and Acting Chief Economist.

Mr. White joined GAO in 1990 from Hamilton College where he was an Associate Professor in the economics department, teaching public finance. Prior positions include faculty appointments at Williams College and New York University, plus a Senior Fellowship with the Rockefeller Institute of Government.

Mr. White has a Ph.D. in economics, with a concentration in public finance, from Columbia University. He has a bachelor's degree in economics from the University of California, Berkeley.

Chair LANDRIEU. Thank you. Mr. White, let me start with you on this 1099 because this is an issue that has really gotten everybody's attention, and I want to start with, the legislative history, I understand, of this provision—and I appreciate your testimony about the need for tax compliance. It is important when taxes are levied, for people to pay them, and it is important for the government to design systems to make sure that people are paying their rightful share of taxes.

The question is, where that burden of compliance should fall, and my understanding of this particular provision, and I want you to comment, is it was established—the threshold—in 1954. The history of the information reporting requirement, Congress intended the threshold amount for triggering informational reporting to correspond to the personal independent exemption level in the Internal Revenue Code.

In 1954, that exemption was $600. Today your threshold stays at $600, but the dependent exemption has risen to $3,650. So, my question is, not the intent, but how did it stay so low for so long, and why wasn't it raised? Why didn't someone suggest that it be raised to a more reasonable threshold?

Mr. WHITE. There is no automatic adjustment for inflation, which is part of the problem, and that would be in our table where we suggest some mitigations. That is one of the options.

Chair LANDRIEU. But in all the reports ever requested by any member of Congress on this subject or related, do you know if the IRS ever suggested this would be something that might make sense? And Dr. Sargeant, I know you have only been on the job three months, but in any of the reports that you have had a chance to review yet in your office, was there ever a report submitted that it might just be a good idea to raise the threshold on 1099s commensurate with inflation?

Mr. WHITE. We suggested it in the 2009 report. I am not aware of what IRS has done on this question.

Chair LANDRIEU. Okay.

Mr. SARGEANT. With regard to the reports that I have read, I have not seen any mention with regard to the need to raise——

Chair LANDRIEU. Okay, well, I would like to go ask both of you to go back and just review any of the reports that your individual agencies submitted, to let this committee know if this was ever flagged or brought to anyone's attention, because if not, what it tells me is there is a systematic malfunction somewhere in this government where there is really no entity kind of looking out for how to just sort of automatically adjust these requirements, and if it is going to take an Act of Congress to adjust every single one of them, we are going to be spending an awful lot of time and creating an awful lot of havoc when something could be done quite more efficiently in an administrative way.

Now, we are going to repeal 1099, but the time and effort it takes to do this could have been avoided in some way had there been some sort of system of just, you know, regular review. And I think, Dr. Sargeant, it leads me to the—hopefully the purpose of your office is exactly this, to be exploring and evaluating new proposed regulations and how they might effect small business, reviewing long time regulations.

In fact, I think in the law, you know, and I am on a little bit of a learning curve here, but I think that in the law there is something like every ten years the Office of Advocacy conducts a detailed examination of the cost of federal regulation. There is a time frame, if the staff could—there is a specific time frame for reviewing. I think if a law is ten years old—are you following what I am saying?

Mr. SARGEANT. Yes.

Chair LANDRIEU. Is not that part of your portfolio of responsibilities?

Mr. SARGEANT. Senator, under the RFA Section 610 calls for a periodic review of rules, but that is done by the Agency, and so we will continue to work with the Agency to review those rules——

Chair LANDRIEU. But what role do you have as that Agency reviews its ten-year-old rules and regulations? Do they call you in or your office in to do that review with them? Do they do a first draft and submit it to you for review?

Explain a little bit about how that works.

Mr. SARGEANT. What has happened in the past is that small businesses would reach out to us to make their comments known about various rules that are on the books, and so we would reach out to these agencies to review these rules, and by law, under 610, they have to review these rules every ten years. Rules that are on the books more than ten years, they have to be reviewed to see whether these rules are necessary. So, we continue to reach out to these agencies to make sure that they are doing this review.

Chair LANDRIEU. Okay. Let me ask you this. Your office has been involved, as you said, on behalf of several small businesses. I understand that your office can do your most effective work when you are able to coordinate with agencies early in their rulemaking process. I really need you to try to give me one or two specific examples, since you have been in your office, about how that process has worked and with what specific agencies, let us say in just the last couple of months, that they have called you in early on when they are thinking about rules, whether it is Fisheries, or OSHA, or any other agency out there.

Mr. SARGEANT. Well, Senator, we have held nine roundtables since I have been in office, and what we do is that we work with small businesses and we also——

Chair LANDRIEU. But nine roundtables where? In the country?

Mr. SARGEANT. Roundtables in D.C. itself.

Chair LANDRIEU. In D.C. with small businesses?

Mr. SARGEANT. With small businesses, but also with representatives from the various agencies. We held a roundtable with Labor because there was a concern with what we call the H–2B rule. This would have a significant impact on small businesses, and so what we did is that we brought together those that would be impacted by this rule, but also we made sure that Labor, those who were writing the rules, were in this room and we assured Labor that this would not—that we would make sure that it will be a good dialogue in terms of small businesses would be able to voice their concern and those who are writing the rules would be able to respond as to why they think these rules are necessary.

So, that is one example that we played very early on.

Chair LANDRIEU. So, you are using a roundtable model specifically called on a specific regulation. You bring the department that is either writing or renewing the regulation with small business. Those are public meetings. You have had nine of them in Washington.

Mr. SARGEANT. Yes.

Chair LANDRIEU. You can submit a list to us of what they were and what topics and your recommendations from each——

Mr. SARGEANT. Yes.

Chair LANDRIEU. I am assuming?

Mr. SARGEANT. Yes, yes. Yes, Senator.

Chair LANDRIEU. Okay. Mr. White, my last question I will turn it over to Ranking Member Snowe, do you have any other suggestions in terms of the latest one or two reports that GAO has issued about specific action this committee could take to either increase our investment in this area or give more support to this office or a process that could be put into place that would help us to identify more quickly rules and regulations that are having, you know, a detrimental effect on small business and making the appropriate or necessary changes?

Mr. WHITE. I think with respect to taxes, which is what I know about, one thing to watch is the new credit card reporting requirements that have been put in place, and IRS has already said, the Commissioner has already stated, that IRS will rescind the 1099 reporting requirements for businesses that make their payments by credit cards because those payments are going to be recorded in the future to IRS.

IRS is in the process of implementing that process, and so this may be a mechanism to reduce the burden of 1099 reporting if this credit card reporting turns out to be an effective substitute for that, so I would watch the effectiveness of that and what the impact is, specifically, on 1099 filing of that program.

IRS also, in recent years, has undertaken a lot of additional research on the causes of noncompliance by businesses, particularly small businesses, and as the results of that research come forward, I think there will be more information about the burden on small businesses of complying with certain requirements. We had recommended that IRS, as part of that research process, focus specifically on the 1099 issue and they had agreed to do so.

Chair LANDRIEU. Thank you.

Senator Snowe.

Senator SNOWE. The more we discuss these issues, it underscores that we ought not pass regulations without knowing the effects before their implementation or enactment. The bottom line is, today, small businesses disproportionately bear the weight of what is happening. Dr. Sargeant, I recommend that you take Main Street tours before the reality becomes pretty clear and stark about what is happening. The cause and effect of actions here affecting Main Street is pretty evident. We have to reorganize this whole regulatory process, and in the meantime aggressive advocacy is necessary on your part, and rigorous examination of all of these potential regulations coming down.

Wall Street reform resulted in 553 new regulations. In 2010 the Administration promulgated 43 major new regulations from var-

ious agencies. There were 41 separate rulemakings in the healthcare reform in addition to another 100 additional regulatory guidance requirements within the healthcare reform law that was enacted this year.

So, all of this is going to require a major burden in your office, and that is why I would like to know exactly what plan you have developed to respond to all of these rules that will be coming to the forefront that are going to have enormous implications on small businesses across this country?

Mr. SARGEANT. Senator, with regard to the CFPB, and thank you, Senator, for being—for your commitment to the office. We now have oversight with regard to CFPB via the SBREFA Panel process. We have met with the staff at CFPB. They have also come over to the Office of Advocacy, and so it pays to work very early on. You know, what is good about this new agency is that it is a new agency and so it does not have some of the histories of not in compliance, so we are working with them and we have training in terms of, you know, this is the RFA.

We have done about 40 panels with EPA and another 12 with OSHA, so we have a lot of examples of running the SBREFA Panels, and so there is a roadmap, there is a flow chart that we can share with CFPB to make sure that they are in compliance, kind of the best practices, and so we have encouraged them to work with us very early on to avoid some of the holes, some of the pitfalls, that could result in not being in compliance because the SBREFA process really works, and it results in better rules because it brings small business in very early and so we know that small businesses have—they agree that SBREFA works, so does the Agency, so that is why it is very important for us to work with CFPB to make sure they buy in.

Senator SNOWE. Well, in that instance, because of the requirements in the law—now, is the panel going to be up and running and that process underway before the bureau is established? The point is, we do not want to have the bureau established and they go running forward with all these regulations and eventually we get around to setting up the Small Business Review Panel.

How is that going to work?

Mr. SARGEANT. Well, under 609(a), there is a process and a timeframe that has been laid out in terms of what you need to do, what type of notification that must be given for the SBREFA Panel process. Now, I have met with the staff at CFPB and they are not—they do not have enough staff yet. They are very early on but we continue to work with them to make sure that they do not get ahead of themselves in writing rules.

Senator SNOWE. Are you taking steps overall to triage all these new regulations that are going to be coming to the forefront among the various newly enacted legislation and all the other regulations? Do you have a plan to implement all that and to respond to that because there is a breadth of regulations?

Mr. SARGEANT. Well, Senator, I am pleased to have a staff of very talented lawyers who work with the various agencies to make sure that they are ahead of the process and they have very good contacts with these agencies to make sure that any rules that are in process that we can make sure that they follow the RFA process.

Senator SNOWE. Exactly why is it that you felt it was necessary to deal more confidentially with the Treasury Department, on the implementation of the 1099 requirement? I mean, they call for a public formal response. Why is it that your office did not do that on this critical issue?

Mr. SARGEANT. Senator, before I joined the Office of Advocacy, the Office was, very early on, involved with the 1099 back in June, and so they were contacted by small businesses, because this 1099 provision is burdensome. As someone who comes from small business and who has to respond to the paperwork, you know, anyone who came from small business would have never advocated side to provision, but once I got into the office, what we did is that we held roundtables with both small businesses and also the trade associations as well, and what came out of this meeting is that this was a reporting requirement. This was not a fix; this was a, how to report 1099s, just like James said, with regard to credit cards. Credit cards would be exempt.

What we found is, you know, many small businesses do not use credit cards, they use cash, and credit cards have fees, and so once again, that was not good for small businesses, but what came out of the panel is that they said, you know, this still does not solve the problem of the 1099 reporting requirement. What you need is a legislative fix, and so immediately after the panel I contacted the IRS chief counsel to have a meeting to share with him the concerns that small businesses have. With regard to the interagency confidential process, that was instituted by Executive Order 13272 by our previous president, and that has worked well in terms of making sure that rules would not even—rules would not come to the fore, that they will be less burdensome.

So, it is a process that has been used, and my predecessor, Tom Sullivan, also used it very well, as well, and so I thought that it was worthwhile to use it.

Senator SNOWE. I have other questions, Mr. White, but I will wait during my second round. Thank you.

Chair LANDRIEU. Okay.

Senator Shaheen.

Senator SHAHEEN. Thank you, Madam Chair. Mr. White, you provided us with a very, I think, good list of ways to address the 1099 reporting requirements. Now, I certainly agree with the Chair and Ranking Member that we are going to repeal that requirement through legislation, but it is an interesting list, I think, with respect to other reporting requirements that exist for small businesses.

So, how many of these things can be done with that legislative action and how many are being contemplated by your office as you think about other reporting requirements for small business?

Mr. WHITE. Most of them could be implemented by IRS, some of them might require legislative action, and most of them also have pros and cons, so what we have done with IRS is, in some cases, make recommendations that IRS gather more information, for example, so that there is better data about exactly what those pros and cons are. Part of the problem with the new requirement for information reporting on goods is there is no information out there about the number of firms that would have to do such reporting,

how many reports each firm would have to file or what the cost of filing those kinds of reports would be. That is the sort of information you would like.

Some of the options are thinking creatively about the problem and ways to address it at lower cost. For example, many small businesses either are unaware that they have got a 1099 filing requirement, the current—under current law, the current requirement.

Senator SHAHEEN. Okay, but I do not want to talk about 1099 because I think that is going away. So, talk to me about other regulations that small businesses have that—and you said you have made recommendations to the IRS relative to many of these items. Do you know what the status of their review of your recommendations are and what the status is? And whether they are moving forward on this?

Mr. WHITE. They have been very responsive in our moving forward with some of our key recommendations, so there are current—there are information reporting requirements under current law that would stay in place and as I said a minute ago, we recommended that IRS, as part of their ongoing research efforts, make that a special focus.

In the past, information reporting was not a focus of IRS research. We asked them to include them in their research plans going forward. It is a very systematic, sophisticated research effort that they have got underway and they have incorporated information reporting into that.

Senator SHAHEEN. Do you think that this committee could get the list of recommendations that you have made to the IRS and perhaps we could get a report on where they are in looking at those?

Mr. WHITE. Yes. Absolutely.

Senator SHAHEEN. Thank you.

Dr. Sargeant, one of the things that you and Mr. White actually both have alluded to is the importance of leveraging our existing support structure for small businesses to help them learn about what their regulations are and appropriate compliance. Can you talk a little more about what you are doing in that respect, about how you envision using part of the SBA apparatus, for example, like the Small Business Development Centers, to help do that? Or is that part of what you are thinking?

Mr. SARGEANT. Senator Shaheen, the small businesses need to know how to comply with regulation, but they also need to have a mechanism to have their voice heard, and so that is what the Office of Advocacy does.

With regard to the SBDCs, they are SBA, and although we are independent from SBA, we sometimes work with SBDCs to make sure that there is a forum or there is an avenue for those businesses to seek training and to know more about some of the programs that are available for small business.

With regard to outreach, outreach is very important and that is why we are very aggressive in making sure that we bring on the ten regional advocates. You know, it has been almost two years not having regional advocates and they are our eyes and ears on the ground, and that is the direct contact where small businesses in

each region because we recognize this is not a one size fits all. What goes on in Iowa may be different than what goes on in D.C., and so it is very important to have someone on the ground, a contact, so that a business who may have some concerns or they may—they are not sure what is coming out of D.C., that they would be able to contact that person so that their voice is heard.

My focus is to make sure that the voice of small business is heard at all levels of government.

Senator SHAHEEN. And can I just ask one final question, Madam Chair?

Chair LANDRIEU. Go ahead.

Senator SHAHEEN. When you said you have ten regional advocates, can you tell me where the Regional Advocate for the northeast is located?

Mr. SARGEANT. The Regional Advocate for the northeast? Oh, the Regional Advocate of the northeast is located in Boston and we are in the process right now of bringing them on. We have identified a few, but once we have identified the advocate, there is the process that you have to go through to get them in, in government, the background checks, but we hope to have all ten by the first of the year.

Senator SHAHEEN. So, we do not actually have somebody hired for the position right now to serve the state of New Hampshire?

Mr. SARGEANT. Well, we have the person and they are going through the process right now. They have been identified, it is just dotting the i's and crossing the t's in terms of becoming a federal employee.

Senator SHAHEEN. And that person—those folks do not need approval by Congress, Senate approval, do they?

Mr. SARGEANT. Those folks do not need Senate approval, but they still need to go through the government process.

Senator SHAHEEN. Thank goodness. Thank you.

Chair LANDRIEU. Dr. Sargeant, let me clarify something and then I will recognize Senator Snowe for one more question and then I would like to move to the second panel. I appreciate Senator Risch being with us.

Let me ask you this. How long have those regional offices been vacant? I am aware that they are vacant now, I just assumed that was a recent occurrence, but you said they have been vacant for a while?

Mr. SARGEANT. They have been vacant almost—I would say almost going on two years.

Chair LANDRIEU. Two, okay.

Mr. SARGEANT. It has been a while.

Chair LANDRIEU. So, they were all full in the last administration?

Mr. SARGEANT. Yes.

Chair LANDRIEU. And then with the change, they just—those positions just have not been filled because your position was not filled until three months ago, right?

Mr. SARGEANT. That is correct. Yes.

Chair LANDRIEU. And you are still on only a recess appointment because of some opposition. Is that correct?

Mr. SARGEANT. That is correct.

Chair LANDRIEU. Okay, so it is very important, I believe, and I am going to ask my colleagues to carefully think through the importance of establishing this director permanently, getting this office staffed up. It is crucial, as our office, to mitigate against unnecessary and burdensome rules. If we do not give them the tools they need and the employees they need, we cannot then expect them to do the kind of work we are requiring them to do.

So, I am asking my colleagues that are here and not here, to consider the importance of this, and I most certainly will commit to you to work closely with your office over the next several weeks to identify, you know, really good, aggressive people.

