

**TARGETED TAX REFORM: SOLUTIONS TO RELIEVE  
THE TAX COMPLIANCE BURDENS  
FOR AMERICA'S SMALL BUSINESSES**

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**HEARING**

BEFORE THE

**COMMITTEE ON SMALL BUSINESS  
AND ENTREPRENEURSHIP  
UNITED STATES SENATE**

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

\_\_\_\_\_  
JULY 22, 2015  
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ONE HUNDRED FOURTEENTH CONGRESS

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# **TARGETED TAX REFORM: SOLUTIONS TO RELIEVE THE TAX COMPLIANCE BURDENS FOR AMERICA'S SMALL BUSINESSES**

**WEDNESDAY, JULY 22, 2015**

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

The Committee met, pursuant to notice, at 10:07 a.m., in Room 428A, Russell Senate Office Building, Hon. David Vitter, Chairman of the Committee, presiding.

Present: Senators Vitter, Fischer, Gardner, Ernst, Ayotte, Enzi, Shaheen, Cantwell, Heitkamp, and Coons.

## **OPENING STATEMENT OF HON. DAVID VITTER, CHAIRMAN, AND A U.S. SENATOR FROM LOUISIANA**

Chairman VITTER. Good morning, everyone, and welcome. The hearing of the Senate Small Business Committee will come to order. Thanks for joining us today to examine targeted solutions to relieve the tax compliance burden for America's small businesses.

We will be hearing today from two panels of witnesses. The first is a panel of small business owners who will offer their own experiences on tax compliance, and then the second panel includes representatives from small business advocacy groups, two of which are also small business owners. I want to thank all of our witnesses today for being here and testifying.

As Chair of this Senate Committee on Small Business and Entrepreneurship, I have really had the pleasure of partnering with business owners and their advocates to address many issues. In my discussions with that community, there is one that is raised really more than any other, and that is the burdensome federal tax code and the burden of compliance because of its complicated nature.

The administrative burden of tax compliance is now a greater strain on small businesses than even their tax liability, according to an NSBA small business survey. I do not need to tell the business owners here today about that burden because you all live it every day. But, I do want to describe it for the others in attendance so they can better grasp what we are talking about.

The federal tax code now is about 74,000 pages long. That is about four million words. And, it is continuing to grow, really, with no end in sight. Under this Administration, it has already grown approximately 7,000 pages. And just for some historical perspective, the code was only 400 pages long when it was first created.

While it is convenient to think that only a company's CPA needs to be able to navigate such a behemoth, the reality is that the business owner must be up to date on scores of yearly changes in order to stay in compliance him or herself. So, I think it is safe to say that every single business owner would much rather focus his or her time and energy on growing the company.

Next, according to the National Federation of Independent Businesses, small businesses annually spent 1.7 billion hours on tax compliance—that is billion with a “b”—and \$15 to \$16 billion on compliance costs. To put it another way, that is over 194,000 years' worth of time spent cumulatively to comply with all the rules and regulations.

To bring it down to hours we can actually wrap our heads around, nearly 40 percent of small businesses spend 80 hours or more a year on tax compliance, and a quarter of all small businesses spend more than 120 hours. And that does not even take into account state and local income, sales, property taxes, etc. That is just the federal compliance burden. Imagine if those billions of hours spent complying with the IRS could actually be spent on focusing on the business and job growth.

Finally, the cost of compliance to small businesses is 70 percent higher than bigger firms, and the reason is simple. Small businesses simply do not have the army of accountants and tax attorneys that much bigger entities have. So, clearly, it is a disproportionate burden and hindrance to small businesses.

So, just to recap and offer some perspective on what a typical small business owner may face to remain in compliance, it is equivalent to navigating over five King James Bibles, takes up roughly two 40-hour work weeks, and it is the cost of taking your family to Disney World, all of that just to comply with the tax code. And, of course, I am not even talking about the actual liability, the actual burden of paying the bill.

While broad tax reform is certainly needed, small businesses should not have to wait for super-broad wholesale tax reform to have these compliance issues addressed in a common sense way. Congress can and should act on them right now.

And, so, today, I am filing a Small Business Tax Compliance Relief Act. We are going to talk about various parts of it here. That is the purpose of this hearing, to touch on those subjects, and I am certainly inviting all of the committee's input as we go to a markup in the near future. This provides relief from those provisions most often cited by small business as overly restrictive, confusing, or just really nonsensical to the small business. These are issues that have been raised at previous committee hearings and small business roundtables, and the legislation provides real solutions to those very real problems.

And even though wholesale reforms and tax rates are not touched, small businesses have indicated that addressing these specific issues would be a significant win to reduce their compliance burden in a substantial way. Or, in terms we can all understand, it helps a small business' bottom line even without touching the tax liability itself.

In addition, many of these provisions enjoy broad support, as evidenced by the many groups that have signed on to supporting this,

and I have a stack of those letters of support. Let me just list the groups very briefly: the NFIB, National Federation of Independent Business, the National Small Business Association, LABI, the Louisiana Association of Business and Industry, the Angel Capital Association, the Louisiana Society of Certified Public Accountants, the Small Business and Entrepreneurship Council, the Small Business Investor Alliance, the Small Business Advocacy Council.

And, outside of those who have given their letter of support, we also have five groups endorsing the bill publicly, the American Institute of CPAs, the National Association for the Self-Employed, the Chamber of Commerce of Hawaii, the Colorado Association of Commerce and Industry, and the Greater North Dakota Chamber of Commerce. And, I would ask unanimous consent to make all of this part of the record. Without objection, so ordered.

[The letters appear in the Appendix.]

Many of these compliance solutions even have bipartisan support, and that is very significant, and we are continuing to build bipartisan support and take suggestions for this bill as we go to a markup.

In conclusion, small businesses are the job creators around America, but when you consider the burden of tax compliance that is placed on their shoulders, you may have to wonder how they stay open at all. It is an unfortunate truth, but Congress and the IRS simply do not often lean toward the options of small businesses when crafting laws and regulations, and it is certainly the mission of this committee to try to correct that and try to balance that out.

I am confident that our witnesses today can shed light on these and other issues. So, again, thanks to all of our witnesses. Thanks to all of the groups that have weighed in on this important issue.

And now, I will turn to our Ranking Member, Senator Shaheen, for her opening comments.

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

Senator SHAHEEN. Thank you, Mr. Chairman.

Welcome to all of our witnesses today and to our second panel. Thank you all very much for taking the time to be here today to testify.

I want to just explain to all of you that I am going to, unfortunately, have to leave before the end of the hearing to go to another briefing on the Iran negotiations, so I apologize for missing what I know will be very important discussion.

As Chairman Vitter explained, and as all of you know too well, our tax code is in desperate need of reform. It is too long, too complex, and it creates a burden on middle-class families and small businesses across this country.

When I hear from small businesses who are concerned about red tape, they are often talking about our antiquated tax code. As the Chairman said, of all the paperwork small businesses do to meet federal requirements, 80 percent relates to tax compliance. There is bipartisan agreement that we need comprehensive tax reform that simplifies the code and that creates a more level playing field for small businesses to compete with big business.

As the Finance Committee considers tax reform, it is important to explore every opportunity for supporting our nation's job creators. That is our small businesses, where two-thirds of the jobs that are created come from small businesses. In the past, this committee has advanced a range of measures to reduce the tax burden on small business. For example, the committee, working with the Finance Committee, helped craft the Small Business Jobs Act of 2010, which provided \$12 billion in small business tax relief.

I know the Chairman has introduced legislation this week, and I look forward to reviewing it and to working with him on it so that we can pass a bipartisan bill out of this committee.

I also look forward to hearing more from you all today about ways that we can help you as you are navigating the tax code.

I want to take a moment before I close to recognize a witness on our first panel, Ms. Cori O'Steen, the owner of UPakNShip in Akin, South Carolina. Ms. O'Steen has a great story of entrepreneurship. She started selling clothing on eBay to make ends meet, but found herself transitioning her business model to shipping supplies. Her company now has 15 employees and continues to grow.

I look forward to her testimony, because one of the things she is going to refer to this morning is the Marketplace Fairness Act, or as we call it in New Hampshire, the Unfairness Act. As we discuss ways to reform the tax code to make it work for small businesses, we need to make sure that we do no harm. The Marketplace Fairness Act would enable states to collect taxes from remote retailers with no physical presence in that state. This would impose huge new tax compliance burdens on entrepreneurs trying to grow their businesses through the Internet.

E-commerce has been a real boon to small businesses all across the country. It has helped companies find new markets for their products and new revenues. And I believe, and I appreciate that I think the Chairman agrees, that imposing a new Internet sales tax would be bad for small businesses and bad for the economy.

So, again, thank you all very much for being here. I look forward to hearing your testimony.

Chairman VITTER. Thank you, Senator Shaheen, and welcome to Ms. O'Steen.

Let me now introduce the two other witnesses on our first panel. Diana Beebe is CFO of ProSys, Inc. ProSys is an engineering and technology company headquartered in Baton Rouge, Louisiana. It specializes in providing alarm management, operator interface, and advanced control solutions to process industries around the world, and its recent growth has allowed it to expand with new locations in Houston and Cologne, Germany.

And next, I want to introduce Don Begneaud of Begneaud Manufacturing. Don founded Begneaud Manufacturing in 1978 in Lafayette, Louisiana. The business has grown from welding jobs out of the back of his truck to a precision sheet metal shop employing 50 people. Begneaud has used their "first mover" status to stay on the cutting edge of CO2 and fiber laser cutting, welding, perforating, bending, and other high technologies. And, Don also serves as a member of the Small Business Advisory Council at the state level and a member of the U.S. Chamber Small Business Council nationally.



Thanks to all of you for being here. Thanks in advance for your testimony, and we will start with Ms. Beebe.

**STATEMENT OF DIANA BEEBE, CHIEF FINANCIAL OFFICER,  
PROSYS, INCORPORATED, BATON ROUGE, LA**

Ms. BEEBE. Good morning, Chairman Vitter and distinguished members of the committee. My name is Diana Beebe, and I, along with my husband, Dustin, own an engineering and technology company that is headquartered in Baton Rouge, Louisiana. ProSys specializes in providing alarm management, operator interface, and advanced control solutions to the process industry. As a small company, we are very proud to employ teams of engineers, developers, and supporting staff who partner with our customers to provide a safe work environment in refineries and chemical plants around the world. Now, in addition to our office in Baton Rouge, we have recently opened offices in Houston and Cologne, Germany.

As a growing company, we must keep our eye on maintaining our competitive edge, and this means not allowing our time to be consumed by tasks that do not provide value. In many small businesses, including our own, the business owner wears many hats. The more time the business owner spends on taxes, the less time spent on hiring quality employees, innovating new products, and providing high quality service to our customer. The smaller the business, the more onerous each tax hour is. Many small businesses make bad decisions trying to minimize their tax burden, and for many small businesses, accounting is just simply reduced to tax accounting.