On that goal, let me just say this. In addition, Senator Snowe, I think we have to think about if this office is actually strong enough, even when fully staffed, this is the organizational staff I just received. There are ten attorneys in the country—slots for ten attorneys and nine advocates. It has 19 people on one side, and the entire federal bureaucracy on the other. So, I think we have to be reasonable in what we expect this office to be able to do in this circumstance.

Now, I am happy to say I have just introduced a bill or will be introducing a bill today looking for cosponsors that strengthen this office. If there was ever an office that needed to be strengthened, I would think that this would be one, so that they can do the things we are asking them to do, which is to minimize unnecessary burdens on small business so that they can work. And I will look forward to working with you on that.

But Senator Snowe, let me get to you. But on the record I want to say one thing. David, a banker from Louisiana in my opening statement, I wanted to put this in the record, testified yesterday on our roundtable about additional regulations. His small bank, $150 million bank, New Roads, Louisiana, a tiny little, beautiful little town in Louisiana, $17,000 in 2008, $137,000 in 2009, and $220,000 in 2010. That is just FDIC insurance increases.

Senator Snowe.

Senator SNOWE. Thank you. Your singular mission, Dr. Sargeant, is on the whole rulemaking process, and making sure that these regulations are not burdensome to small businesses and getting ahead of the train, and that is absolutely, indisputably critical. I hope that is all you are focusing on because it is undeniable what is happening across the country in this sphere alone. Many have labeled it as a de facto tax, it certainly is, and so if you need any other resources, step forward.

It is too bad about the Regional Advocates, I know in the northeast we have an outstanding individual, and that those individuals did not carry over until their replacements came to the forefront. I believe that would have been a better way to have done it, but that was not in your sphere of decision-making because I think otherwise it should have carried some continuity in this critical area at this perilous economic time for small businesses and the economy as a whole.

Mr. White, on the issue of 1099, you mentioned specifically, I wanted to ask you—there has never been a cost benefit analysis done on 1099s as it would apply to goods, is that correct?

Mr. WHITE. Not that I am aware of. I have never seen one. As I said, there is not even an estimate in the number of firms that would have to file.

Senator SNOWE. So, the other dimension to all of this is the impact that this is going to have because we have no way of knowing the degree to which it is going to affect small businesses in complying with this regulation.

The National Small Business Network estimates that 1099 mandates would cost businesses and the IRS at least 100 times more to administer than the average $1.7 billion it will yield annually. So, obviously, it is important that we have the ability to look at this very carefully. Hopefully it does get repealed soon, and unfortunately it did not happen earlier, but I hope it does happen now in this Lame Duck because I think it is going to represent serious consequences. It is one more aspect to why businesses are not going to invest in the future when they start adding and calculating the costs of doing business. And without such an analysis, there is no way to know exactly how much this will cost small businesses.

I have no doubt it is going to be an inordinate burden on them. Thank you.

Chair LANDRIEU. Thank you, Senator. I would like to move to our next panel, if we could. I appreciate the cooperation of the members. And thank you all very much.

To save time, as they are coming forward, let me introduce Mr. Roger Harris, president and chief operating officer of Padgett Business Services. He brings over 30 years of experience in accounting and financial experience in the service and retail industries. He is a resident of Athens, Georgia. And we welcome him today.

Larry Nannis is a CPA.

[Bangs gavel.]

Chair LANDRIEU. Thank you for your cooperation. Mr. Nannis is a CPA, has over 40 years of serving small businesses and is currently chair of the National Small Business Association. We welcome Mr. Nannis with us today.

Next, Mr. Andrew Langer, president of the Institute for Liberty. He came from the Institute from the National Federation of Independent Business. We thank you for being here, Andrew.

Finally James Gattuso is a senior research fellow at the Heritage Foundation specializing in regulatory and telecommunications issues. I would like to start with Mr. Harris, if we could, and as you all know, we have asked you to limit your opening remarks to five minutes. We have reviewed your testimony, we have highlighted it, we appreciate it. If you want to summarize it, that would be terrific.

Mr. Harris.

STATEMENT OF ROGER HARRIS, PRESIDENT AND C.O.O., PADGETT BUSINESS SERVICES/SMALLBIZPROS, INC.

Mr. HARRIS. Thank you, Senator Landrieu, Ranking Member Snowe. It is a pleasure to have the opportunity to be back before the committee again.

Chair LANDRIEU. Just speak a little bit into your mic; you have to kind of lean forward.

Mr. HARRIS. My name is Roger Harris, president of Padgett Business Services. We have been providing accounting and tax services to small business owners for over 40 years, and just to give you an idea of who are client is, it would be represented by the chart on the left, the less than 20 employees, so the burdens that our clients are seeing in regulation and compliance is very heavy.

I think what someone once described a small business owner as, is someone who has the opportunity to do the one thing they love and the 99 things they hate. And record keeping and compliance would probably top the list of the 99 things that they hate, and every minute or every dollar we take from them from doing the one thing that they love and make them spend it on one of those things that they hate, it makes them less productive and have less of an opportunity to help us when we need them the most at this time to get out of the economic difficulties that we are in.

There has been a lot of discussion about 1099s and I want to first of all commend the Chairman for being a sponsor of the repeal which I think is ultimately what we need in this process, but I think even if we get repealed, we can still learn from what we are going through. I think what we see is that we have made some assumptions and we heard today that third party reporting does, in fact, help compliance.

That does not necessarily mean that all third party reporting is good, and when we jump to conclusions that we can have a system that is currently in place, which deals with the non-corporate taxpayer and a level at $600, and just advance it into the corporate world and leave the amount the same, we end up with a cost benefit analysis. I am not sure if anyone has done one, but I am not sure it is necessary. I think we all recognize that the amount of burden that we would place on our small business owners and the amount of benefit to the system would not be very great.

And I think that we have to make sure that any time we are going to assess burden on a small business owner that we look back and understand the real cost in what that is, and sometimes, I think, we do not take enough time to examine what we are doing, we just do it, and let them absorb it. And they will absorb it. They will complain about it, I can tell you, I have never heard complaints like I have heard this year about 1099s, and on behalf of our offices and our clients, thank you for issuing the repeal.

But we need to not make this kind of mistake again. We need to make sure that as we go forward, we look for ways to minimize the burden on the small business owner if we expect them to help us through this recovery. And I think if we just looked at the pure numbers of small business owners that are out there, and if we could somehow just empower them to add one person to their payroll, the impact that we would have in this country would be tremendous. And we can do that if we are smart in how we regulate and how we ask them to comply.

I will make two other quick comments and then I will reserve the time for the others and look forward to your questions.

The most recent study that I have seen from the IRS said over 85 percent of all small business owners need the services of a tax preparer. For me, that is good. For the country, that is not. We have to address the overall compliance burden and where more and

more people feel like they are qualified to take care of their own obligations.

Secondly, one of the biggest and this chart is a great example of that, one of the most onerous parts of any small business is the cost of dealing with employees and while we have—at Padgett we are fortunate to have 300 offices in the United States, we have 100 in Canada.

So we are able to compare and I can tell you, the system here is vastly more complicated than the system our Canadian offices have to follow through. We have thousands of taxing jurisdictions, they have a handful. They have predominantly annual filings, we have more filings than we can keep up with.

Just last week, because we are in all 50 states and we provide the regulatory software for our offices, we got 17 changes in one day from 17 different states, and so I think one of the ways that we have to address, is we have to look at burden in its total and each of us can justify the rule that we want to pass or the obligation that we are passing, but we must recognize that this is also taking place at a state level, at a local level, at an industry level, and all other places, and until we address burden in total, I am afraid that we are going to continue to raise that cost of the most precious asset we want our business owners to have, which is a new employee.

Again, thank you for the opportunity to be here today, it is a pleasure, and I look forward to your questions.

[The prepared statement of Mr. Harris follows:]

PADGETT BUSINESS SERVICES® WHERE YOUR SUCCESS TAKES ROOT™

Contact: Roger Harris
President & COO
Padgett Business Services
(706) 548-1040
rharris@smallbizpros.com

Testimony of Roger Harris, President Padgett Business Services
US Senate Committee on Small Business & Entrepreneurship
November 18, 2010

Good morning Madam Chairman and members of the committee. My name is Roger Harris, President of Padgett Business Services. It is a pleasure and an honor to again have the opportunity to speak to your committee. Padgett Business Services has been providing accounting and tax services to small business owners across North America for more than forty years. Today we provide services to tens of thousands of small business owners across the United States through our US network of 300 offices.

Someone once described a small business owner as someone that got to do the one thing they loved along with ninety-nine things they hate. I can assure you, record keeping and the associated burden is one of those ninety-nine things they hate. However, small business has accepted its responsibility to record and report information for years and will continue to do so if they believe the burdens are reasonable and the benefits are clear and understandable. However, we all need to understand, as your Committee does, that when new requirements are placed on the small business owner they are faced with spending more time and money on things that do not help them grow their business and employ more people, something we desperately need them to do. For that reason we must be careful not to increase the burdens on small business owners without completely understanding the true costs of those burdens.

First we should all recognize that rules and regulations are placed on small business from many places. While today we are focusing on Federal rules and regulations, small business owners are also being asked to comply with State and Local regulations and from many other agencies at all levels as well. These entrepreneurs may also be asked to produce information for their insurance company, their customers, their vendors, and the list goes on and on. If we want small business to continue to be the engine that runs our economy we must make sure we give them the time to do so.

I would like to discuss with the committee the concern all small business owners have regarding the new 1099 information reporting requirements scheduled to begin in January of 2012. While all studies indicate that when third party reporting is in place, compliance increases, it does not mean that all third party reporting is beneficial and necessary. In my many years of working with small business owners it would be difficult to find an issue that has generated as many discussions and concerns as this new reporting requirement. I want to commend Senator Landrieu and her committee for recognizing the concerns of the small business community and offering a bill to make this a more acceptable requirement.

If you took a poll of small business owners and asked if they would prefer to modify or repeal the new reporting rules, I think we all know how that poll would come out. As a general rule if a small business owner is asked if they want more records to keep, or more forms to file, they will not be in favor of that expansion. The real question is will they accept these new rules and will the system as a whole be better off at the end of the day. I think the reporting requirements that are in place today help prove that point. Most small business owners must track payments to non corporate taxpayers for services provided if the amount of those payments exceeds $600 per year. They must gather identifying information from the person they pay and must file annual 1099 forms with the IRS. When this requirement was first presented we heard many of the same concerns we are hearing today. But with the passing of time, the current reporting requirement is considered a routine process for most small business owners. There were added costs when the current rules were enacted and those costs are still there today. While I have no personal information I assume today's requirement has resulted in increased compliance and therefore an increase in tax revenues.

Given that small business already has procedures in place to comply with the current rules why are the new requirements so unpopular and why is the opposition to them so strong? One part of the new regulations expanded this reporting provision to cover corporate taxpayers as well. While this would increase the number of entities covered and the payments that must be tracked, this is not from where the significant increase in burden comes.

If nothing is changed beginning January 1, 2012 business owners will be required to keep up with and report to the Internal Revenue Service all amounts paid in consideration for property in excess of $600 per year. This means that a small business owner must have a system to track almost all of their payments by Vendor, produce a 1099 form and file that form with the IRS and the recipient each year. This in and of itself adds tremendous burden on the small business owner, but it does not end there. Many of these vendors are large companies and have many different business structures. This requirement would require the small business owner not only gather basic reporting information but also understand the many different business structures that a vendor could present if the information they report is going to be accurate and useful. The new rules, if they do not change, would mean a small business owner must get the name, address and tax identification number of their phone company, then keep up with all payments and report

them to both the phone company and the IRS. Who would benefit from this increase in burden? Not the IRS, not the phone company, and certainly not the small business owner. So if this new requirement is needed it must be modified to insure the burdens are reduced and the benefits are increased. How can this be done?

As a first step I agree with the changes made by your committee in the "Information Reporting Modernization Act of 2010". The threshold must be increased to at least $5000 and indexed for inflation to make sure it stays current with inflation. I also support the exemption for payments made by credit and debit cards and the need to make reporting to the IRS easier. These are positive steps but I would like to offer additional modifications as well.

Either by legislation or regulations there must be exemptions for certain types of industries. Obvious exemptions would be utility companies, insurance companies, airlines, etc. This should help reduce many of the payments that must be reported by a business owner. This also should not reduce compliance because the value of the information gathered by this type of reporting will provide little, if any, useful information to the IRS to supplement its compliance activity.

I also feel there should be a small business exemption. For the smallest of small businesses this burden could be massive, and until such time as they reach a certain size, they should be exempt from these new compliance burdens. Others have suggested this type of exemption and based it on the number of employees. I do not believe that in this economy we should tie any increase in burden to hiring an additional employee. I suggest the exemption should be based on annual sales. I think most business owners would not hold back additional revenues if it meant additional paperwork. I would offer an exemption of $1,000,000 in annual sales. Until a business exceeds the threshold they are only required to comply with the current rules for 1099 reporting.

I would also suggest we look for a way to only require payments to be reported when they are paid to a business and the information will help the IRS in its compliance activities. If a business gets a significant amount of their revenue from individual customers, where no reporting is required, and only a small amount from their business customers, I question the benefits of that information when compared to the burden placed to the small business owner. Congress should work with the IRS to determine if it is possible to issue guidelines so that payments made to a business which receives a certain percentage of their revenue from individuals, or a small amount of their revenue from business customers, can issue a document to their business customers indicating that they are exempt from the new 1099 reporting requirement. This would help exempt some payments that are made to a business, which would otherwise be required to be reported, when very little of that businesses revenue is generated from other business customers.

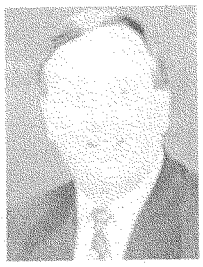
I would offer one word of caution as we look for additional ways to reduce the 1099 burden on small business owners to a more acceptable level. We must never create a situation where it is better to do business with a larger business than a smaller business because the amount of burden is greater if you buy from the small business. An example

of that would be to create an exemption for publicly traded companies because they are audited every year. Only large companies are publicly traded but they compete every day with small business that provides the same product. I would hate to see other business owners buying from the larger business because doing so would not require them to issue a 1099 to the larger business, but would be require a 1099 if they bought the same product from the smaller business.

While this new regulation does not take effect until 2012 the small business community needs to know what this could mean to them well before the end of next year. If this regulation stays in place in its current or similar fashion much work is needed to prepare systems and gather information to be in a position to comply. For that reason I would ask that these new regulations be given a high priority by Congress to decide their final fate. No matter what the final decision is, much work will be required to properly educate all that will be impacted by these new rules.

I appreciate the opportunity to be here today and I hope my comments and perspective are helpful. I look forward to working with you and your staff going forward so we can reduce or eliminate the burdens many small business owners face everyday. Hopefully, if we allow these businesses to focus on the one thing they love, they can either build or maintain a successful business. Nothing would be better today for our economy.

I look forward to your questions.



Roger Harris

President and C.O.O.,
Padgett Business Services®/SmallBizPros, Inc.
President, Padgett Foundation
160 Hawthorne Park, Athens, GA 30606
Phone: 706-548-1040, Fax: 800-548-1040
E-mail: rharris@smallbizpros.com

Padgett Business Services® has claimed small business as its niche, providing accounting and financial guidance to service and retail businesses with fewer than 20 employees for over 40 years. As president of Padgett Business Services® since 1992, and an employee of Padgett for more than 30 years, Roger Harris has become an expert on the issues small business owners face. Prior to that, Harris' history with Padgett includes being President/Chairman of the Board from July 1982-December 1992 for the largest franchise in the Padgett system, giving him ten years of franchise experience.

Regional and national print and broadcast media, including the *Wall Street Journal*, *The Morning Business Report*, *Bloomberg Business News* and *Accounting Today* have frequently called upon Harris to interpret the economic shifts in the increasing small business sector. Harris has been named by *Accounting Today* as one of the Top 100 People in Accounting for the last three years, including 2010. The reach of his expertise, in conjunction with the growing realm of small business, is evident in Padgett's consistent years of growth.

Acting on behalf of both Padgett Business Services® and associations of tax practitioners, Harris has testified several times on IRS reform. He has offered testimony to the Senate Small Business Committee and the House Ways and Means Committee. Harris' testimony focused on the need to maintain required compliance with the **Electronic Federal Tax Payment System**. In addition to testifying on the **EFTPS**, he testified on **The Internal Revenue Service Restructuring and Reform Act of 1997**, before the House Ways and Means Committee on Oversight. The Senate Committee on Small Business heard Harris' testimony on Senator Bond's (R-MO) **Putting the Taxpayer First Act**. The Small Business Administration recognized Roger Harris as the *Small Business Advocate of the Year* for Georgia in 1997. Harris also testified on the IRS Reform Act of 1998, the 1999 Tax Filing Season, and the IRS Fiscal Year 2000 Budget before the House Ways and Means Oversight Committee. He testified again before the House Ways and Means Oversight Committee on the 2001 Tax Filing Season and the IRS Fiscal Year 2002 Budget.

IRS Commissioner Charles O. Rossotti appointed Mr. Harris to the Internal Revenue Service Advisory Council (IRSAC). The Council provides a public forum for raising, studying and making recommendations on tax administration issues, as well as on IRS restructuring and modernization. Harris served as IRSAC Chair for 2002 and 2003.

In his role a Chairman of IRSAC Mr. Harris recently provided testimony to the IRS Oversight Board.

In March 2005, Harris provided input to President Bush's Advisory Panel on Federal Tax Reform. President Bush established the panel to seek options on reforming the tax code to make it simpler, fairer, and more pro-growth to benefit all Americans. The panel, chaired by former U.S. Senators Connie Mack and John Breaux, submitted to the Secretary of the Treasury a report containing revenue-neutral policy options for reforming the Federal Internal Revenue Code. Harris was invited to share his expertise on the small business community, gained from his interaction with the over 400 Padgett offices in North America, which service over 100,000 customers in the United States and Canada. From 2006 to 2010, Harris continued to share his expertise by appearing as a panelist on the monthly IRS sponsored web-cast, Tax Talk Today.

An Athens, Georgia resident, Harris earned his degree in accounting from the University of Georgia. He is affiliated with the National Association of Enrolled Agents, where he is Chair of its Legislative Affairs Subcommittee, and the National Society of Accountants, and has served as Chair on its Federal Taxation Committee. He is enrolled to practice before the IRS and is an accredited tax advisor and tax return preparer. Mr. Harris is married and has two children and one grandchild.

Chair LANDRIEU. Mr. Harris, let me thank you, and I want to assure you that I, as the Chair of this committee, will be calling on you regularly with the expertise that you and your firm have, because I think it is particularly important to have that breadth that broad view, not just a specific view, as we really try to make an impact here.

This is not a fly by night effort on this committee's part. We are going to be at it for as long as I am the Chair and the Raking Member has been a real leader in this effort as well, so as long as the two of us stay in the leadership of this committee, I can promise you this is just the beginning of our efforts to really get a handle on this and make some significant changes, and we hope that you will be available to us as we move forward.

Mr. HARRIS. Thank you. I would welcome that.

Chair LANDRIEU. Thank you.

Mr. Nannis.

STATEMENT OF LAWRENCE S. NANNIS CPA, CHAIR, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. NANNIS. Chairwoman Landrieu, Ranking Member Snowe, and members of the committee, I want to thank you for the opportunity to testify on ways to reduce the regulatory and administrative burdens placed on America's small business.

My name is Larry Nannis. I am a certified public accountant and partner in the firm of Levine, Katz, Nannis and Solomon located in Needham, Massachusetts. We provide financial management and tax advise to entrepreneurial firms.

I am also serving as the chairman of the board of the National Small Business Association.

Small business owners face an overwhelming regulatory burden in complying with Internal Revenue Service regulations. The burden is not only a heavy one, but is disproportionate as well, and as you heard from Dr. Sargeant, the cost of tax compliance for small firms is 67 percent higher than for their larger counterparts. For firms with fewer than 20 employees, the per employee cost of complying with the tax code is $1,304.

Before I go on, though, I would like to thank Chairwoman Landrieu and Senator Shaheen for your courageous moves yesterday in cosponsoring the legislation that would repeal the expanded Form 1099 reporting requirements. Less there are some who believe that this is not the correct response, permit me to briefly explain why this repeal is so necessary. Section 906 of the Patient Protection and Affordable Care Act would mean that every small business owner, including me, will face an increased paperwork and administrative burden for each additional 1099 form prepared.

In fact, LKNS, if the law had applied in 2010, we would have increased our 1099 production from two to 79, and in reviewing the records of a lot of my clients, the minimum impact on the number of forms that would have had to have been created was threefold.

Additionally, many small businesses, in an attempt to reduce data collection and paperwork burdens, will simply reduce venders and refuse to entertain new business dealings. This will have a disproportional impact on small businesses and entrepreneurs attempting to get a foot in the door.

Although this could simplify the accounting burden, it would have a devastating competitive impact on small, local, independent businesses who now sell the same services or products to other businesses. NSBA has been adamant that the only solution to this huge problem posed by the new 1099 reporting provision is full repeal, and Chairwoman Landrieu and Senator Shaheen, it appears as if you agree.

Unfortunately, perplexing paperwork and an oppressive federal regulatory regime continue to overburden innumerable small business owners across the country. SBA research demonstrates, as the chart shows, that in total companies with fewer than 20 employees pay more than $10,585 per employee to comply with federal regulations. For large firms it is 36 percent less.

Despite the efforts of SBA's Office of Advocacy, which reports that its intervention results in foregone first year regulatory cost savings of $7 billion in Fiscal Year 2009, the federal regulatory and paperwork burden continues to balloon and is now at approximately $1.75 trillion.

In the written testimony that you have received, we have outlined many ways that the administrative burden on small business should be reduced and I urge you to consider them. In the interest of time I would like to highlight two of them, one of them brought up by Ranking Member Snowe earlier.

Federal agencies should be required to perform and submit cost benefit analysis on proposed regulations and paperwork. This is a routine business practice that federal agencies would be well served to emulate.

In the tax area, NSBA believes efforts to reduce the regulatory and administrative burdens on small businesses must focus on overall simplification, eliminating inequities within the Tax Code, and enhancing taxpayer education and outreach. Congress should stop trying to impose more burdens on taxpayers and replace the current Tax Code altogether with something that makes more economic sense, such as the Fair Tax. A long time proponent of the Fair Tax, NSBA believes that now, more than ever, a sensible, fair method of collecting taxes is needed contrary to the present system. Perplexed, bothered, and bewildered American taxpayers spend $265 billion in recent years just trying to comply with tax laws and regulations.

Now, those willfully disregarding their tax liabilities should be held accountable, but with the complexity facing many taxpayers, NSBA believes a key priority should be the development and implementation of initiatives to improve IRS guidance. NSBA concludes that the committee should work with the IRS to conduct more research to better identify noncompliant taxpayers, enhance taxpayer services to inform taxpayers of correct tax obligation, and adjust its enforcement tools to target those who intentionally evade paying taxes. Adding new burdens and requirements on small businesses already struggling to do the right thing is simply the wrong answer.

It is my hope that Congress and the Administration can work together toward the straightforward repeal of the 1099 provision. Now is the time for Congress to support proposals that are fair and

reasonable and that do not hinder the survival, growth, and innovation of our nation's entrepreneur.

I would like to thank Chairwoman Landrieu for holding this hearing, bringing this proposal to the forefront, and for the opportunity to testify. Thank you.

[The prepared statement of Mr. Nannis follows:]

Testimony of Larry Nannis

Levine, Katz, Nannis + Solomon, PC

On Behalf of
The National Small Business Association

Senate Committee on Small Business and Entrepreneurship

Hearing:

"Next Steps for Main Street: Reducing the Regulatory and Administrative Burdens on America's Small Businesses."

November 18, 2010

1156 15th Street, N.W., Suite 1100
Washington, DC 20005
202-293-8830

Chairwoman Landrieu, Ranking Member Snowe and members of the committee, thank you for the opportunity to testify on ways to reduce the regulatory and administrative burdens placed on America's small businesses. My name is Larry Nannis and I am a Certified Public Accountant (CPA) and partner of Levine, Katz, Nannis + Solomon, PC, which provides financial management and tax advice to entrepreneurial firms, located in Needham, Massachusetts. I also serve as the Chairman of the Board for the National Small Business Association (NSBA).

Small business owners face an overwhelming regulatory burden in complying with Internal Revenue Service (IRS) regulations. We tend to be an easy target since unlike big corporations—which have hordes of accountants, benefits coordinators, attorneys, personnel administrators, etc. at their disposal—small businesses often are at a loss to keep up with, implement, afford, or even understand the overwhelming regulatory and paperwork demands of the federal government.

Approximately 36 percent of NSBA members have fewer than 5 employees—few, if any, of whom is a tax specialist—leaving business owners with no other choice but to hire outside help to keep track of all their additional reporting and filing requirements, which means even more paperwork.

Not only is the burden a heavy one, but it is disproportional as well. According to Small Business Administration (SBA) Office of Advocacy research, the cost of tax compliance for small firms is 67 percent higher than for their larger counterparts. For firms with fewer than twenty employees, the per-employee cost of complying with the tax code is $1,304.

This data tells us that we have crafted a tax system that is so complex and burdensome that small businesses are spending valuable time and financial resources on record-keeping and outside help to ensure compliance instead of using these resources to invest and grow their business.

As indicated, tax paperwork and compliance are already major expenses for small businesses and now a new form 1099 reporting requirement, signed into law as part of the Patient Protection and Affordable Care Act (PPACA) will only increase these costs. The new filings substantially increase the current requirement by expanding both the types of businesses and transactions considered reportable.

Information Reporting Requirements on Payments to Corporations

An ugly by-product of the health care reform legislation is a "pay-for" requiring businesses that purchase more than $600 of goods or services from another business to submit two 1099 forms—one to the IRS and one to the service or goods provider. Under past law, service recipients were only required to file 1099 forms for non-corporation service providers. The Department of Treasury has argued that the exemption of corporations under the old system created compliance issues and this new proposal will level the playing field.

However, in practicality, this means that every time a small-business owner ships a package with Federal Express or buys office supplies with Staples, and the expenses total more than $600 by year-end, they would need to keep the receipts, prepare a form 1099 and file them not only with the IRS, but with Federal Express and any other companies as well. As enacted, every small-business owner—including myself—will face an increased paperwork and administrative burden for each additional 1099 form prepared. In fact, at Levine, Katz, Nannis + Solomon, PC, if the law applied for 2010, we would increase from just two 1099s to more than 79 forms filed.

Increased costs are incurred for mailing additional forms and for hiring outside assistance to ensure that businesses are correctly complying with the law. The new requirements will dramatically increase these costs, as owners will be forced to spend more time collecting the information needed to properly complete these forms, pulling capital out of the business that could be better used to reinvest in the business and create jobs.

Furthermore, if a business previously has not been required to utilize the form 1099 filing system, greater difficulties with compliance is likely to ensue. While the proposal seeks to capture non-compliant corporations, it clearly places the burden on the wrong taxpayer—the compliant small-business.

It must be said—NSBA does not condone the non-payment of tax obligations. The overwhelming majority of small businesses are honest, hard-working organizations that are critical to the economic success of the American economy. Given the extraordinary burden that compliance with the unbelievably complex tax code already imposes on small businesses, it is unfair to ask truthful small businesses to do even more in order to catch a few potential cheats.

Additionally, if allowed to be implemented, Section 9006 of the PPACA will also have a chilling effect on new business relationships, most of which will be small businesses and startups. NSBA members have feared another way businesses may try to avoid the reporting burden is by consolidating all their purchases with a few larger vendors.

Meaning, many businesses in an attempt to reduce data collection and paperwork burdens will simply reduce vendors and refuse to entertain new business dealings. This will have a disproportional impact on small businesses and entrepreneurs attempting to get a foot in the door. Although this could simplify the accounting burden, it would have a devastating competitive impact on small local independent businesses who now sell the same services or products to other businesses.

Another component of the new reporting requirement is an exemption on any payments above $600 which are made with a credit card. While seemingly a way to ease the burden, this provision stands to harm small businesses in four key ways.

First, this will force small-business owners into using credit cards more frequently for larger purchases, which, given the failure of Congress to protect these cards, could constitute significant new costs for small businesses. Second, it will cause increased

credit-card transactions from customers, which means increased costs in swipe fees for the small-business owner, and in many cases and inability to compete with large on-line retailers. Third, the provision will hamper business-to-business transactions as 47 percent of small businesses do not accept credit cards for the purchase of their goods and/or services. Fourth, small-business customers will look to ease this reporting requirement by consolidating purchases, which gives an inherent advantage to large suppliers over small businesses.

In 2009, according to the July 2010 NSBA Economic Survey, small businesses were required to file 1099 reports on an average of 10 independent contractors. This could change drastically under the new law, however. The new 1099 reporting requirements stand to increase the average number of firms for which small-businesses must file a 1099 report from an average of 10 to an average of 86. Furthermore, small businesses reported that, among those 86 companies with which they spend more than $600 annually, only 30 percent of those purchases are made with a credit card.

Data Use

Meanwhile, this mandate has nothing to do with health care coverage or reform, but is deemed a way to raise revenue by closing the tax gap—the difference between taxes owed and taxes paid—estimated to be $345 billion in tax year 2001. This type of reporting, which uses form 1099 to indicate how much money businesses pay to corporations, was an idea proposed by the Bush administration to help better keep track of what businesses spend and earn, which in turn helps better keep track of tax liability. Yet, little data exists to demonstrate that the newly collected information is a source of the tax gap and it is unclear whether and how the IRS can use this paperwork.

Moreover, NSBA is concerned what the IRS will do with this amount of data. We do not believe that the IRS even has the capacity to utilize this data nor does the IRS have the matching capabilities to handle the massive volume of paperwork resulting from this proposal. There is no data available to justify this additional burden—the data does not prove whether business-to-business versus business-to-consumer transactions are the problem, it does not specify if underreporting is more prominent in payments over or under $600, it does not breakdown the underreporting of income by cash or credit card transactions, and it does not indicate whether some industries are more non-compliant than others. While the concept of significantly increasing taxpayer compliance may appear justifiable, the practical impact of implementing it could be devastating to the individual taxpayer.

Legislation

NSBA has been adamant that the only solution to the huge problem posed by the new 1099 reporting provision is full repeal. As critical a component of our nation's economy as small business is, one has to wonder why Congress continues to harm these budding business-owners. Fortunately, many members of Congress agree that full repeal of this provision is really the only way to fix the problem.

Senator Mike Johanns has stepped up to the plate and offered legislation to fully repeal this reporting requirement. The *Small Business Paperwork Mandate Elimination Act*, which, if passed into law, would repeal the onerous paperwork burdens imposed on business by the ill-conceived expanded information reporting mandate contained in Section 9006 of the PPACA. Companion legislation *(H.R. 5141)* has been introduced in the House by Rep. Dan Lungren.

In September, the Senate shot down two separate amendments to the Small Business Jobs Act that addressed the requirement. The first, again sponsored by Johanns, would have fully repealed this $17 billion revenue-raising provision. The second, by Sen. Bill Nelson would have scaled back the requirement by repealing the law for all businesses with fewer than 25 employees, and increasing the threshold to $5,000.

I should also mention that Chairwoman Landrieu has also introduced the *Information Reporting Modernization Act of 2010 (IRMA Act)*, a bill to modernize and simplify the form 1099 reporting requirements in response to NSBA's and others growing concerns about the 2012 reporting requirements. The IRMA Act raises the reporting threshold to $5,000 for purchases of goods or services paid for with cash or check, as well as adjust the amount annually for inflation. The bill also requires the IRS to upgrade its scanning technology to allow for a free online entry and submission of the 1099 form on its site.

Honestly though, these compromise languages would not do anything to ease the paper trail businesses would be required to maintain, nor would it ease the business consolidations as a result of the new requirement. Again, for my company, if the threshold was raised from $600 to $5,000, we would jump from two 1099s filed to approximately 37.

Further Regulatory Burdens

Unfortunately, repealing the form 1099 reporting requirement will not lift the regulatory yolk from the necks of America's small businesses. Perplexing paperwork and an oppressive federal regulatory regime continue to overburden innumerable small-business owners across the country.

SBA research demonstrates that, in total, companies with fewer than 20 employees pay more than $10,585 per employee to comply with federal regulations each year. Large firms pay about $7,755—or 36 percent less per employee.

According to Office of Advocacy's "The Impact of Regulatory Costs on Small Firms" report, environmental regulations appear to be the main reason for the disproportionate impact on small firms. Compliance with environmental regulations costs 364 percent more for small firms than large firms. The cost of tax compliance is 206 percent higher for small firms than the cost for large firms.

Despite the efforts of SBA's Office of Advocacy, which reports that its interventions resulted in foregone, first-year regulatory cost savings of $7 billion in Fiscal Year 2009, the federal regulatory and paperwork burden continues to balloon. SBA estimates that the overall cost of federal regulations in FY09 was $1.75 trillion.

NSBA Recommendations

The status quo of increasing regulatory and paperwork burden is untenable. The federal regulatory framework is broken. Therefore, NSBA proposes the following solutions:

• *Consider Indirect Economic Impact*: The largest loophole in the federal regulatory framework is that agencies are only required to consider the direct impact of proposed regulations. This must change. The indirect economic impact of proposed regulations also must be considered. Additionally, each Initial Regulatory Flexibility Analysis required under the Regulatory Flexibility Act also should contain detailed alternatives, which would minimize any significant adverse impact.

• *Provide Small-Business Assistance*: Federal agencies must do more to provide compliance assistance, including publishing plain-language compliance guides for small businesses. Agencies must simplify their regulations, instructions, and compliance processes. Helping small businesses comply, rather than punishing those that inadvertently do not, should be the goal.