Good business behavior of understanding your true costs of delivering your goods and services to the marketplace is replaced by business decisions for tax purposes. We spend way too many accounting hours just on tax credits and compliance and too few accounting hours on producing financial and budget statements, analyzing the income and costs, and helping the business making wise financial decisions that will continue to build a strong, stable company.

Mr. Chairman, your recently introduced Small Business Tax Compliance Relief Act offers numerous common sense compliance solutions that businesses have been requesting for years and are steps in the right direction. Increasing the cash flow accounting threshold from \$5 million to \$10 million will move out a looming deadline and allow us to have a staff in place to handle the burdens of transitioning to accrual accounting. It is tough for a small business owner to understand having to pay taxes on money that they did not earn.

Another provision in the bill addresses limits on the amounts that can be deducted for certain types of expenditures. Now, certain of these amounts are so small that it renders them ineffective and basically reverses the original intent. It makes sense to adjust these amounts and index them to inflation to be in line with the original intent.

A complex tax code with frequent changes is a threat for small businesses that are trying to produce value for customers, employees, and business owners. Large complex legislation provides uncertainty and benefits large corporations that have the resources to

analyze the impact this legislation has to their market sectors and businesses. This is why many small businesses see big government and big business going hand in hand.

I am encouraged that there are provisions in the Small Business Tax Compliance Relief Act that will remedy the “gotcha” mentality that, correctly or incorrectly, many small businesses believe to be pervasive within the IRS. Including the IRS under the purview of the Office of Advocacy to better enforce the Regulatory Flexibility Act and the Small Business Regulatory Enhancement Flexibility Act, and requiring IRS to convene SBREFA panels that include small business representations are good steps in making sure that rules and regulations issued are sensible and reflective of the small business reality. Now, small businesses also welcome further efforts from IRS to lay out tax provisions in layman terms to minimize the burden and the cost of compliance.

We would not have made it today without great employees. We have quite a few employees that have been loyal for a number of years, through good times and bad times. One of the ways we stand by them is providing a great benefit package. We have always offered a full benefit plan including health care, 401(k), short-term and long-term disability, group term life, and dental. Like many small businesses, we have been locked into our grandfathered plan for some time and we are fearful that we could experience a cost increase due to ACA that will put us at a disadvantage to large self-insured corporations. The financial resources that we anticipate we will set aside to further grow our business will have to be held back to be sure we can continue to offer excellent benefits to employees. And, further, self-employed business owners, unlike other businesses, cannot fully deduct the costs of own health insurance as ordinary business expense and, therefore, increase payroll tax burden.

In conclusion, as a small business owner, I am encouraged that members of Congress listen to the people and are working to a simple, fair tax code.

And, I appreciate the opportunity to speak with you today and I will be glad to answer any questions that you have. Thank you.

[The prepared statement of Ms. Beebe follows:]

Testimony  
Diana Beebe  
Business Owner, Treasurer of ProSys, Inc.  
July 22, 2015

Good Morning Chairman Vitter and distinguished members of the committee. My name is Diana Beebe, and I along with my husband, Dustin, own an engineering and technology company headquartered in Baton Rouge, Louisiana. ProSys specializes in providing alarm management, operator interface, and advanced control solutions to the process industry. As a small, growing company, we are proud to employ a team of engineers, developers, and supporting staff who partner with our customers to provide a safer work environment in refineries and chemical plants around the world. In addition to our office in Baton Rouge, we have offices in Houston and Cologne, Germany.

As a growing company we must keep our eye on maintaining our competitive edge. This means not allowing our time to be consumed by tasks that do not provide value. In many small businesses, including our own, the business owner wears many hats. The more time the business owner spends on taxes, the less time spent on hiring quality employees, innovating new products, or providing high quality service to our customers. The smaller the business the more onerous each tax hour is. Many small businesses make bad decisions trying to minimize their tax burden. For many small businesses, accounting is simply reduced to tax accounting. Good business behavior of understanding your true cost of delivering your goods and services to the marketplace is replaced by business decisions for tax purposes. We spend too many accounting hours on tax credits and compliance and too few accounting hours on producing financial and budget statements, analyzing income and costs, and helping the business make wise financial decisions that will continue to build a strong, stable company.

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A complex tax code with frequent changes is a threat for small businesses that are trying to produce value for their customers, employees, and business owners. Large complex legislation provides uncertainty, and benefit large corporations that have the resources to analyze the impact these legislation have to their market sectors and businesses. This is why many small businesses see Big Government and Big Business going hand in hand.

I am encouraged that there are provisions in the Small Business Tax Compliance Relief Act that will remedy the "gotcha" mentality that, correctly or incorrectly, many small businesses believe to be pervasive within the IRS. Including the IRS under the umbrella of the Office of Advocacy to better enforce the Regulatory Flexibility Act and the Small Business Regulatory Enhancement Flexibility Act and requiring IRS to convene SBREFA panels that include small business representations are good steps in making sure that rules and regulations issued are sensible and reflective of the small business reality. Small businesses welcome further efforts from IRS to layout tax provisions in layman terms to minimize the burden and cost of compliance.

We would have not made it to where we are today without great employees. We have quite a few employees that have been loyal for a number of years through good times and bad. One of the ways we stand by them is providing a benefit package. We have always offered a full benefit plan including: healthcare, 401k, short-term and long-term disability, group term life, and dental. Like many small businesses, we have been locked in to our grandfathered plan for some time. We are fearful that we could experience a cost increase due to ACA that would put us at a disadvantage to large self-insured corporations. The financial resources that we anticipate we will set aside to further grow our business will have to be held back to be sure we can continue to offer excellent benefits to employees. Further, self-employed business owners, unlike other businesses, cannot fully deduct the cost of own health insurance as ordinary business expense, and therefore increase payroll tax burden.

In conclusion, as a small business owner, I am encouraged that members of Congress listen to the people and are working toward simple, fair tax code.

I appreciate the opportunity to speak to you today, and I will be glad to answer any questions you might have.

Chairman VITTER. Thank you very, very much.  
And next, we will hear from Don Begneaud. Don.

**STATEMENT OF DON BEGNEAUD, FOUNDER/OWNER,  
BEGNEAUD MANUFACTURING, LAFAYETTE, LA**

Mr. BEGNEAUD. Okay. Thank you, Chairman Vitter. First of all, I was about to say, because of my reading disability, I was going to not read this and I was just going to talk, but the more I think about it, let me still take a stab at just reading—

Chairman VITTER. Sure. However you would like.

Mr. BEGNEAUD [continuing]. And please bear with me.

So, in my 37 years of business, I have been no stranger to the burdens that small businesses face, particularly those that tax can bring. The expected financial burden taxes place on businesses is expanded to include an administrative burden when the business is small. Operating on limited monetary resource and staff, the majority of small businesses make a sincere effort to remain in compliance with the regulations, but frequently find themselves faced with administrative burdens that tie up their limited resources.

I come before you to offer my support for the targeted tax reform that Senator Vitter is proposing. Having affected change in taxes at the local and state level through influence and inspiration, I feel it is necessary to be here in support of the outlined initiatives that are sure to have an impact on my business, Begneaud Manufacturing, and in particular, in support of the overall spirit of cooperation and collaboration. This bill makes specific efforts to ensure that government and businesses are working together instead of opposing, and in doing so, making strides towards a common goal.

A couple of key provisions in the bill stand out for me as being in service of collaborative working partnerships. Requiring that the IRS include Small Business Review Panels for their input on potential impact shows a willingness to listen and learn from those who live the realities of small business ownership daily. Without lobbyists to represent their cause, small businesses rely on outreach from governmental agencies to help ensure their voices are heard. Instituting panels as a means to be certain that small business concerns are voiced solidifies the IRS's commitment to understanding the unfamiliar challenges faced by so many across the country.

This bill also grants authority to the IRS Commissioner to waive penalties and deadlines for businesses, as appropriate, if it is found that businesses have been acting in good faith. As I mentioned previously, the majority of the small businesses operate from the intent to stay in compliance. Confusing regulations with limited resources can lead businesses inadvertently falling out of compliance. It is refreshing to see that this bill seeks to put emphasis on correcting the actions of small businesses and going forward as opposed to punishing their attempts.

A common term in political rhetoric today is "fight." Fighting for and against does not leave us with much energy to do anything else.

In Louisiana, many of my colleagues fought against a state use tax for years without much headway. Only through our influence of Governor Blanco were we able to achieve what so many had

fought for, achieving good change for the state. In her statement about the bill, attached, she mentioned how powerful and simple active influence was. Government and businesses so often fight each other, working in opposition, with each claiming that one must suffer at the expense of the other. I firmly hope, though, that if both look to serve the other, it would benefit the whole.

My personal declaration that I have committed to, I am a commitment to inspiring others to collaborate, creating new value for all to enjoy. I believe that what Senator Vitter is proposing in this bill falls directly in line with my values. The proposed bill includes excellent steps towards our government making a good faith effort to work with small business and meet them where they are. I offer you my full support and collaboration effort.

[The prepared statement of Mr. Begneaud follows:]

Donald Begneaud  
Founder/Owner  
BEGNEAUD Manufacturing

July 20, 2015

In my 37 years of business, I've been no stranger to the burdens that small businesses face, particularly those that taxes can bring. The expected financial burden taxes place on businesses is expanded to include an administrative burden when the business is small. Operating on limited monetary resources and staff, the majority of small businesses make a sincere effort to remain in compliance with the regulations but frequently find themselves faced with administrative burdens that tie up their limited resources.

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A common term in political rhetoric today is "fight." Fighting for and against causes does not leave us with much energy to do anything else. In Louisiana, many of my colleagues fought against a state use tax for years without much headway. Only through our *influence* of Governor Kathleen Blanco were we able to achieve what so many had fought for, affecting good change to the state use tax. In her statement about the bill, attached, she mentioned how powerful the simple act of influence was. Government and business so often fight each other, working in opposition, with each claiming that one must suffer at the expense of the other. I firmly hold, though, that if both look to serve the other, it would benefit the whole.

My personal declaration states that "I am a commitment to inspiring others to collaborate, creating new value for all to enjoy." I believe that what Senator Vitter is proposing in this bill falls directly in line with my values. The proposed bill includes excellent steps towards our government making a good faith effort to work with small businesses and meet them where they are. I offer you my full support of this collaborative effort.

Chairman VITTER. Thank you very much, Don. Thanks for your testimony.

And now, we will turn to Ms. O'Steen. Welcome.

**STATEMENT OF CORI O'STEEN, OWNER, UPAKNSHIP, RANCHO CUCAMONGA, CA**

Ms. O'STEEN. Thank you. Chairman Vitter, Ranking Member Shaheen, and members of the committee, thank you for holding this important hearing and for inviting me here to participate. My name is Cori O'Steen and I own and operate UPak, Incorporated, an online company that sells shipping supplies and custom packaging.