• *Use Plain Language*: NSBA also urges Congress to ensure the realization of the recently codified Plain Writing Act, which mandates the use of plain language in all federally-written letters, forms, notices, or instructions, especially those that provide facts about federal benefits or services, information on how to obtain those benefits or services, and explanations on how to comply with federal requirements, including taxes. NSBA also encourages Congress to expand this requirement to federal regulations. Publishing clear and comprehensible regulations will increase regulatory compliance. The vast majority of small-business owners strive to adhere to a vast array of federal obligations but many have difficulty deciphering what is being required of them.

• *Increase Agencies' Flexibility and Expand Exemptions*: Federal agencies must be permitted increased enforcement flexibility and the ability to grant common-sense exemptions for first-time offenders.

• *Streamline Paperwork*: Agencies must seek ways to consolidate forms and eliminate the duplication of paperwork, harmonize data, and coordinate due dates.

• *Perform Cost-Benefit Analysis*: Federal agencies should be required to perform and submit cost-benefit analysis on proposed regulations and paperwork. This is a routine business practice that federal agencies would be well-served to emulate.

• *Improve Information Collection*: The Paperwork Reduction Act requirement that agencies' chief information officers review and certify information collection requests is

ineffective. This provision should be strengthened or the Office of Information and Regulatory Affairs should develop stricter criteria for approval. If all else fails, Congress should consider limiting the number of information requests an agency can issue each year. Federal agencies should ensure that their information collections will provide public benefit and utility and eliminate unnecessary requests. Agencies also should expand their ability to accept voluntary electronic information submissions.

• *Fair Tax*: Congress should stop trying to impose more burdens on taxpayers and replace the current tax code altogether with something that makes more economic sense, such as the Fair Tax. A long-time proponent of the Fair Tax, NSBA believe that now, more than ever, a sensible, fair method of collecting taxes is needed—contrary to the current system.

• *Overall Tax Reform*: NSBA believe efforts to reducing the regulatory and administrative burdens on small businesses must focus on overall simplification, eliminating inequities within the tax code, and enhancing taxpayer education and outreach. Perplexed, bothered and bewildered American taxpayers spent $265 billion in recent years just trying to comply with the tax laws and regulations. Yet, even with this vast expenditure of money, no one—including small-business owners—is sure they successfully complied with the law.

Accurate tax reporting and compliance is extremely important to small business. Those who make a good faith effort, yet are inaccurately complying should be assisted through education and tax simplification efforts. Those willfully disregarding their tax liability should be held accountable. The more assistance offered to taxpayers and the simpler it is to understand and comply with tax laws, the more taxpayers will accurately meet their tax obligations. However, increased enforcement at the expense of taxpayer education will not in the long term accomplish sustained, improved compliance.

Vague rules and poorly defined regulations understandably result in mistakes. In order for taxpayers to comply more easily with the tax laws, taxpayer services should include providing timely guidance on issues, promoting electronic filing of tax returns, explaining IRS notices and correspondence, and helping taxpayers with problems. With the complexity facing many taxpayers, NSBA believes a key priority should be the development and implementation of initiatives to improve IRS guidance.

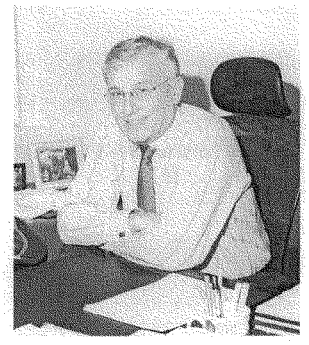
Conclusion

NSBA concludes that the Committee should work with the IRS to conduct more research to better identify noncompliant taxpayers, enhance taxpayer services to inform taxpayers of correct tax obligations and adjust its enforcement tools to target those who intentionally evade paying taxes. Adding new burdens and requirements on small business already struggling to do the right thing is simply the wrong answer.

It is my hope that Congress and the administration can work together toward a straightforward repeal of the 1099 provision. Now is the time for Congress to support

proposals that are fair and reasonable, and that do not hinder the survival, growth and innovation of our nation's entrepreneurs. I would like to thank Chairwoman Landrieu for holding this hearing, bringing this proposal to the forefront and for the opportunity to testify.

Lawrence S. Nannis, CPA



Lawrence S. Nannis C.P.A. (Larry) has more than 40 years of experience serving small, privately-held businesses and their principals. His primary focus is in providing growth, financial and tax management advice to entrepreneurial companies at all levels of the growth curve. In addition, he works with many small businesses who receive their research and development funding from the government through the SBIR program, Broad Agency Announcements and direct budget appropriations (Plus-Ups and Earmarks).

Within these areas of expertise, he has developed financial management systems to help companies transition from Researching technologies to Manufacturing a product. These financial management systems not only provide information to help the company manage their growth but also meet the requirements of accounting for Federal awards and the Internal Revenue Service.

Larry is the Chair of National Small Business Association, the oldest small business advocacy organization in the county. In 2003 – 2005 he served as the Chair of the Smaller Business Association of New England (SBANE) and served as an officer and director of the Northeast Chapter of the National Defense Industrial Association until 2010. As a member of these groups, Larry has been active in advocating for legislation that will insure that Small Business remains the economic engine of today's economy. He is a member in the AICPA and MSCPA.

Larry has been a speaker at national conferences on Accounting for Federal Awards and was also named National Small Business Accountant Advocate of the Year by the Small Business Administration.

Larry received a Bachelor's Degree in Accounting from Boston University School of Management and a Master's Degree in Taxation from Bentley College.

Larry's areas of expertise include:

- Technology/Emerging Businesses
- Research and Development Companies
- Government Contractors and Awardees
- Professional Service Entities

Chair LANDRIEU. Thank you, Mr. Nannis. Let me just clarify for the record, you said the figure was $250 billion annually for compliance?

Mr. NANNIS. Correct.

Chair LANDRIEU. Could you restate that? Is it $258?

Mr. NANNIS. $265 billion.

Chair LANDRIEU. $265 billion annually.

Mr. NANNIS. In recent years, just to try to comply with the tax laws and regulations.

Chair LANDRIEU. And that would be tax laws, federal, state, and local, you think?

Mr. NANNIS. Correct.

Chair LANDRIEU. Okay, federal state and local.

Mr. NANNIS. Correct.

Chair LANDRIEU. So, it would be all.

Mr. Langer.

STATEMENT OF ANDREW LANGER, PRESIDENT, THE INSTITUTE FOR LIBERTY

Mr. LANGER. Thank you. And thank you for having me here, Madam Chairwoman and Ranking Member Snowe, especially, thank you as well for inviting me.

My name is Andrew Langer. I am the president of the Institute for Liberty. We are a 501(c)(4) advocacy organization based here in Washington, D.C. and we focus on the impacts of the federal regulatory state on small business. I have been working on these issues for almost my entire career in D.C., first working with an environmental attorney on the impact of environmental regulations on jobs, and then working for the National Federation of Independent Business, as you said.

This is a serious problem, and I always get buoyed when I come before a body such as this and hear advocates like you really understand, fully understand, what we are facing here. One of the issues that I have found in the last two years, as our economy has slipped into the doldrums, is that folks simply do not understand the role that regulations have played in where we are today. A couple of weeks ago I debated a gentleman, a pundit from CNN, who completely dismissed the idea that the $1.75 trillion regulatory state has any impact whatsoever on our ability to create jobs. But as you so adequately said earlier, the fact that, you know, if we offer some meager tax credit to a small business, it gets dwarfed by the $11,000, $10,600 cost that is out there.

For a business with ten employees, it is $106,000 every year that goes out the door.

And we talk about money, and that is important. I also talk about time, as was referenced earlier on. We have to be focusing on the issue of time management and the impact that agencies put on the mandates that agencies put on individuals in how they deal with things frequently. We can talk about $1.75 trillion or the $10,600 number, but we also need to be thinking about the fact that every seven and a half hours that an agency puts on a small business owner's time is a full day's worth. And with any, you know, in any business, it is between 200 and 250 days per year

that they can get out of their employees. Every day that is lost is a half percent of that employee's productive time.

So, when we are talking about tax burdens and we are talking about three to five hours, that is a half a day of somebody's time that they are not spending being productive in their business. And so, it is one of the things that we have recommended at the Institute for Liberty, and I have recommended while I was at NFIB, that we need to get the agencies to start discussing burden, not just in terms of monetary value, but in terms of time as well. And I will talk about that more in a moment.

This issue of cutting regulatory costs, as I said, cannot be ignored. If we cut regulations—regulatory costs by 30 percent, we can save the economy roughly $600 billion, which is the rough equivalent of the first stimulus package that was passed by Congress and signed by the President. Without spending a dime of federal taxpayer money, we inject the economy with an influx of capital, of time and of energy.

That translates into jobs. You save a business $30,000. If they are spending $106,000, $30,000 that they save is the equivalent of hiring one person with benefits, and when you do the math, saving $600 billion for small businesses means that we could virtually wipe out the unemployment rate in America today. We have to take the steps to do that.

One of the things that was discussed in the first panel is this issue of regulatory budgeting, the role that Congress must play in dealing with these issues. I think that is absolutely essential that Congress steps forward and begins to do some sort of an assessment of the impact of the new mandates that they are putting out there, because it does start the way—and you were very right in your introductory remarks, Senator, when you said that this started, did not start with this Administration, it was accelerated, it has been accelerated by a tremendous amount in the last 18 months, but it did start 35 years ago.

We can actually start directly the evisceration of America's manufacturing sector with the rise of the three great regulatory regimes in the early part of the 1970s. This is going to take a long time to undo, but we have to start today. The fact is, that over the last decade, regulatory costs grew by about 10 percent every five years or so. That cost skyrocketed in the last five years to, went up 37 percent from $7700 per employee per year to $10,600.

One of the things we have to get a handle on, and I will say this in sort of my conclusory remarks, is that we have to get a handle on the indirect impact that regulations have. S. 3024 was a great step in the right direction and to build on that we have to get at this issue of indirect economic costs.

Senator, in your home state of Louisiana, one of the things that would have been very, very helpful, I think, over the last year, would be how the—the impact of the off-shore drilling moratorium did not just impact the oil industry, but impacted the small businesses in your state, and frankly, small businesses all around the country, because the fact is that one of the things that drove this economy under was not just the burst of the housing bubble, but it was the run up in energy prices two years ago that small businesses could not face.

The fact is——

Chair LANDRIEU. You have got to wrap up.

Mr. LANGER. I am. I am wrapping up right now.

Chair LANDRIEU. Good.

Mr. LANGER. I just want to say, the bottom line is that offices like the Office of Advocacy have to be protected by this body, they do essential work. I think unfortunately that there are folks in the Administration who simply do not place an emphasis on the regulatory burden. That needs to stop.

[The prepared statement of Mr. Langer follows:]

Testimony before the United States Congress on behalf of the

Testimony of

Andrew M. Langer
President
Before the

The Senate Committee on Small Business
Hearing on Small Business Regulatory Burdens

The Context of Regulation: Reducing the Incremental Costs

on the date of

November 18, 2010

Chairwoman Landrieu, Ranking Member Snowe, and members of the Senate Small Business Committee:

On behalf of the thousands of small-business owners who support the Institute for Liberty, thank you for the opportunity to discuss with you the burden of regulatory paperwork imposed by the federal government and to offer some insights about how to improve the way in which the federal government goes about reducing the amount of paperwork filled out by America's small businesses each year.

The Institute for Liberty is a 501(c)(4) advocacy organization based in Washington, DC. We focus on public policy issues impacting small business and entrepreneurship in the United States, and work hard on informing and activating small business owners on these issues. We believe wholeheartedly that America's small businesses and America's working families are inextricably intertwined—and that as America's small business sector suffers, the rest of the economy does as well.

I have testified before Congress nearly two-dozen times on these issues. Prior to coming to the Institute for Liberty, I handled regulatory affairs for the National Federation of Independent Business, the nation's largest small business association. I have, for nearly a decade, been in near-daily contact with small business owners throughout the nation, and am currently authoring a book on the subject, "The War on Small Business."

In September, I attended a celebration of small business' most powerful statutory ally, the Regulatory Flexibility Act, and heard Chairwoman Landrieu's statements regarding the current state of America's regulatory burdens. I appreciate your invitation to come before you to discuss these burdens in more detail. My testimony is going to cover two main areas: a presentation of the general regulatory and paperwork burden at both the macro and microeconomic levels, and then offer recommendations of changes to federal law and policy which will work to reduce these burdens.

Introduction

I believe that at the outset, it is important to lay out just who we are talking about here. When IFL talks about small business, we are generally not talking about businesses which fit into the larger end of the Small Business Administration's definitions for small business. Ninety percent of small businesses have fewer than 20 employees. Moreover, the typical small business employs ten people and reports gross sales of between $350,000 and $500,000 per year.

Clearly, we are talking about the truly small businesses—businesses whose priorities and abilities to handle regulatory challenges are greatly different from their larger counterparts. Being a small-business owner means, more times than not, you are responsible for everything (ordering inventory, hiring employees, and dealing with the mandates imposed upon your business by the federal, state and local governments). That is why government regulations, and the paperwork they generate, should be as simple as possible. The less these businesses spend with "government overhead," the more they can spend growing their business, employing more people and growing America's economy.

Unreasonable government regulation, especially onerous paperwork burdens, continues to be a top concern for small businesses[1]. Regulatory costs per employee are highest for small firms, and small businesses consistently rank those costs as one of the most important issues that advocates ought to work to change. In the past, I have testified before Congress on the series of reports commissioned by the Small Business Administration's Office of Advocacy, estimating the regulatory compliance costs for firms with fewer than 20 employees.

Ten years ago, that cost averaged $6,975 per employee, per year, and from 2000 to 2005, that cost rose roughly 10% to $7,647 per employee, per year (PE/PY).[2] Given what we knew about new pressures coming from the Congress post 2007, and the change in administration in 2009, we had speculated that those costs would grow at a slightly higher pace between 2005 and 2010.

---

[1] In NFIB's publication, *Problems and Priorities*, paperwork ranked 8th out of 75 major problems faced by small business.
[2] Crain, W. Mark, *The Impact of Regulatory Costs on Small Firms, 2005, http://www.sba.gov/advo/research/rs264.pdf*

But we were unprepared for the true shock at SBA's 2010 report. Though outside organizations had estimated that the cost of regulations had skyrocketed from a historic high of $1.1 ***trillion*** annually, we were stunned to see the SBA confirm that federal regulatory costs now top ***$1.75 Trillion*** and that the PE/PY cost is now ***$10,600!***[3] This means that for one of America's average small business owners, with ten employees, those costs now approach a total of $106,000 annually. That represents a rise of an ***unprecedented 37%!*** This is due in no small measure to the continued growth of the regulatory state: according to the Competitive Enterprise Institute's Wayne Crews, mandates have brought an average of approximately 4,000 new rules each year[4]

Though I will discuss this in greater detail, one cannot ignore these costs when talking about America's economic vitality. Because few people are aware of this number, because it is not something talked about in the popular media, when confronted with this stark reality, many (especially my colleagues on the left) are unwilling to believe that this is possible. But the reality gets even more stark: ecause our economy is $14 trillion in size, our regulatory costs are now ***roughly 12.5% of our total GDP***. This cannot be ignored as we are trying to find solutions to our economic doldrums.

Assume for a moment that we could cut regulatory costs by 30%. Every average, 10-person small firm would save, on average nearly $32,000, enough to hire one additional person (with benefits). Assuming that there are anywhere between 6 million and 24 million small businesses (depending on who you talk to)—this means that we could, without spending a dime of additional federal money, create millions of jobs. With an unemployment rate at approximately 9.5%, creating 10 million additional jobs through cutting regulatory burdens is something we have to consider!

---

[3]Crain and Crain, *The Impact of Regulatory Costs on Small Firms, 2010 Edition* http://www.sba.gov/advo/research/rs371.pdf

[4] 4,101 final rules in 2004, 3,943 final rules in 2005. Crews, Clyde Wayne, *Ten Thousand Commandments, 2006 edition.*

We do not think it is overstating the case to say that S. 3024, The Job Impact Analysis Act[5], incorporated a lot of the recommendations IFL and others have made over the years. In terms of recognizing the important role that regulations have played in putting a dampening effect on the nation's economic vitality, the provisions of S. 3024 go a long way towards addressing those concerns. We are especially encouraged by S. 3024 finally giving the SBA's Office of Advocacy the independent budgetary line authority that it has long needed. Provided that Congress does its proper role in oversight of SBA operations, giving Advocacy its own line in the budget ensures that the operation will be properly funded, regardless of whether or not an administration see's that office's mission as vital.

Moreover, I have, in just about every appearance before Congress, fought long and hard for greater administrative emphasis on the opinions levied by the Chief Counsel for Advocacy and his staff. While we would still like to see greater deference for Advocacy's opinions codified, the S. 3024's directive that agencies are now required to respond directly to the comments made by Advocacy is a tremendous step in the right direction. There is no other organization, either within or without the federal government, that does the research that the SBA's Office of Advocacy does (though IFL is working hard to be replicate Advocacy's work outside of the federal government). They are one of the most important, if not ***the*** most important voice for small businesses on regulation within the Administration, and when they speak, the agencies ***must*** respond!