I stumbled upon eBay in 2003 while looking for discount brand-name clothing for my children. I immediately started selling my children's outgrown clothing in an effort to make ends meet. I could not find the shipping supplies I needed then, but my father was in the packaging business. I bought two cases of poly mailers, our flagship product, and I planned to sell what I did not need. While I did not realize it at the time, our business was born.

Like most small businesses, my expectations in the early days were modest. But, I am one of the fortunate small business success stories. What started as a single mother packing orders in her family room as a way to earn money while being at home with her kids has grown into a business which today employs 15 people and has warehouses in California and South Carolina.

It is hard for me to believe that my business is now 12-and-a-half years old. Its existence at times has been a turbulent one. We have lived through some economic highs and certainly some economic lows, but we are surviving, and I attribute a lot of that to the relative ease with which I am able to reach new customers and new markets through the Internet. Today, I operate web stores on Amazon and eBay and I have created my own Web site, UPakNShip.com.

I applaud the committee for holding this hearing today. As a small business owner, tax compliance is certainly a major concern of mine and I welcome the opportunity to discuss how we can relieve any unnecessary burdens. If one purpose of this hearing is to identify policies that would create significant tax compliance burdens for small businesses, then I encourage you to look no further than the Marketplace Fairness Act and its counterpart in the House, the Remote Transactions Parity Act.

These proposals, written without apparent regard for small businesses that use the Internet, fundamentally fail to appreciate the incredible burden associated with complying with thousands of dynamic, remote sales tax rates and rules across the country. These bills also expose businesses like mine to new audit and litigation liabilities.

While I understand that states want to collect revenue, requiring businesses to do this work on their behalf is a bad solution for small businesses. This is especially true for small businesses that have chosen to reside in states like New Hampshire, that have fewer regulatory burdens and do not require sales tax collection.

I do not believe that states should be able to export their laws to another jurisdiction. I believe the constitutional nexus limita-



tions exist for a very sound reason. Simply, it protects my business from abusive cross-border enforcement from remote jurisdictions.

The Marketplace Fairness Act and the Remote Transactions Parity Act represent a complete departure from that principle. Instead, these bills would subject my business to the legislative, executive, and judicial whims of a remote taxing jurisdiction, but foreclose my access to any public benefit or recourse at the ballot box.

Although I understand that this specific issue is not in your jurisdiction, as members of this committee, you will have an important responsibility to protect small businesses. As you consider ways to improve tax compliance for small businesses, I urge you to be cautious of bills like these that would create new regulatory burdens for businesses like mine and others across the country.

Thank you again for allowing me to testify this morning. It is important that Congress hears the small online business voice in this discussion, and I look forward to answering your questions.

[The prepared statement of Ms. O'Steen follows:]

**Testimony of Cori O'Steen**

Owner, Upak, Inc.

U.S. Senate Committee on Small Business and Entrepreneurship

*"Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burdens for  
America's Small Businesses"*

Chairman Vitter, Ranking Member Shaheen, and Members of the Committee –

Thank you for holding this important hearing and for inviting me here to participate. My name is Cori O'Steen, and I own and operate Upak Inc., an online company that sells shipping supplies and custom packaging. I stumbled upon eBay in 2003 while looking for discount brand name clothing for my children. I immediately started selling my children's outgrown clothing in an effort to make ends meet. I could not find the shipping supplies I needed then but my father was in the packaging business. I bought 2 cases of poly mailers, our now flagship product, and I planned to sell what I did not need. While I did not realize it at the time, our business was born.

Like most small businesses, my expectations in the early days were modest. But I am one of the fortunate small business success stories. What started as a single mother packing orders in her family room as a way to earn money while being at home with her kids has grown into a business which today employs fifteen people and has warehouses in California and South Carolina.

It's hard for me to believe, but my business is now twelve and a half years old. Its existence, at times, has been a turbulent one – we have lived through some economic highs and certainly some economic lows. But we have survived, and I attribute a lot of that to the relative ease with which I am able to reach new customers and new markets through the Internet. Today, I operate web stores on Amazon and eBay, and I have created my own website, upaknship.com.

I applaud the Committee for holding this hearing today. As a small business owner, tax compliance is certainly a major concern of mine, and I welcome the opportunity to discuss how we can relieve any unnecessary burdens.

If one purpose of this hearing is to identify policies that would create significant tax compliance burdens for small businesses, then I encourage you to look no

further than the Marketplace Fairness Act and its counterpart in the House, the Remote Transactions Parity Act. These proposals, written without apparent regard for small businesses that use the Internet, fundamentally fail to appreciate the incredible burden associated with complying with thousands of dynamic remote sales tax rates and rules across the country. These bills also expose businesses like mine to new audit and litigation liabilities. While I understand that states want to collect revenue, requiring businesses to do this work on their behalf is a bad solution for small businesses. This is especially true for small businesses that have chosen to reside in states like New Hampshire that have fewer regulatory burdens and do not require sales tax collection.

I do not believe that states should be able to export their laws to another jurisdiction. I believe the Constitutional nexus limitation exists for a very sound reason – simply, it protects my business from abusive cross border enforcement from remote jurisdictions. The Marketplace Fairness Act and the Remote Transactions Parity Act represent a complete departure from that principle. Instead, these bills would subject my business to the legislative, executive, and judicial whims of a remote taxing jurisdiction but foreclose my access to any public benefit or recourse at the ballot box.

Although I understand that this specific issue is not in your jurisdiction, as members of this committee you all have an important responsibility to protect small businesses. As you consider ways to improve tax compliance for small business, I urge you to be cautious of bills like these that would create new regulatory burdens for businesses like mine and others across the country.

Thank you again for allowing me to testify this morning. It's important that Congress hears the small online business voice in this discussion, and I look forward to answering your questions.

Chairman VITTER. Thank you very much, Ms. O'Steen.

As we said before, because Senator Shaheen has to go to an Iran briefing soon, we will start with her.

Senator SHAHEEN. Thank you very much, Mr. Chairman, and again, thank you to all of our witnesses for your testimony this morning.

Ms. O'Steen, I am going to begin with you because you mentioned the Internet sales tax legislation and talked about the compliance burden that that would put on small businesses. Now, one of the things that has been proposed as part of the legislation is to offer software to small businesses to help them with that compliance. But, can you talk about whether you think that would address the concerns you have about compliance.

Ms. O'STEEN. No, it does not, because currently, such software do not exist, and I, for one, sell across many channels. I have five different channels. I sell on eBay, Amazon, my own Web site, I sell through POs and invoicing customers directly, then also a retail type of establishment for walk-in customers. And, I do not believe that the software could be made that could possibly comply with all the different channels people sell on. I just do not think it is possible. People, they build their own Web sites from scratch. I do not know how a software developer can predict how something is going to work on somebody else's homemade Web site. So, while they could figure out on large platforms how to make it compliant, on small ones, it just—I do not see how it could ever be.

Senator SHAHEEN. Thank you. I share that skepticism.

Mr. Begnaud, you talked about the importance of cooperating between business and government to address the concerns that you have. It is an issue that I share, and I applaud the changes you were able to make in Louisiana state tax law to address some of your concerns. Certainly, advocacy is one of the ways to address these issues.

Can you talk about what particular in the tax code you think would be important to change to make it fairer for small businesses. Are there any specifics that you have seen that you would like to see?

Mr. BEGNEAUD. Well, right off the bat, the problem has been the continuous change, and the CPAs of the world, they have to continually go back to school to just learn how to, you know, properly file to keep us in compliance. I can give you an example right now.

Senator SHAHEEN. Sure. That would be great.

Mr. BEGNEAUD. Okay. Just this—from last year's tax return, there has been a change that we no longer can expense our repairs, and believe me, we have high tech, multi-million-dollar machines on our floor that takes a lot of upkeep and repair and we are having to capitalize that vs. expense it, okay. And, so, now my CPA has had to hire a consultant to help him on filing our return because it is so cumbersome. So, now, that is going to come at more cost for us. Our tax return has been delayed. And then to top it off, we have just been hit with identity theft within the IRS, and so it is further putting more burden on us right now. But, it is just so complex that it comes at a cost to us. And when we need to be spending our time being more efficient serving our customers, it is quite challenging.

Senator SHAHEEN. And, the identity theft that you mentioned, was that part of the Office of OPM at the federal level that has been publicized?

Mr. BEGNEAUD. I really cannot answer that. I do not know, other than we had received information from the IRS about, you know, this tax return that we had already filed, and it was not from us.

Senator SHAHEEN. Thank you.

Ms. Beebe, what are—again, talking about the compliance challenges that you face, are there resources that could be available to you through the Small Business Administration or through other efforts that might help you with some of the compliance challenges that you are facing?

Ms. BEEBE. Well, currently, I have actually just recently had to hire a bookkeeper to keep track of all the tax compliance that I have, and that is an additional cost that we have incurred as we are growing. For our business, as we are growing, we are entering a very critical stage. We are growing internationally and also in Houston. In order to have that additional expense just to hire someone to do the tax compliance, you know, is a burden on us, so—

Senator SHAHEEN. Mr. Chairman, I am about out of time, but if I could just follow up, you talked about the potential for international business, which is one of the things that I have been very concerned about as we help small businesses get into international markets. How did you happen to open an office in Cologne, and what resources would be helpful to you as you are looking at the ability to export?

Ms. BEEBE. Yes. We opened our—we want to open an office anywhere in the world as long as we can service the customer. That is the number one thing for our business. Well, we have a gentleman who actually owns an engineering company there that has some contracts with some refinery over there, and we have—my husband and I have the opportunity to purchase that company from him. So, that kind of started our adventure in having an international business.

Some of the resources that would be helpful for small business is actually territorial tax system. Some of the, you know, money that we earn overseas that has already been taxed overseas, if at any point in time we are to bring it back to the United States, we have to be taxed again, and that just really did not leave a lot of money left for us to grow our business. We want to grow internationally. We want to employ and send United States people who have specialized in certain skills overseas, you know. So, that would be a big help, some form of territorial tax system.

Senator SHAHEEN. Thank you very much. Thank you, Mr. Chairman.

Chairman VITTER. Thank you.

And next, we will go to Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman, and thank you for holding this timely hearing on tax compliance relief for small business.

I was in small business. I had a shoe store. Actually, I had three shoe stores. But, even though I understood those stores, one of the things that I do as a Senator is go into different businesses as I travel back to Wyoming pretty much every weekend because I

found that any business that I have not been involved in, the decisions look pretty easy. But once you get to see what the decisions are and how far in advance they have to make them and how complicated they are, and that is even before the government gets involved, it is pretty impressive that people are willing to do that, able to do that, and extremely successful doing that. It does take some fortitude.

I am on the Finance Committee and the Finance Committee makes the ultimate decisions on the taxes. I appreciate Senator Vitter having his bill, which we will emphasize in the Finance Committee and try and get those through.

Ms. Beebe, I appreciate your comments on the territorial tax. I wrote an international tax piece that I think would greatly reduce the taxes for businesses and make it more possible for them to bring their revenue home once they earn it, which, of course, brings me to pass-through profits that small businesses have.