The Shift in Regulatory Costs

But those numbers drop when you get above 20 employees—on average by as much as a full third. Why such a stark contrast? NFIB's Research Foundation has done numerous surveys on paperwork and regulatory compliance, and it has found that businesses with between 20 and 35 employees hire a regulatory professional. Usually, this is someone with expertise in labor regulations and human resources, as these are the rules with the most general application. Also, as the business grows, measures taken to comply with federal regulations can have their cost spread around a larger pool of employees. These "economies of scale" reduce those per-employee costs as well.

[5] http://www.opencongress.org/bill/111-s3024/show

However, until those businesses reach that magic number, it is generally the small business owner, that owner's spouse, or some trusted employee within the business who is responsible for ferreting out regulatory obligations and figuring out what needs to be done in order to be in compliance. Because these individuals do not have the prior regulatory experience or training, it takes far longer for them to become aware of their obligations under the law, and just what those obligations entail.

The Macroeconomic Costs, and the "Context" of Regulation

The average small business cost of nearly $106,000 per year for regulations, the approximately $10,600 per employee per year cost, those are the microeconomic figures—what each individual small business faces. But the problem is truly staggering when one looks at the general regulatory state.

While the Office of Information and Regulatory Affairs reports a cost of $44 billion[6] for all major rules, this presents only a part of the regulatory snapshot. OIRA only reviews ***major*** rules, the dozen or so rules from a previous 10-year period whose annual cost is in excess of $100 million. But it's not the "major" rules that are most damaging. I have testified before on regulation being "death by a thousand pinpricks" for small business. It's not one single rule that is the culprit, but the thousands of smaller rules with incremental impacts that present a slow-bleed for America's small business. Those rules add up to that annual $1.75 trillion—an amount essentially equivalent to the entire federal budget!

Paperwork itself is a tremendous culprit. In the Office of Management and Budget's 2005 report on paperwork, the Information Collection Budget (ICB),[7] they denote an increase of the paperwork burden faced by all Americans of 441 ***million*** hours. Sadly enough, represents an increase overall of only 5.5 percent![8]

---

[6] http://www.whitehouse.gov/omb/inforeg/2006_cb/2006_cb_final_report.pdf

[7] http://www.whitehouse.gov/omb/inforeg/infocoll.html

[8] ICB at i.

In terms of the paperwork burden imposed by regulations themselves, NFIB'sResearch Foundation has conducted in-depth studies of the problem being faced by small businesses. They concluded overall that the cost of paperwork averages roughly $50 per hour. In addition, the following conclusions were reached[9]:

1. The individual(s) completing and maintaining paperwork and records in a small business is dependent on the subject matter of the paperwork and the size of the firm. Owners most frequently handle paperwork and record-keeping related to licenses and permits (55 percent of firms), purchases (46 percent), and clients/customers (46 percent). They least frequently deal with financial (27 percent) and tax (12 percent) records. Three of four pay to have someone (another firm) outside handle their tax paperwork. Paid employees customarily do most of the paperwork and record-keeping in about 25 – 30 percent of firms. Employees are much more likely to do so in larger, small businesses than in the smallest ones regardless of subject matter (except tax). Unpaid family members do the paperwork in less than 10 percent of cases.

2. The cost of paperwork also varies by subject matter and firm size. The more paperwork and record-keeping that must be sent outside, the more expensive the paperwork and record-keeping. Owners of larger small firms pay higher average prices per hour because they are more likely to send their paperwork to outside professionals and because the value of their time on average is higher.

3. The estimated average per hour cost of paperwork and record-keeping for small businesses is $48.72. By subject matter the average per hour cost is: $74.24 for tax-related, $62.16 for financial, $47.96 for licenses and permits, $43.50 for government information requests, $42.95 for customers/clients, $40.75 for personnel, $39.27 for purchases, and $36.20 for maintenance (buildings, machines, or vehicles).

4. The typical small business employs a blend of electronic and paper record-keeping. Less than 10 percent use paper exclusively and a handful use only electronic means. The type of record most frequently completed and maintained on paper is licenses and permits.

5. No single difficulty creates the government paperwork problem. The most frequently cited problem is unclear and/or confusing instructions (29 percent). The second most frequently cited difficulty is the volume of paperwork (24 percent). Duplicate information requests (11 percent) place third, followed by maintenance of records that ordinarily would not be kept (10 percent) and requests for inaccessible or non-existent information (9 percent). Twenty (20) percent could not decide.

---

[9] NFIB Research Foundation National Small Business Poll, Vol. 3, Issue 5, *Paperwork and Recordkeeping*, 12-03, http://www.nfib.com/PDFs/sbpoll/sbpoll12_2003.pdf

While the use of computers by small businesses and small-business owners has certainly helped reduce the burden of regulations, technology alone cannot solve the problem. More than filing forms and storing copies, paperwork requirements involve understanding what the government wants and how they want it, gathering the necessary information and organizing it properly, determining what to keep and for how long, etc. Then there is the cost. Even with the most efficient computer equipment, documentation is not cheap. People must organize and input the necessary data, and people are expensive.

According to research by the NFIB Research Foundation, 92 percent of small businesses use computers in some aspect of their business. Eighty-two percent of small businesses have internet access, and of those, 57 percent have high-speed internet access. Half of the businesses that use the internet use it to find out regulatory information, and the smaller of small businesses are more likely to use the internet to educate themselves. They use it for specific searches, and to sift through information.[10]

But taken in the context of the ICB, the costs continue to be startling. If you only look at the average costs, then at the most macro of economic levels, the cost of the ***increase*** in paperwork alone amounts to nearly $21.5 ***billion*** annually![11] The total cost of paperwork therefore is nearly half a ***trillion*** dollars (roughly $409 billion).[12]

Some people might argue that the increase in paperwork from the ICB is only 5.5 percent overall. But that only serves to mask the real issue: 441 million hours is an enormous amount of time—time that drags on everyday Americans, and $21.5 billion is real money for real small businesses.

While some might quibble that this is only a marginal increase—one cannot deny that the baseline number is a huge one. A system that measures its paperwork burdens in the billions of hours and in which citizens' spending on paperwork is roughly equivalent to 85 percent of what

---

[10] NFIB National Small Business Poll Volume 4, Issue 8, "Telecommunications," http://www.nfib.com/object/telecomm.html
[11] $48.72 X 441 million hours equals $21,485,520,000
[12] $48.72 X 8.2 billion hours equals $409,248,000,000

the nation spends on defense each and every year is a system doomed to collapse[13]. It requires careful examination—a recognition that a serious problem exists and then taking the appropriate steps to see that problem solved. But there is no "magic bullet" here. While tax paperwork is responsible for a substantial portion of the paperwork burden, there is no single regulation responsible for the lion's share of that burden.

As I said earlier, it's the thousands of regulations, with their incremental costs, that create this "weight". Because regulations are created and expanded without regard to their context, this is simply going to continue. What is meant by context? Regulations are, essentially, created in a vacuum—generally without regard to overall regulatory burdens created by the agency, certainly without regard to pre-existing regulatory costs. Each regulation is measured and judged based on its own individual costs.

The problem is that taken individually, each incremental cost can appear inconsequential. A new regulation by an agency might add 7.5 hours of training time per employee per quarter of a year, and taken alone, that might seem to be a harmless mandate. But let's assume for a moment that this agency already has regulatory requirements that cumulatively require 150 hours of time. Assuming a 7.5 hour work day, that's already 20 days of time that one agency's regulatory burden consumes. Another 30 hours of training per year amounts to another 4 days of time—a twenty percent increase.

Further, if we assume that a full-time equivalent's "work year" is roughly 250 days, we're talking nearly ten percent of an employee's time is being taken up for the mandates of one agency. But no small business is regulated by only one federal agency, of course. There could be EPA, OSHA, Transportation, Labor, and a variety of other federal regulators. If four of these agencies each pose time burden of 24 days, that's 96 days that have now been lost to federal regulatory mandates—leaving 154 days for the business of the small business.

---

[13] In FY2005, DOD actually spent just over $475 billion – about $66 billion more than it cost Americans to fill out their paperwork for the federal government.

Time is one of a small business' most-precious and most-finite resources. Every day, every hour is important. But because, by comparison, federal agencies have nothing but time, they have no compunction against taking an hour here, and an hour there. And like the Washington proverb, "a billion here, a billion there, pretty soon you're talking about real money," the hours that the federal government robs from these businesses does add up.

We therefore believe, and will discuss in our recommendations, that some measure of accounting for this needs to be done.

Recommendations for Regulatory Reform in Congress

We are gratified that Congress is once again picking up the mantle of regulatory reform to help small business. In the last several years, a number of laudable steps have been made, recommendations that I, and others, have made to Congress—the Codification of Executive Order 13271, and the awarding of a separate budgetary line-item to the Small Business Administration's Office of Advocacy. Individualizing Advocacy's line item ensures its independence and viability, and codifying 13272 strengthens small business protections by setting out a formal working relationship between OIRA and Advocacy. Of most direct importance to small businesses, Congress has mandated that agencies publish their compliance guides concurrently with each new final rule.

Imagine the frustration that a small business owner would face—they would be required to follow the mandates within a final rule on its date of enforcement, but the guide to how they might comply might be months away! Thankfully, Congress has stepped in to fix that problem.

In terms of solutions, there are two ways of looking at the problem: you can reduce the number and scope of proposed and existing regulations themselves (the supply side); and at the same time you have to look at how to change the time needed to figure out how to comply with them (the demand side).

On that former side, we have a series of recommendations for legislation dealing with proposed regulations, the burdens they impose, as well as for reviewing agency practices with regards to

new regulations and regulations already on the books. We believe that the following are the basic principles that ought to be contained in any legislation proposed:

1. **Modify Section 610 of the Regulatory Flexibility Act**: Section 610 of the Regulatory Flexibility Act (RFA) mandates that federal agencies develop a plan for the periodic review of regulations that have or will have a significant economic impact on a substantial number of small entities. Unfortunately, agencies either fail to engage in the proper reporting, or when they do, their reports do not have any useful information. This is partially a problem of oversight, and partly a problem of guidance, and while the Office of Advocacy has done an excellent job in training agencies in RFA compliance, without stringent reporting guidelines, there is a limit to what Advocacy can accomplish.

   Modifications to Section 610 ought to specifically outline what should be included in such reports. Section 610 ought to be expanded to cover the review of all rules (currently, such review only cover regulations the agency considered "economically significant" at the time they were proposed. Section 610 reviews ought to be judicially reviewable as well. Also, OIRA should be required to report on reviews that were undertaken in the previous year, when they annually report to Congress on the costs and benefits of regulation.

2. **Include Indirect Economic Impacts in Regulatory Review:** One of the ongoing deficiencies in both the RFA and the Small Business Regulatory Enforcement Fairness Act (SBREFA) has been that *indirect* economic effects on small businesses go ignored in these evaluations. Either ancillary impacts aren't taken into account, or industries not directly affected but nevertheless impacted by the rulemaking are ignored. In one hearing on regulatory burdens held by the Small Business Committee on November 15, 2007, Joe Rajkovacz from the Owner-Operator Independent Driver Association testified on this very issue. He suggested that Congress ought to require, "agencies to consider the impact of its actions on small businesses who are not those in the regulated community" but who are impacted by the agency action.[14]

3. **Expand Small Business Protections to the IRS, CFPB and other Agencies :** As discussed above, the IRS accounts for the largest share of the regulatory and paperwork burdens faced by small businesses, and while IFL suggests that the "bright line" between the OMB and the IRS be removed by the administration, Congress can also play a distinct role. The RFA's jurisdiction over the IRS must be clarified. Moreover, the rules over which agencies must have their regulations subjected to SBREFA panels, similar to those faced by proposed OSHA and EPA regulations, must be expanded. We applaud the work done to date by Sen. Snowe and others on expanding SBREFA protection to the CFPB, and would like to see that work officially adopted as federal policy. Most importantly, small business protections must expressly cover all new information collection requests (ie, questions) and not just new forms, as the IRS currently inteprets the law.

[14] Testimony of Joe Rajkovicz before the House Small Business Committee, November 15, 2007 at 3.

4. **Require that Agencies Publish the Name and Direct-Dial Phone Number For A Regulation's Principal Author:** One of the most problematic situations for a small business owner is knowing who to turn to when a question arises. Though single agency points of contact for regulatory questions has been helpful, there are certain questions which require an in-depth expertise which these contacts might not otherwise have. We believe that the person primarily responsible for a regulation's shepherding through promulgation would have the greatest expertise on a regulation—and if a small business owner is going to be required to follow a regulation, then it's only courteous and fair that the person who wrote the regulation be made regularly available for questions about that regulation arise.

5. **Financially Penalize Agencies Who Ignore Their Regulatory Flexibility Obligations:** As was testified to in the past, many small business owners and their representatives believe that agencies only pay scant attention to their obligations under the law. Part of the reason for this is that there is no penalty when the agencies treat their obligations in a pro-forma manner. We recommend that should it be found that they affirmatively ignored their obligation, that some financial penalty accrue to the agency, possibly by cutting that agency's travel budget.

6. **Expand the Purview of the Regulatory Fairness Boards to Include Review of Agency Compliance with Regulatory Flexibility Laws:** Currently, there exists no body which engages in an across-the-board, comprehensive review of agency compliance. Some have discussed putting this review in the hands of Congress, some have discussed creating an independent commission to engage in such a review. We believe that the Regulatory Fairness Program administered by the National Ombudsman for Small Business at the SBA has been a rousing success. Small business owners use this program and have gotten great results from the personnel at the SBA. We believe that these successes ought to be built upon—and that expanding this program's scope to include RegFlex compliance review would be appropriate.

7. **Mandate That Each Agency Annually Publish An Accounting of Their Total Regulatory Cost:** As mentioned earlier, currently the only annual accounting of regulatory costs done by the federal government is performed by OIRA, and it only looks at the costs of major regulations for the previous 10 years. If we want to get an honest, accurate look at regulatory burdens, then each agency ought to be accounting for its fair share. This would actually simplify matters for both OIRA and members of the public who are interested in assessing these costs: OIRA could still publish its report on the costs of major rules, but they could also take the numbers put forth by each agency as to the costs of ***all*** of their rules (major and not-so-major), add them up, and come up with a far-more-accurate figure for annual regulatory costs. If agencies have to do annual budgets, and regular audits of their books and business practices, then they ought to also report on what impact they're having to the economy at large.

8. **Mandate that New Rules Assess Not only Cumulative Regulatory Costs for Small Business, But Present Those Costs in the Context of their Overall Regulatory Burden:** We believe this is critical. If we all agree that it is not just "major" rules, but the incremental costs of all rules that create this burden for small business, then we have to assess costs within context. Agencies are forced to continuously restate the burden that they already impose, and have to then show how they are about to add to that burden. This ought to be done in a variety of metrics as well: dollar costs, costs in man-hours, costs in days lost.

9. **Mandate the Adoption of Comparative Risk Assessment as a Regulatory Prioritization Tool:** One of the single greatest problems with the federal regulatory state is that there are no measures to force agencies to actually prioritize their mandates. While Congress drives the statutory process, agency discretion is still left in terms of how they prioritize public policy considerations. The use of benefit-cost analysis, while helpful, only tells the financial side of the story. Comparative risk assessment, because it allows us to compare and contrast policies throughout and across agencies, gives us a clearer picture as to what the most pressing public policy problems are. An attempt was made in the middle-part of the decade to incorporate CRA as a decisionmaking tool—that effort needs to be renewed.

The Business Gateway: Helping Businesses Learn How To Comply

We also must take a different approach towards simplifying the methods by which small businesses learn what regulations they are obligated to comply with, and how they ought to comply. To its credit, the federal government has recognized that technology can provide a number of solutions to the federal regulatory and paperwork burdens. Two separate tracks, very different, and important in their own way, are being pursued: one dealing with increasing participation and making the formulation of rules more streamlined (e-docketing); the other meshing technological tools with the problem of regulatory understanding, compliance, and paperwork burdens (the Business Gateway).

It is unfortunate that the federal government initially got their priorities backwards, focusing first on e-docketing and e-democracy rather than putting more resources towards the Business Gateway. IFL supports the federal government in attempting to open up the regulatory process to more perspectives—e-docketing promised to make it easier for small businesses and individuals to offer their thoughts on proposed rules. By offering a "real world" perspective, career civil servants can make regulations that are smarter and more meaningful. What's more, electronic

docketing is an excellent tool for those doing the regulatory decision-making, in that it makes it easier for regulators to break down and analyze comments.

But as discussed earlier, the problem is that too many small businesses are spending too much time doing federal paperwork already, and it is simply too much to ask of them right now to take additional time and resources to comment on a complex regulatory proposal. Sure enough, there are some businesses and individuals that will comment, and the regulatory state can only benefit from their expertise, but the executive branch must reduce burdens elsewhere if they hope to invest a more substantial set of the population in the rulemaking process.

This is why we believe that more resources should have been directed earlier on to the Business Gateway project (once called the "Business Compliance One-Stop" or BCOS). The Business Gateway is a good step in this direction, and a greater emphasis must be placed on the continued development and implementation of this system, and NFIB is heartened that the second generation of this project came on line in October of 2007 (NFIB has been and will continue to be an active participant in the development and implementation of this program).