We are talking about doing some corporate tax reform. But, a lot of the businesses—most of the businesses in the United States, when they earn a profit, they have to pay the taxes on it that year, even though they cannot take it out of their business at that point in time because they have to keep reinvesting it to grow their business, as you all know. So, we want to make sure that whatever advantages go to the big corporations, they certainly also go to the pass-through corporations.

We just did some regulation hearings in the Oversight Committee for Government and found out a lot more about how many costs there are to doing those things. I appreciate all of your suggestions.

I have been working on marketplace fairness for a long time, though, so I do have to make a couple of comments and maybe ask a couple of questions in regard to that, because, again, when I was in small business, and it is even more prevalent now with the phones and the barcodes and things, in a retail store, people come in and they get the full explanation of exactly how something works and exactly what they need, and then they look it up on their phone and they find out they can get it cheaper online. And, often, that cheapness is just the difference in sales tax. And, so they order it right in front of the store owner and he knows that it is just that sales tax thing that is keeping him from getting the business, and that is where the Marketplace Fairness Act came from.

Now, Ms. O'Steen, you mentioned that you sell stuff on eBay and on Amazon. I know that Amazon already collects the sales tax for people and it does all the distributions. eBay has a subscription that they can do that takes care of the software problem, because they—for a small subscription, they will collect the tax and make the distributions for the tax. But, the most important thing that we had in Marketplace Fairness was a small business exemption, and that was at a million dollars in sales annually. Until a company gets to a million dollars in sales annually, they do not have to comply with it at all, and that number is up for negotiation, because on the House side, they have a remote transaction thing at \$5 million. So, you might be more in favor of the House bill than the Sen-

ate bill, although they are very, very similar and get to the same point, again, just to make it fair for the brick-and-mortar folks.

I will submit some questions, since I have used up the time that you could answer those questions. But, the SBA Office of Advocacy estimated that 99.9 percent of online businesses would be exempt under the million-dollar provision.

So, with that, I will yield back my time.

Chairman VITTER. Okay. Thank you very much, Senator Enzi.

Next, we will go to Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

I want to just kind of follow on with Senator Enzi's line of reasoning, but before I do this, I want to talk or ask Ms. Beebe, as you work internationally, especially in Europe, are you subject to a Value Added Tax in any of those jurisdictions?

Ms. BEEBE. We have—the way it is set up—the way we have set up our business is a whole separate entity over in Germany and they have a whole different tax system over there.

Senator HEITKAMP. Right. That would be the point, though. As you are saying, corporate income tax is comparable with a territorial tax, we need to look at the overall tax burden. Obviously, the United States has elected not to do a Value Added Tax, although typically in Europe, a Value Added Tax is the major revenue producer for most of the countries. And, so, we just want to make sure that when we are talking about comparing apples to apples, that we actually have the same kind of set of facts.

And, so, I just want to kind of lay that down that it is important that the United States has elected to have a system where we allow for a foreign tax credit. That is something that is an anomaly in international taxation, something that we need to look at. I am not saying I am opposed to the territorial tax, but let us not just take two pieces of a tax structure and compare them and say these are equivalents.

I want to talk to Ms. O'Steen for just a little bit. You know, let me give you an example. I have a lot of people in North Dakota who do exactly what you do, and when a North Dakota customer comes to their store, they are subject to the state sales tax along with any kind of local tax that they are subject to.

Do you not think one of the primary elements of taxation is that people who do exactly the same thing ought to share the exact same burdens?

Ms. O'STEEN. Yes, I do agree with that, but the Marketplace Fairness Act was not leveling the playing field. What the Marketplace Fairness Act is doing is asking me to remit sales tax based on a customer location. When I go shop at a retail store, I am charged based on the retail store location.

Senator HEITKAMP. That is not exactly true. If you were a business who basically was audited, you would be subject to sale and use tax. That has been a compliance burden for years and years. There is not any state that has a sales tax that does not impose a corresponding use tax. And, so, I just want to give you the perspective of people who work in Main Street businesses who get asked to contribute to the local school fundraiser or do the Girl Scout thing.

And, there is a woman that we met a couple years ago who runs a pet store, and she specializes. She trained all of her employees to basically understand pet ailments and to recommend different kinds of pet products, pet nutrition products. Unfortunately, the jurisdiction she is in has a 10 percent sales tax. She was losing business every day. She also has a small Internet business that she runs. She is losing business every day because that 10 percent, she cannot compete against. But, yet, she is providing the customer with the service.

And, so, it is a very challenging issue, and I understand and appreciate what you are saying, but the more international and the more national our businesses become, the more important it is to really level the playing field, and I think Marketplace Fairness is an issue that cuts across small business. In fact, the people in my state who support Marketplace Fairness tend to be the small businesses who see the loss in sales every day because they cannot compete against a five, seven, 10 percent disadvantage.

And, so, what we have been trying to do, and just to catch everyone up, Justice Kennedy in a recent Supreme Court case revealed that if this case went to the Supreme Court again, he would vote the other way. He would vote to basically reverse the Commerce Clause limitations on Quill, which means that there is probably a five-vote majority, which means that if, in fact, the courts resolve this and not the United States Congress, what is likely to happen is there will not be a small seller exemption. There will not be a requirement for software and that people cooperate. There will not be restrictions on the number of audits. It will be wide open, and then you will be subject to jurisdiction from literally thousands of jurisdictions, as opposed to the streamlined process that has been set forth in Marketplace Fairness.