Everyone involved in regulation: the regulated community, activist stakeholders, members of Congress and their staffs, the federal agencies and their personnel, all must ask the same question—what is it that we want from the regulated community, in the end?

The answer, at least in our estimation, is simple: we want the regulated community to understand its responsibilities when it comes to regulatory compliance and comply with those regulations that apply to them. What's more, Americans want to be in compliance with the law. They want to keep their workers and their communities safe and secure, and the last thing they want is for a government inspector to show up at their offices and fine them for some transgression.

Unfortunately, the regulatory state is so complex (consider in your minds, for a moment, the wide expanse that is the Code of Federal Regulations, and just what a small-business owner would need to do to figure out his responsibilities) that it is next-to-impossible for any small business to be in compliance with all of the regulatory requirements he faces .

But imagine a system in which a small-business owner could enter some simple information about his business: his industrial classification code, a zip-code, number of employees, etc. As discussed above, 92 percent of small businesses have computers, most with internet access (the majority of it high-speed), so the vast majority of businesses could do this if they so chose.

Then the system takes that information and spits out each and every regulation that applies to this business, along with simple compliance information. It would be even better if this system could provide an on-line access for small businesses to submit forms, should they choose to submit them that way (the operative word being "choose" – not mandate).

Yes, this is an ambitious idea. But in an era in which huge databases can be accessed from thousands of miles away in a safe, secure and fast manner, it is not an impossible task. The current iteration of the Business Gateway, Business.gov, is a solid step in the right direction. But it must do more, far more, in terms of offering a simple way for businesses to determine what their regulatory responsibilities are and to make living up to those responsibilities as easy as possible.

What it will take is leadership from Congress: funding, oversight, and the political will to see it happen.

If Congress is serious about reducing paperwork, then it must do something about making the fully-functional, fully-realized Business Gateway a reality. Once that is established, businesses know their responsibilities, and compliance is made as simple as possible, then businesses will not only have the time and resources to devote to helping the government craft smarter regulations, they will have an incentive to be invested in the process.

Not all businesses would do it (not all businesses have computers), so the option to find out about regulations in the traditional manner would still have to be in place. In fact, there are a

number of small businesses that will never be on computers[15] (which is why small business advocates advance the position that when agencies desire to work with the public via computers, it is a voluntary and not mandatory program). But such a system would be far superior than that which is available to small-business owners today, and a tremendous leap in seeking greater regulatory compliance.

Until then, however, the benefits of technology, whose primary purpose is e-docketing, accrue mostly to those who work in government.

The Intermediate Step

While we believe that the Business Gateway will be a tremendous tool for truly improving compliance and reducing burdens on small businesses, we recognize that there are a number of interim steps that will need to be taken, steps that will also require tremendous leadership on the part of the Congress.

Success of the Business Gateway will hinge on the quality of the information it provides: simple explanations and easy-to-understand-and-follow step-by-step instruction on how to comply. This means a wholesale restructuring of the information that is conveyed to the public: a comprehensive review of all regulations mandated by the agency, the review of all guidance documents, manuals, and other publications the citizenry uses to determine what their obligations are and how to go about them.

Then the agency will have to start building from the ground up: creating plain-language guides to each of their regulatory regimes. Guides that are as short as possible. Guides that are easy to find, take a common-sense approach to compliance, walk small business owners or their employees through the compliance process, and offer them clear suggestions in what they ought to be doing to be in compliance with that particular regulation.

[15] In fact, in conversations with NFIB field personnel, I learned that organization has a number of members who are Amish small-business owners. Clearly, these are small businesses that will never be using computers in their daily work, and any move to make computer communications mandatory (or any other sort of mandatory electronic interaction) would be grossly unfair to them.

There are no two ways about it: this will be a Herculean task. Nevertheless, it must be undertaken. Heretofore, the agency has balked at such reviews, and it's not difficult to understand why. They get no credit for it, simply put. Why put resources into developing easy-to-understand compliance guides when Congress and activist stakeholders are going to ask them why they didn't spend more resources on investigations and prosecutions.

So it is thus incumbent upon Congress to give the EPA the support it will need to do this. What is important is that in the near term, before the Business Gateway is in its final form, the Agency will be developing useful tools that can be utilized by small businesses as soon as they are made available.

Conclusion

There are many metaphors used to describe how incremental costs can have catastrophic results, like "the straw that broke the camel's back." Or how an individual feather can weigh next-to-nothing, but a ton of feathers still weighs the same as a ton of bricks.

The same holds true with regulation. A single regulation, taken in isolation, might have virtually no cost. But the body of regulation costs the American economy over a billion dollars annually. A single federal paperwork mandate might take fifteen minutes. But all told, these mandates take over 8 ***billion*** hours.

Something has to be done. Congress has to step in and take a look at both the continued regulatory burden that pours out of federal agencies, focusing on tailoring new regulations that harm small business, changing regulations that are already on the books, and working with the agencies to assess costs and create good tools to help small businesses fulfill their obligations under the law.

Thank you again for the opportunity to testify. I look forward to answering any questions you might have.

ANDREW M. LANGER

Andrew Langer is the President of the Institute for Liberty, an advocacy organization dedicated to fighting the petty tyrannies of government and protecting America's right to be free. A long time fighter for small business, Mr. Langer came to IFL from the National Federation of Independent Business, where he headed that organization's regulatory practice for six years.

Mr. Langer focuses on the incremental threats to small business and entrepreneurship, helping policymakers understand why small businesses are different than big businesses, how the regulatory state impacts those small businesses, and what government can do to best help small businesses. He has testified before Congress nearly twenty times, and is routinely asked by foreign governments to consult on making improvements to their small business sectors.

Most recently, Mr. Langer has been a leader in the National "Tea Party Movement". He has spoken at a half-dozen different Tea Parties, and served as the Master of Ceremonies for the National Tax Day Tea party in Washington, DC. The Institute for Liberty was a national sponsor of the 912DC March on Washington, and Mr. Langer was a speaker at that event.

The son of an environmental scientist and an epidemiologist, Langer attended the College of William and Mary in Virginia, where he received a BA in International Relations. He also holds a Masters in Public Administration from Troy State University. Mr. Langer's writings have appeared in US News and World Report, USA Today, National Review Online, Townhall.com, and the Daily Caller. He frequently appears on talk radio programs throughout the country, and has appeared on CNN, Fox News, MSNBC, and Al Jazeera. He is currently authoring a book entitled, "The War on Small Business".

Chair LANDRIEU. Thank you, Mr. Langer. I appreciate it. Very articulate.

Jim.

STATEMENT OF JAMES GATTUSO, SENIOR RESEARCH FELLOW, REGULATORY POLICY, THE HERITAGE FOUNDATION

Mr. GATTUSO. Thank you. Madam Chairman, members of the committee, thank you for the opportunity to testify today on this important topic.

Every year Americans are reminded of the costs of federal taxation when they file their income tax returns to the IRS.

Chair LANDRIEU. Try to speak into your mic a little bit more.

Mr. GATTUSO. I am sorry.

Chair LANDRIEU. It is okay.

Mr. GATTUSO. They see a clear and specific bottom line telling them how much they paid into Washington. Not so with the cost of regulation. These costs are hidden, embedded in the prices of products and services, in reduced innovation, and lost jobs. And by any reckoning, these costs are substantial. As you have heard according to the report released by the Small Business Administration, these costs have been estimated at $1.75 trillion annually and the regulatory burden falls disproportionately upon small businesses.

I did not want to be the only witness today not to say that because I think we have heard that number many times today. But as important, these costs are increasing. According to a recent report we completed at the Heritage Foundation, in Fiscal 2010 alone, some 43 major new rules increasing regulatory burdens were issued by federal agencies. The total costs for these rules, based on estimates by the regulators themselves, topped $26.5 billion. That is the highest cost for new regulations since at least 1981 which is as far back as records go. It was a record breaking year.

Now, it should be noted that the actual costs of these regulations was almost certainly much higher than the reported $26.5 billion. At the first matter, the cost of non-economically significant rules, those rules deemed lightly not to have an annual impact of $100 billion—$100 million or more, is not calculated at all by agencies. Moreover, regulatory agencies did not quantify costs for 12 of the economically significant rules adopted in FY2010. So, $26.5 billion is a record, but I think the number is, in truth, much higher than that.

Looking ahead, many more rules are in the pipeline. This year's record for regulatory increases may not stand for long. We will have a flood of rulemakings coming in the financial regulations sector—in the financial sector, from the financial regulation bill that was passed this year, of rulemakings from the healthcare reform bill that was passed this year, and for many other agencies, some that we have not heard about in a while, but the Consumer Product Safety Commission is still issuing major rules based upon the reform legislation passed in its are, two or three, I believe three years ago.

And then there are agencies moving forward without specific Congressional authorization, the Federal Communications Commission may still be considering rules on the internet, which arguably,

and I believe, would be without Congressional authorization at all. The Environmental Protection Agency is also moving ahead without specific Congressional authorization on greenhouse gas regulation. We may see record-breaking years next year and into the future.

Now, there are steps that Congress can take to increase the scrutiny of new and existing rules to ensure that each is necessary and that costs are minimized. Among these, requiring a cost analysis of all legislation imposing new regulatory burdens. Currently, although all proposed legislation must be scored by the Congressional Budget Office to determine likely fiscal costs, there is no similar requirement that regulatory costs be reported. Members should not be asked to vote on proposals without the best possible estimate of their likely costs. All bills proposing new or expanded regulations should undergo a regulatory impact analysis analyzing and quantifying, where possible, the likely costs and benefits.

This regulatory scoring would ideally be performed by a new Congressional regulation office similar to the Congressional Budget Office. Such a step could be taken by Congress on its own initiative and without Presidential approval.

Secondly, establish a sunset date for new federal regulations. Once adopted, rules tend to be left in place even if they have outlived their usefulness. Currently under Section 610 of the Regulatory Flexibility Act, rules that have a substantial effect on a significant number of small entities must be reviewed by the agency every ten years. In practice, however, such review, if it occurs at all, is usually performed in a cursory manner. To ensure that substantive review occurs, regulations should automatically expire, if not explicitly reaffirmed by regulators.

Lastly, consider requiring Congressional approval of major regulations that place new burdens in the private sector. Under the 1996 Congressional Review Act, Congress has the ability to veto new regulations coming from agencies under an expedited process.

To-date, however, that authority has only been used successfully once. To improve Congress's ability to oversee rulemaking and to increase accountability in Congress for rules that are adopted, the presumption of the Congressional Review Act should be reversed and rules should not take effect until approval is granted by Congress. Such a system should be seriously considered.

However, in doing so, Congress should be careful to avoid two dangers. I will finish up quickly.

First, the process should apply only to the imposition of new burdens on consumers in the economy. It should not be required in order to lift such burdens. And secondly, it should be clear that Congressional approval, under the process, is conditional upon a prior grant of regulatory authority to the agency by Congress and that the Congressional review process does not, itself, constitute a grant of authority.

That concludes my remarks and I would be happy to take any questions.

[The prepared statement of Mr. Gattuso follows:]

214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

Assessing the Regulatory and Administrative Burdens on America's Small Businesses

Testimony before
The Senate Committee on Small Business and Entrepreneurship

November 18, 2010

James Gattuso
Senior Research Fellow in Regulatory Policy
The Heritage Foundation

My name is James Gattuso. I am a Senior Research Fellow in Regulatory Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Chairman Landrieu and members of the Subcommittee, thank you for the opportunity to testify today on this important topic.

Every year, Americans are reminded of the costs of federal taxation when they file their income tax returns with the IRS, and see a clear and specific bottom line telling them how much they paid to Washington. Not so with the cost of regulation. These costs are hidden - embedded in the prices of products and services, in reduced innovation, and in lost opportunities.

And, by any reckoning, these costs are substantial. According to a report by economists Nicole Crain and Mark Crain, recently released by the Small Business Administration, total regulatory costs amount to about $1.75 trillion annually, nearly twice as much as all individual income taxes collected last year[1].

This regulatory burden falls disproportionately upon small businesses, which are less able than their larger competitors to spread the costs of regulation. According to Crain and Crain, the cost of regulation to firms with 20 or less employees is some $10,500 per year, compared to an average of $8,000 for all firms.

The impact on small businesses, moreover, goes beyond the direct costs of regulation on their own activities. Small businesses, like individual Americans, also pay "regulatory taxes" in the form of higher prices for goods and services, reduced economic activity and hindered innovation caused by excessive regulation generally.

Not all regulations are unwarranted, of course. Most Americans would agree on the need for protections against terrorism, although the extent of such rules is certainly subject to debate. Some rules, such as anti-fraud measures, are necessary for markets to work. But there is always a cost. And, for the same reasons that federal spending is reported, so, too, should regulatory costs.

And these costs are increasing. As outlined in a recent Heritage Foundation report, in fiscal 2010 alone, some 43 major new rules increasing regulatory burdens were issued by federal agencies. The total costs for these rules, based on estimates by the regulators themselves, topped $26.5 billion, the highest level since at least 1981, the earliest date for which figures are available[2].

Fifteen of the 43 major rules issued during the fiscal year involved financial regulation. Another five stem from the Patient Protection and Affordable Care Act adopted by

---

[1] Nicole V. Crain and W. Mark Crain, "The Impact of Regulatory Costs on Small Firms," Small Business Administration Office of Advocacy, September 2010,

[2] See, James L. Gattuso, Diane Katz, and Stephen A. Keen, "Red Tape Rising: Obama's Torrent of New Regulation, Heritage Foundation Backgrounder No. 2482 (Oct. 26, 2010).

Congress in early 2010. Ten others come from the Environmental Protection Agency (EPA), including the first mandatory reporting of "greenhouse gas" emissions and $10.8 billion in new automotive fuel economy standards (adopted jointly with the National Highway Traffic Safety Administration (NHTSA)). The bulk of the reported cost, over $23 billion, came from the Environmental Protection Agency.

It should be noted that the actual cost of regulations adopted in FY 2010 is almost certainly much higher than $26.5 billion. As a first matter, the cost of non-economically significant rules—rules deemed not likely to have an annual impact of $100 million or more—is not calculated by agencies. Moreover, regulatory agencies did not quantify costs for 12 of the economically significant rules adopted in FY 2010.

Many of the rules lacking quantified costs involve financial regulation. The Federal Reserve Board, for instance, did not quantify any costs for its new "Truth in Lending" regulations—which impose fee and disclosure requirements for credit card accounts—although the new rules are generally expected to be costly. Similarly, costs were not calculated for new Federal Reserve Board regulations on prepaid electronic gift cards.

Moreover, even the best impact analyses will be unlikely to fully quantify the impact of rules. For many economic regulations, for instance, the major cost may not be any direct burden on consumers or businesses, but constraints on innovation. There simply is no way to assess such losses - you can't measure inventions that were never created. Such losses thus are not reported in the totals.

Many more rules are in the pipeline. According to one estimate, the financial regulation legislation recently adopted by Congress will alone require 243 new formal rule-makings by 11 different federal agencies[3]. A similarly large number of rulemakings will likely be required to implement the new health care law. Significant new regulation is also in the pipeline at EPA, as well as at independent agencies such as the Federal Communications Commission and the Consumer Product Safety Commission. Taken together, these initiatives embody a stunningly full regulatory agenda—indicating that this year's record for regulatory increases may not stand for long.

One significant effect of regulation is reduced employment, and the estimated jobs effect of rules now in the pipeline is substantial. A pending EPA rule on boilers, for example, threatens some 71,000 jobs related to the paper and pulp industry. Another regulation, of cement kilns, could put over 11,000 jobs at risk.

Other proposed rules would hit the job market more broadly. According to one study, adoption of "net neutrality" rules by the FCC could reduce employment by hundreds of

[3] Davis Polk, "Summary of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010," Davis Polk & Wardwell, LLP, July 21, 2010,

thousands of jobs.[4] And, according to a report by the Manufacturer's Alliance, the EPA's proposed ozone rule could reduce employment by 7.3 million by 2020[5].

There is no magic bullet that will stop the excessive growth of regulation, but there are steps that Congress can take to increase scrutiny of new and existing rules to ensure that each is necessary and that costs are minimized. Among these:

- Require a cost analysis of all legislation imposing new regulatory burdens. Although all proposed legislation must be scored by the Congressional Budget Office to determine likely fiscal costs, there is no similar requirement that regulatory costs be reported. Members should not be asked to vote on proposals without the best possible estimate of their likely costs. All bills proposing new or expanded regulation should undergo a regulatory impact analysis analyzing and quantifying (where possible) the likely costs and benefits. This "regulatory scoring" would ideally be performed by a new "Congressional Regulation Office," similar to the Congressional Budget Office. Such a step could be taken by Congress on its own initiative and without presidential approval.

- Establish a Sunset Date for New Federal Regulations. Once adopted, rules tend to be left in place, even if they have outlived their usefulness. Currently, under section 610 of the Regulatory Flexibility Act, rules that have a substantial effect on a significant number of small entities must be reviewed by the promulgating agency every 10 years. In practice, however, such review, if it occurs at all, is usually performed in a cursory manner. To ensure that substantive review occurs, regulations should automatically expire if not explicitly reaffirmed by regulators. This requirement should be applied to all rules, not just those affecting small business. Such "sunset" dates should also be included in legislation imposing new regulation.

- Consider requiring congressional approval of major regulations that place new burdens on the private sector. Under the 1996 Congressional Review Act Congress has the ability to veto new regulations coming from agencies. To date, however, that authority has only been used successfully once. Under legislation (S. 3826) introduced in the Senate by Senator Jim DeMint, and in the House by Congressman Jeff Davis (H.R. 3765), the review process would be strengthened by requiring congressional approval before regulation takes effect. Such a system would ensure a congressional check on regulators, as well as ensure the accountability of Congress itself Such reform should be seriously considered.

  In doing so, Congress should be careful to avoid two dangers. First, the process should apply only to the imposition of new burdens on consumers or the

[4] Charles M. Davidson and Bret T. Swanson, Net Neutrality, Investment & Jobs: Assessing the Potential Impacts of the FCC's Proposed Net Neutrality Rules on the Broadband Ecosystem, Advanced Communications Policy and Law Institute, New York University, June 2010.
[5] Donald A. Norman, "Economic Implications of EPA's Proposed Ozone Standard," Manufacturer's Alliance Economic Report (Sept. 2010).

> economy. It should not be required in order to lift such burdens. Second, it should be clear that congressional approval under this process is conditional upon a prior grant of regulatory authority to the agency by Congress and that the congressional review process does not itself constitute a grant of authority.

While reforming the regulatory process is important, it is also important to note that such reforms will not by itself solve the problem of overregulation. No set of procedural reforms will be enough to stem the regulatory tide. Ultimately, regulatory burdens will rise until policymakers fully appreciate the burdens that regulations impose on Americans, and exercise the political will necessary to limit and reduce those burdens. I hope today's hearing provides a start towards that end.

****

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2009, it had 581,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2009 income came from the following sources:

Individuals	80%
Foundations	17%
Corporations	3%

The top five corporate givers provided The Heritage Foundation with 1.6% of its 2009 income. The Heritage Foundation's books are audited annually by the national accounting firm of McGladrey & Pullen. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own and do not reflect an institutional position for The Heritage Foundation or its board of trustees.

Heritage Expert

Download Hi-Res

James Gattuso

- Senior Research Fellow in Regulatory Policy
- Thomas A. Roe Institute for Economic Policy Studies

James Gattuso handles regulatory and telecommunications issues for The Heritage Foundation as a Senior Research Fellow in its Roe Institute for Economic Policy Studies.

Prior to joining Heritage in 2002, he was Vice President for Policy at the Competitive Enterprise Institute. In that position, he oversaw the institute's policy work, and supervised the overall management of the organization. Before that, Gattuso served as Vice President for Policy Development with Citizens for a Sound Economy from 1993 to 1997, where he directed the research activities for that organization.

Gattuso also has served in the federal government. From 1990 to 1993, he was the Deputy Chief at the Federal Communications Commission's Office of Plans and Policy. From May 1991 to June 1992, the FCC detailed him to the office Vice President Dan Quayle, where Gattuso served as Associate Director of the President's Council on Competitiveness.

Gattuso is currently serving his second tour of duty at Heritage. From 1985 to 1990, he was a Heritage policy analyst with a responsibility for a broad range of issues, including telecommunications, transportation and antitrust policy. Before coming to Heritage the first time, he was an associate with the

Washington law office of Squire, Sanders and Dempsey, where he handled matters before a number of regulatory agencies.

In 2002, Gattuso's work on government bailouts and free markets earned him the prestigious Drs. W. Glenn and Rita Ricardo Campbell Award. It is given to the Heritage employee who has delivered "an outstanding contribution to the analysis and promotion of a Free Society."

Gattuso graduated magna cum laude from the University of Southern California in 1979. He received his law degree from the University of California at Los Angeles in 1983, where he was a member of the UCLA Law Review. He is a member of the California and District of Columbia bars and is the author of a number of articles written for newspapers, magazines and journals. His commentaries have appeared in FOXNews.com, *The Hill, The Los Angeles Times, USA Today* and *The Washington Times* .

All Publications by James Gattuso

- Reports
- Commentary
- Blog Posts
- Video

- Backgrounder posted October 26, 2010 by James Gattuso, Diane Katz, Stephen Keen Red Tape Rising: Obama's Torrent of New Regulation

Abstract: The burden of regulation on Americans increased at an alarming rate in fiscal year 2010. Based on data from the Government Accountability Office, an unprecedented 43 major new regulations were imposed by Washington. And based on reports from government regulators themselves, the total cost of these rules topped... Read more

- Commentary posted July 9, 2010 by David C. John, James Gattuso Reinforcing 'Too Big to Fail'

After many weeks of negotiations, Congress is close to passing its mammoth financial regulation bill. At more than 2,300 pages, the legislation represents the largest expansion of Washington's role in the financial industry since the Great Depression. The goal: to minimize the chances that another financial crisis —... Read more

- WebMemo posted June 28, 2010 by David C. John, James Gattuso Financial Reform in Congress: A Disorderly Failure

After weeks of negotiations, a congressional conference committee has finally come to an agreement on a financial regulation bill. Weighing in at close to 2,000 pages, the legislation represents the largest expansion of Washington's role in the financial industry since the Great Depression. Final votes are expected in the House... Read more

- Commentary posted May 14, 2010 by David C. John, James Gattuso Deal with Fannie and Freddie Now or We'll Pay Later

What's the main selling point for the financial regulation bill Congress is debating? That it would end

taxpayer bailouts. The Senate even added an amendment directly noting that the bill is intended to "prohibit taxpayers from ever having to bail out the financial sector." But... Read more

- WebMemo posted April 22, 2010 by James Gattuso Senator Dodd's Regulation Plan: 14 Fatal Flaws

The Senate is expected to take up a proposal, originally authored by Senator Chris Dodd (D–CT), to reform the financial regulatory system in the U.S. The goal is clear: to minimize the chances that another financial crisis—and bailouts—will arise again. The objective is a good... Read more

- Commentary posted April 22, 2010 by James Gattuso Financial Reforms Go Too Far

As the debate over financial reform intensifies, it's easy to forget that there is a shared desire across the political spectrum to put an end to bailouts and to the idea that any firm should be too big to fail. Supporters of the plan now pending in the Senate argue... Read more

- WebMemo posted April 15, 2010 by James Gattuso The FCC and Broadband Regulation: What Part of "No" Did You Not Understand?

Last week, the Federal Communications Commission's (FCC) plans to regulate broadband Internet services were derailed by a U.S. appeals court, which ruled that the FCC lacks authority over broadband. The decision, while not unexpected, was a crushing defeat for the agency, which has proposed far-reaching... Read more

- Lecture posted April 2, 2010 by James Gattuso, Todd Zywicki, Alex Pollock, David C. John Protecting Consumers in the Financial Marketplace: Thinking Outside the Boxes

Abstract: Do consumers need a new regulatory agency to protect them in the financial marketplace? The question has been at the center of the ongoing congressional debate over financial services reform. But... Read more

- WebMemo posted April 2, 2010 by James Gattuso Financial Regulation Reform: 16 Key Studies and Analyses

The 1,334-page financial markets bill now pending in the Senate would implement a vast array of changes in the way banks and other financial institutions are regulated. Issues range from how best to protect consumers to how to liquidate failing firms to what rules to apply to complex financial... Read more

- Backgrounder posted March 31, 2010 by James Gattuso, Stephen Keen Red Tape Rising: Regulation in the Obama Era

Revised and updated April 8, 2010 Abstract: Americans are endlessly paying taxes--on their income, on their property, on almost anything they purchase. But the heavy burden that the U.S. government places on its citizens... Read more

View All

Commentary on July 9, 2010 Reinforcing 'Too Big to Fail'

- Commentary on May 14, 2010 Deal with Fannie and Freddie Now or We'll Pay Later
- Commentary on April 22, 2010 Financial Reforms Go Too Far
- Commentary on March 30, 2010 Use Bankruptcy Courts Not Financial Regulation
- Commentary on January 22, 2010 An Agenda Too Big
- Commentary on August 11, 2009 Commercials Help People Get Better Care
- Commentary on October 18, 2007 Pro-taxes or pro-Internet?
- Commentary on October 13, 2007 Do Regulators Need Expanded Authority Over Consumer Goods?
- Commentary on July 6, 2007 Fairness Doctrine, R.I.P.
- Commentary on January 6, 2007 AT&T-BellSouth Merger: Regulation Through the Backdoor

View All

- Blog Post on 11/5/2010 10:00:29 AM Net Neutrality Goes 0 for 95

For years, supporters of Internet regulation have argued that it is a political winner—that voters would flock to..... Read more

- Blog Post on 11/2/2010 2:00:53 PM Who's the Bully? FCC to Impose Anti-Bullying Mandates on Schools

The Federal Communications Commission is joining the fight against bullying. Reportedly, the agency will soon issue..... Read more

- Blog Post on 10/19/2010 9:30:48 AM Fox v. Cablevision: Should Washington Be Television's Umpire?

Last Sunday, countless Philadelphia Phillies fans settled down in front of their TV sets to watch their team take on..... Read more

- Blog Post on 10/1/2010 10:00:24 AM Welcome to the National Nanny League: Cincinnati Reds Busted for Smoking

The scene was a familiar one: A team wins a championship and celebrates in the clubhouse afterward. And that's just..... Read more

- Blog Post on 9/29/2010 6:00:46 AM Waxman Net Neutrality Plan: Internet Regulation Lite, Anybody?

Just days before Congress recesses for the upcoming elections, House Commerce Committee chair Henry Waxman stepped into..... Read more

Blog Post on 9/22/2010 9:00:33 AM Red Tape Rises Again: Cost of Regulation Reaches $1.75 Trillion

How much does federal regulation cost Americans each year? The question is not an easy one. While the revenues and..... Read more

- Blog Post on 9/16/2010 6:00:05 AM Zoning Out of Wireless: Local Red Tape and Cell Phones

Americans are increasingly cutting the cord on their phones. By the most recent estimates, 40 percent Americans rely..... Read more

- Blog Post on 9/10/2010 7:30:39 AM And Then There Was Light: Will Energy-Efficient Light Bulbs Increase Energy Use?

It seemed so simple: To reduce energy use, Americans must abandon the old-fashioned incandescent light bulb in favor of..... Read more

- Blog Post on 9/2/2010 9:00:10 AM FCC's Neutrality Regulation Express Sidetracked

The FCC's plans for regulating the Internet through "neutrality" regulation—once considered on a fast track—was..... Read more

- Blog Post on 8/5/2010 12:30:34 PM A Google-Verizon Truce On Internet Regulation?

Google and Verizon, two of the leading antagonists in the long-running drama over FCC net neutrality regulation, may be..... Read more

- Play Movie video on Thursday, July 29, 2010

James Gattuso on the Auto Bailouts on CNBC James Gattuso discusses the failure of the auto industry bailout. Read more

- Play Movie video on Thursday, June 24, 2010

James Gattuso on Financial Reform on FNC James Gattuso comments on President Obama's remarks on the Dodd financial reform bill. Read more

Play Movie video on Thursday, June 24, 2010

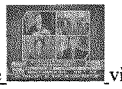
James Gattuso on Financial Regulation on FBN James Gattuso discusses the Dodd financial regulation bill. Read more

- Play Movie video on Wednesday, June 02, 2010

James Gattuso on Government Intervention in BP on FBN James Gattuso discusses the extent to which the government should interfere with BP management during the response to the oil spill disaster. Read more

- Play Movie video on Thursday, May 20, 2010

James Gattuso on Financial Regulation on BNN James Gattuso discusses the biggest flaws in the current financial regulation legislation. Read more

- Play Movie  video on Sunday, April 25, 2010

James Gattuso on Financial Regulation on FBN James Gattuso discusses the Dodd financial regulation bill. Read more

- Play Movie video on Tuesday, April 20, 2010

James Gattuso on a Potential Bank Tax on CNBC James Gattuso discusses a potential bank tax and the Dodd financial regulation bill. Read more

- Play Movie video on Monday, April 12, 2010

James Gattuso on the Dodd Bill on FBN James Gattuso discusses the Dodd financial regulation bill. Read more

- Play Movie video on Monday, March 08, 2010

James Gattuso on Traffic Safety Regulation on CNBC James Gattuso discussing the bureaucracy of traffic safety monitoring and regulation on CNBC. Read more

- Play Movie video on Sunday, January 31, 2010

James Gattuso on Executive Bonuses on CNBC James Gattuso discussing banking executives' bonuses. Read more

View All

Contact James Gattuso

Send an email

Media information line:
202-675-1761

Areas of Expertise

Regulation
Internet And Technology
Fairness Doctrine
Net Neutrality
Federal Communications Commission
Bailouts

Search Research

Search James Gattuso's work Search

© 2010, The Heritage Foundation
Conservative policy research since 1973

Chair LANDRIEU. Thank you. We do have several. Let me begin with asking all the panel, starting with you, Mr. Harris. You know, when I consider the testimony that I am hearing, I almost do not know where to start. I mean, it is quite overwhelming, honestly, and while both Senator Snowe and I and others of the committee have introduced, and actually passed, you know, legislation recently to begin addressing this, it just seems that it is just a huge endeavor.

One simple approach that comes to me, and I want to ask all of your views on it, and do not hold back, if you do not think this has any, has limited merit, what would you all think of a blanket exemption of all rules and regulations for businesses at least below 10 employees or 25 employees to start, and then work our way up from there? Is there any, can you think off the top of your head, which you have to right now, for the benefits or disadvantages of such—just a blanket exemption? Mr. Harris.

Mr. HARRIS. Well, I think we have certain exemptions in place now where we recognize we need to give a start up business a chance to get off the ground before we impose the heavy rules and regulations.

Chair LANDRIEU. Can you give an example of something like that?

Mr. HARRIS. Well, I think in any legislation, if you look at the healthcare bill, the exemption for the credit below—I mean, we apply credits and benefits to smaller businesses to try to help them get through their start up phase, and sometimes I think we ignore opportunities to do that as well, so as a general rule, I think that is a terrific idea. I think, even in my testimony, I talked about exempting smaller businesses from the 1099 rules before repealing them.

Chair LANDRIEU. And when you say smaller, what is it that comes to your mind? Is it 10, 25, 50? In your experience, you know, as we try to say creating, allowing that room for entrepreneurship, it would seem to me clear that it would be a business of 10 or less, and potentially 25 or less, not that it is easy for businesses with 35 employees to comply, I am not suggesting that, but just to sort of take a step at a time as we approach this regulatory nightmarish situation that we are seeing.

Mr. LANGER. The tipping point.

Chair LANDRIEU. The tipping point. How do we begin chipping away? So, you would think that as some kind of blanket exemption might be helpful?

Mr. HARRIS. I think personally I would like to see the exemption be based on a revenue as opposed to an employee count. I hate to see burden increase by hiring one more person, so I would start with, I would say, if we are going to create an exemption, let us do it on an annual revenue basis. So, I think all people would be happy to see their revenues go up in accepting additional burden, but I am not sure we should hold back employment.

And again, I cannot speak to the impact it could have on compliance, you know, I am not sure of that impact, but from the small business standpoint, I think it would be very welcome to say, we are going to let you grow to a certain point before—and then we will gradually increase your burden, and I think that would be wel-

come and it would encourage some people. I just cannot speak to the regulatory compliance side of that.

Chair LANDRIEU. Mr. Nannis.

Mr. NANNIS. I think one of the things, and to Mr. Harris' point, I think to have a blanket exemption, be it on a revenue model or an employment model, I think would go a long way to simplifying just a whole lot of issues with regards to small business, not the least of which is the definition of what a small business is.

If you look at the size standard regulations, and I know we are not talking about that, it varies depending on what industry you are in. If you look at the tax regulations, if you look at the tax laws, there are certain places where it is under 25, there are certain places where it is over a million or under a million, that tax laws is impact. I think that to come up with a standard, and I agree, I am not sure that the employment number would be the right one, but probably a revenue number, would go a long way to simplifying a whole lot of stuff relative to regulatory and legislative issues as they pertain to small business.

Chair LANDRIEU. Mr. Langer.

Mr. LANGER. Well, here is what we know. We know that for small businesses, you know, the 20 employee number is, in terms of regulatory burden, seems to be what changes things. That you get above 20 employees, the regulatory costs drop by about a third to 50 percent depending on what industry you are in and what you are doing. We know that most businesses hire their first full time regulatory professional at about 35 employees and that generally has to do with employee benefits, HR rules that are out there. And again, this changes depending on the industry you are in.

From an environmental health and safety standpoint, which is where you are going to run into your biggest push back on a blanket employee-size model, you have a number of environmental regulations which do not get triggered until you hit above 10 employees, so you might be able to get covered in terms of that if you wanted to do a blanket prohibition.

You know, it is one of these things where we have to recognize that there may have to be a sliding scale given the economic state of the nation, that when unemployment rises above a certain level and economic growth drops below a certain level; we need to relax the rules that impact small businesses. Wealthier nations are able to better protect their environmental and safety, and as nations grow less wealthy, they have to prioritize jobs over the environment. I think we have to recognize that is a fundamental economic truth.

In principle, I think it is a very interesting idea. I think the implementation is where the devil's going to be in the details.

Chair LANDRIEU. Mr. Gatt——

Mr. GATTUSO. Gattuso.

Chair LANDRIEU. Gattuso.

Mr. GATTUSO. I do have some concerns about an approach like that in three main areas. First, I think it would cause distortions. You would be in effect giving an advantage to small businesses which are valuable, contribute usually to the economy, but should be competing on a level playing field. I usually hate to use that term, but a level playing field with large businesses. Remember,

larger businesses tend to be small businesses that were successful. Think of Apple Computer, think of Amazon.com, and it is better overall for the consumer if the most efficient firm be allowed to produce its good and services for the economy. That is also good for small businesses because remember, small businesses are also consumers of goods, so I think on the whole that would help small business. You do not want these distortions.

Secondly, there is a bad incentive effect. Again, as I said, large businesses tend to be small businesses that grew. I think you would be creating an incentive to stay small despite the success of a company that decreases the incentive to work your business to—into new fields. It creates an incentive to remain small which really we want these companies to grow, we want the successful ones to advance, to hire more people.

And lastly, I think that there is a probability of huge gaming of such a system. I think suddenly we would see numbers of small businesses in form would skyrocket. Suddenly you would see all sorts of businesses that claim to be small, claim to only have so many employees, but in truth are arms of larger businesses, so I think even the effect would not be to help small business.

Chair LANDRIEU. Okay, so the survey is, three of you are for it, one of you is against it. I would like all of you to think more about it in the next, you know, few weeks, maybe submit a little bit more detail about your thoughts on that too because I am going to seriously consider something like that to this committee.

Last question, I will turn it over to Senator Snowe, all of you, if you had to pick not 1099, because we have already skinned that cat, what are your two most aggravating other rules and regulations, if you could pick two, I know, out of the hundreds that aggravate you, but Mr. Harris, are there two that continue to be sort of, two or three, that people just clamor, it does not make sense to them, it is not cost-effective? Could you suggest a couple to us?

Mr. HARRIS. Well, and I am not sure if this is one or 100, but I think if we looked at today's discussion of 1099 rules and tried to take the current set of rules for employee reporting, W–2s, withholding, multiple filing; I cannot imagine if we were trying to introduce that process today what the testimony would be like, if we were going to say, not only are you going to have to keep up with how much you pay your employee, we are going to make you agents of the state, federal, and local governments and withhold that money and you are responsible for submitting that money to the government, and multiple forms to back up those payments, and if you are late or do not make a payment on time, you, the business owner, are going to be penalized.

Given the discussion we had with 1099s, I would love to try to see that process being sold. So, I am concerned that we have just accepted that because it is the way we have always done it, without any examination of everything we are doing as it relates to hiring an employee and tracking their wages and tracking their payments. Is it just the way that we are doing it now, or could it be done better?

Chair LANDRIEU. Well, let me ask you this, though, when you are a business owner, do not you have to know how much you are paying people?

Mr. HARRIS. Oh, sure. Sure, you do. That is what I am saying.

Chair LANDRIEU. You have to track that right.

Mr. HARRIS. You have to track it. And I am not saying—but, it is a very complicated redundance. We found multiple forms to different agencies reporting the same information that again we have just let this system kind of grow and let everybody have their piece of it. We let the states have their piece of it, the federal have their——

Chair LANDRIEU. So, if it could be one simplified form about employees that just gets circulated among all the various agencies, that in itself would be a significant help?

Mr. HARRIS. I think that would, I think there are multiple forms that you file for the same thing.

Chair LANDRIEU. Mr. Nannis, anything come to your mind?

Mr. NANNIS. I think in general, and again, this may be one of those that it is one or it is 100, is the whole issue of explanation of what it is that you are submitting to the government. I know there is a Plain Language Act that was recently passed and I believe that it is really important that the language of describing how a form gets prepared. I mean, in my business I am a tax return preparer, and I have four people on my staff alone to help me understand what some of these rules are, and I think that in many issues, certainly in the—within the Internal Revenue Code, there are sentences there that are the most amazingly long sentences that take forever to just get through. I believe strongly that implementation, complete implementation of plain language all the way through to the Internal Revenue Code.

Chair LANDRIEU. Well, let me ask you since I am going to prepare a floor speech on this, if you would send me a few of those sentences it might help. I will put them in charts, put them up on the Senate floor. We will have a little fun with that.

Go ahead, Mr. Langer.

Mr. LANGER. Yeah, you know, one of the things that I have always heard a lot about was when the Department of Commerce puts out their economic census forms, which is sort of a restatement of, you know, what your business is up to. It goes along with the authority that Commerce has to collect the census data.

Most business owners do not understand why they are having to fill out this stuff that they have already filled out before when they fill out their tax forms, especially now that the mandates are increasing. So, that is one that hits a lot of different industries. The problem has always been that there is not a silver bullet, that it is all the little mandates that add up to very, very big things, which is why we have been so outspoken about getting the agencies to stat burden, both in dollar terms and in time terms, and maybe setting some restrictions on the agencies in terms of their ability to add further burden without taking burden away elsewhere.

Chair LANDRIEU. Thank you.

Mr. Gattuso.

Mr. GATTUSO. The first one I mentioned is sort of the general field of mandates for employee benefits such as in the new healthcare bill, but there is plenty of other mandates. I think that gets to the heart of the jobs issue, it most directly hinders job

growth and is—if you had to start in one place, I think you would start there.

As a second one, this might not be the most—certainly not mentioned the most often and might not be the largest, but maybe the most neglected and that would be the rules being applied by the Consumer Product Safety Commission on toys and other consumer goods. I think the bill passed three years ago on this issue was done under, with good intentions, but I think it was so sweeping that it is driving a lot of small businesses out of business to providing very little if any safety advantage for the public.

Chair LANDRIEU. Senator Snowe.

Senator SNOWE. Thank you, Madam Chair. I want to thank you all for your outstanding suggestions and input here today. It is critical. Unquestionably we are facing what I describe as a regulatory stampede. I mean it truly feels that way. On my Main Street tours, it is just staggering, the disconnect, between the reality of what we do here and what actually occurs on Main Street. We have got to turn it around.

I also got a preview of the resistance. I encountered, for example, in establishing a review panel for the Consumer Financial Protection Bureau, I could not understand why there was such strong resistance to the idea of ascertaining what the effects would be of any potential regulations before they were promulgated, and I cannot tell you the degree to which that was opposed and fought even in the conference committee.

So, it makes me wonder what the hidden agenda is, let alone what is described as a de facto tax, and I could not agree more.

So, the question is, where do we go from here? Senator Pryor and I have introduced legislation, one of the provisions which was incorporated in the jobs bill that passed, and became law recently which is to require the Advocacy Office to respond to agencies with respect to rulemaking. But the question is whether or not to require every agency, every department to have a review panel. It is clear we have it with OSHA and we have it at EPA and now it makes me wonder why we never had it and applied it to every other agency.

Would you agree that that is a step forward? And would that have an enormous benefit? Secondly, applying it to the indirect costs as well as to the direct economic cost, because there are a lot of hidden costs in the indirect effects of regulation? Mr. Gattuso, what would you say?

Mr. GATTUSO. I think that would be an excellent idea. You know, the analysis of cost is, again, as Andrew said, not a silver bullet. We will never find out exactly what our regulatory cost is. You are not going to get down to the penny, but we should know as much as we possibly can, and I hear objections to activities like this on the basis of resources and time. Regulators say we do not have time to do that, we do not have the resources to do that. Well, if you are imposing $100 million or $1 billion of cost on the public, you should be able to spend the time necessary to find out what effect it will have.

Senator SNOWE. Absolutely.

Mr. Langer.

Mr. LANGER. Well, to gin on to what James said, that is why we have also advocated for this issue of comparative risk assessment, which I know, sort of, folks' eyes glaze over, but it is a way of prioritizing public policy problems to ensure that they are actually problems. You know, why would we spend all of this enormous time and money dealing with something that is not actually posing a risk to the public, not just on health and safety, but on other issues as well, financial issues, consumer products, which as health and safety issue, but, you know, these are areas where we actually have to sit down and assess, really, have a look before you leap, as James said, really understand what we are doing beforehand so that we are not about to cause $100 billion worth of damage to the economy. It really is essential, but really the things that you have laid out, especially for the future and the deference that needs to be accorded to the Office of Advocacy, that can only be of enormous benefit to small businesses.

Senator SNOWE. Mr. Nannis.

Mr. NANNIS. Other than to be redundant, I think that in my business one of the things that we do as auditors and as CPAs is we look at internal control, and one of the biggest issues that we have is trying to convince companies that they ought not to spend a dollar to save a dime, and I think cost benefit analysis, I think your suggestion for looking at the indirect cost benefits, these are the types of things that will go a long way to ensure that we are not asking small business to do something that will just undermine their ability to be able to grow. So, the suggestion makes a lot of sense.

Senator SNOWE. Mr. Harris.

Mr. HARRIS. I am not sure exactly how to do this, but the experience I have got is, I served on the IRS Advisory Council for four years and continue to go to some, what they call, stakeholder meetings where there is the back and forth of what they are talking about and how it would be impacted in the real world, as I will call it.

Sometimes it works better than others, particularly the sooner you can be brought into the discussion and have your input heard, the better the end product usually becomes, so anytime you can generate that back and forth of understanding, I think, again, the 1099 issue, if there had been a one day give and take between the business community and the people writing the legislation, we could have saved a lot of these headaches just in the sense, so I would always advocate the more you can bring in input from the outside of how is this going to be felt before it is felt, would be hugely beneficial.

Senator SNOWE. On a couple of other issues, I will ask anybody to respond who cares to, the whole idea that much regulating is outside of the review process, for example, in OSHA, regional guidance, documents, and there are hundreds of similar items in the healthcare reform law. That is why Senator Enzi and I sent a letter, because of all these increased penalties on small businesses that are going to go from $1,000 to $3,000. It started in October, and then they reduce the penalty mitigation structure, I think one of you made reference to that, maybe it is you, Mr. Langer, in your testimony as well.

It was a 60 percent reduced penalty that is going down to 40 percent, there is another dimension, and they do not have to go through a review process. It is outside that purview. So, we have got that. Secondly, the stampede that I referred to between financial regulatory reform, healthcare, and all the other agencies combined, what would you recommend to Dr. Sargeant about how he ought to be preparing to be an aggressive advocate on behalf of small business and dealing with that immediately?

Mr. LANGER. First? You want me to go first?

Senator SNOWE. Anybody who cares to.

Mr. LANGER. Well, I think first of all, just on the issue of the Office of Advocacy, somebody mentioned earlier this issue as to whether or not advocacy is fully funded and getting the resources. I am not entirely certain that they are and I really think that Small Business Committee needs to make sure that they are getting their due in terms of being able to do their jobs and not being undercut by other elements of the Administration which I have been hearing very, very serious rumors that other agencies, other personnel, are not giving them their due and they need to be accorded the deference.

The fact is that yeah, the issue of regulation by guidance is a very serious one, and I fear that the more we try to ratchet down on the actual administrative regulatory process under the EPA, that they are going to turn around and start doing more regulation by guidance. The Wetlands Manuals over at the EPA, for instance, which have huge force and affect over hundreds of millions of acres across the country, huge impact on businesses and individuals. That is not subject to this. And as we talk about it with the independent agencies as well, those need to come under the rubric. These are all things that need to happen.

I have always been a fan, if we are talking about real, sort of concrete solutions, I am a big fan of making every bureaucrat who puts out a new regulation to put their name and direct dial office phone number on every piece of paper that comes out.

Senator SNOWE. Good idea. I like that.

Mr. LANGER. Thank you. Listen, I think if you want to get at it, you know, you want to get clean language regulations and these folks do not want to get hassled by folks having to pick up the phone and call Washington, make somebody put their name on the regulation they put out there.

Senator RISCH. Put the President's cell phone number.

Mr. LANGER. I am not advocating for that.

Mr. GATTUSO. If I could add too, I associate myself with what Andrew said, the proliferation of guidelines is a problem, and if we make the formal review processes for regulations more effective, there will be more guidelines. It is like pushing on a balloon. Ultimately there is no other solution, there is no magic bullet, but I think you have to drive the review process and the appreciation for cost, down into the agency level. You cannot do it with 19 people, you cannot do it with 100 people, you probably cannot do it with 1,000 people on the outside.

This needs to be internalized in every agency. Every agency should have their own Office of Advocacy internally to watch out for regulatory excess. Every chairman, every agency administrator

should have staff close to him, looking out for him, looking out for rules that are not justified, not fully justified, too expensive. This cannot be completely an outside pressure looking in. You need that outside pressure, but it needs to be internalized as well.

Mr. HARRIS. I would just add one comment to what has already been said. I do not think you are going to do it holding panels in Washington, D.C. You need to be out having panels in the hometowns and talking to the real people that are being impacted by it, and most small business owners are busy and they do not get a chance to fly to D.C. and attend a panel, but they might be able to attend a meeting in their hometown in the evening to talk to people if they really believe that those people are there to help them. So, I would say, get out of Washington and get into the real world.

Chair LANDRIEU. Senator Risch.

Senator RISCH. Thank you very much. First of all, I wanted to comment on Mr. Nannis' statement about the bravery that the good Chairman and Senator Shaheen has shown in introducing the bill to repeal the 1099 problem, and, however, if we are going to pass out medals, we probably ought to look at the background a little bit, and the first thing we ought to look at is how this got there in the first place.

This was buried in a 3,000 page healthcare bill that was shoved down the throat of the American people on a straight party line vote. Senator Snowe and I and every single one of our Republican colleagues on this side of the capital and on the other side of the capital, voted no against that bill and that was one of the reasons, one of the many, many reasons, that the bill was going to strangle small business in America.

Now, if we are also going to examine what size medal the person should get for the bravery, we should look at what happened on September 14, 2010. Now, September 14, 2010, the United States Senate had on the floor the Small Jobs Creation Act. We had an amendment to that bill which specifically repealed the mess they made of the 1099 situation in the healthcare bill. And guess what happened? It failed. It failed on a 46 to 52 vote.

Again, every single Republican voting to put that amendment on this bill, which, by the way, is now law and which would have repealed the 1099 problem. Every single Republican voted for that amendment and we were joined by some of our colleagues on the other side of aisle.

If the brave people who introduced this bill to repeal this had voted with us on September 14, 2010, we would not even be here talking about this today.

In any event, to add insult to injury, that particular amendment has been put in the form of a bill, and the Republicans yesterday, I am told, tried to hotline that bill. Now, that is a procedure where you can push this thing through here and get it passed and get it into law, and I am told my good friends on the other side of the aisle have objected to the use of the hotline.

So, guess what, the 1099 problem is not going to go away. My only point is if we are going to pass out medals, we ought to maybe adjust the size of the medals everybody's going to get for bravery. We want this done and we are going to continue—we are going to

continue to push this. We are going to try to hang it on every bill that goes through here and sooner or later the American people are going to get a hold of their Senators and Representatives by the throat and say, look, we do not want this.

And Mr. Harris, with all due respect, you said you wanted one day, we spent a year shouting from the top of this building that this is what was going to happen if this healthcare bill passed. So, it was more than a day, we spent a year at it, but we could not get it done.

But, I want to promise you this and I want to commit to you this, we are not done. We are going to continue every day, all day, to try to get this 1099 problem resolved because as long as I have been in public service, which is almost all my adult life, this issue probably rises as high as any other issue I have ever seen as far as affecting small business and as far as raising the ire of small businessmen, so thank you very much. Thank you, Madam Chair.

Chair LANDRIEU. Thank you, and I will end the meeting. I would like to comment, though, and I am sorry that it has had to end on a little bit of an argumentative note here because we started out, I think, in a very bipartisan fashion but I do want to respond.

From our perspective, Senator Risch, we did not shove the bill down your throat, we gave you a year to come up with a way to provide Americans with healthcare that every other country in the world, at least developed country, has figured out a way to cover their people and we have not, and you all declined, and we ended up having to pass a bill with only Democrats, none of us passing the bill or voting for it ever said it was perfect, and we recognize that there are portions that must be adjusted as we move along and we are prepared to do that.

Secondly, the bill that you all voted for on the floor on September 14th had an offset that you knew when you introduced it was totally unacceptable to the Democrats and you did it in a very partisan, obnoxious way, in my view, and so that is why we did not vote for it.

And I want this public to be very clear about this, there were amendments put on the floor, both by Democrats and Republicans to repeal 1099, but both leaderships put offsets on that that the other side could not vote for. So, that is why some of us have been working honestly for the repeal of 1099 to find an offset both sides could agree to, and that is what this Chairman has led that effort and I will continue to.

So, I do not want Mr. Nannis to have to debate this with Senator Risch. I will be happy to debate it here on the floor, but the meeting is adjourned.

[Whereupon, at 12:01 p.m., the Committee was adjourned.]

○