And, so, I think it is important that we not have the false choice of this or that, because right now, I think there are many Internet, or many Main Street businesses that are gearing up for a new Supreme Court case, in which case the table might be reversed and we might have small business Internet sellers in the Small Business Committee saying, please, please, please give us the protections that are being offered by the Marketplace Fairness bill.

And, so, this is an incredibly complicated issue. It is an issue of fairness, and I appreciate that this is challenging for small business, but it is really challenging for Main Street businesses that are competing unfairly and lose sales because of this problem. And, so, I, like Senator Enzi, would like to submit some additional questions, but thought it was important to make those two points as we move forward.

And, if I can just, Mr. Chairman, tolerate one more minute, on another committee that I am on, we are looking at streamlining kind of regulation. We are taking a look at what it means for small businesses as we look at other kinds of compliance burdens, including tax compliance burdens. We have a Web site called Cut the Red Tape. I hope that you all take advantage of that and send stories about other kinds of compliance burdens and tax compliance burdens, because we think we can do a much better job for small business in America.

Thank you, Mr. Chairman, for the extra time.



Chairman VITTER. Thank you, Senator.

And now, we will go to Senator Ernst.

Senator ERNST. Thank you, Mr. Chairman, and thanks to our witnesses today for appearing before us.

This has been very beneficial. Small business is something that we rely on across the United States, of course, for many of our employees. You generate so many more jobs, I think, than people realize. So, thank you for doing that.

I would like to get your opinion today on the various tax credits that exist out there. Lots of great small business tax credits, and I will get to your perspective in just a second. There is a small business in Cedar Rapids, Iowa, and it is actually three unique coffee shops in Cedar Rapids, and one of the things that they had mentioned to me was a burdensome process of applying for these various tax credits. And oftentimes when these businesses need an employee, again, small business, they needed those employees yesterday. I mean, they need them right away. They need someone that can get started immediately.

So, the process for applying for tax credits requires the employer to ask some really personal questions in an interview-type setting. Then they have to fill out lengthy forms—this is what they have communicated to me—and get them qualified. And then they can offer the job. And, that takes a lot of time, a lot of process.

And, one of the things these business owners mentioned to me is that it would make so much more sense, or be much more efficient, to have the employee start working and then apply for the credit after that employee has proven to be a successful hire.

And, I would just like to hear from you. I loved hearing from them about the challenges that they have with some of these different tax credits, but I would like to hear from all of you, if you have experienced applying for tax credits, what that process was like, if it could be done more efficiently, just in your own words some of those experiences. Ms. Beebe, if we could start with you, please.

Ms. BEEBE. Okay. Actually, my company had benefited from tax credit. About five years ago, when we are really seriously considering developing alarm management software, we have to heavily invest in R&D and hiring developers who specialize in that and program that software, and we were not aware—small business, we were not aware that there is R&D credit for it, and the only way we realized that there is an option to try to apply for is about three, four years later, and even then, it was a friend of a CPA who said that, hey, you have a technology, you are moving in that direction. This might be something that will help you grow. We are thankful for the credit, because it helped us to hire more developers and IT people in our company, but it comes three or four years later.

I think the biggest thing is, even though tax credits are good, there needs to be more tax reform to make things easier to understand. You know, we are in business to make a profit and not to get credits from government.

Senator ERNST. Great perspective. Thank you.

Yes, Mr. Begnaud.

Mr. BEGNEAUD. I had good experience with state tax credits. It was the Enterprise Zone. But, it did promote me hiring more people, and for the most part, everything went well with that until we reached 2008, when the economy started going down. We dropped from 78 employees down to 40 when we basically no longer could, you know, there was no more credit available for us because we were not still—we were not employing as many people. And, then, since that time, it has just been much more troublesome for us to even be able to have available the tax credits for us because we had dropped so far down. It has just been challenging in business general, all across the board.

Senator ERNST. Right.

Mr. BEGNEAUD. And, then, as far as the R&D tax credits, we did apply for one with the state, and we thought that we had everything all filed properly, and the state denied us on that. And, so, we had spent a bunch of money with a specialized CPA firm just to do the filing for us, just to find out that we got denied.

Senator ERNST. And, I think that is part of the challenge, is that even applying for a tax credit, you need someone else that you are hiring and bringing in—

Mr. BEGNEAUD. And not just your standard CPA. You are talking about the CPA firm that specializes, that understands the law itself.

Senator ERNST. Certainly. Certainly. Thank you.

And, very quickly, Ms. O'Steen.

Ms. O'STEEN. Honestly, we are too small. I know that there are tax credits available in the State of South Carolina for jobs credits, and we have done most of our hiring in the State of South Carolina, as we have only been there for, I believe, three years now—no, we are going on our fourth year—but we have missed out on them because our accountant is located in California and she is not familiar with those. So, I actually need to go find an accountant in the State of South Carolina that can handle the state taxes there—

Senator ERNST. The state ones.

Ms. O'STEEN [continuing]. Which is something I have not actually gotten around to. I have had my hands very full. And, so, I know we are missing out, but I do not know enough about the tax system. It is just so complicated, that I know we are paying more money than we should be and we are losing out on opportunity.

Senator ERNST. Right. Well, my time is up. I do appreciate your testimony today. Thank you very much.

Thank you, Mr. Chair.

Chairman VITTER. Thank you very much, Senator Ernst.

Now, we will go to Senator Ayotte.

Senator AYOTTE. Thank you, Chairman.

Ms. O'Steen, you talked about your business as a mother starting it on eBay as a way to sell clothing that your children outgrew. If there was an online sales tax collection requirement that would have required you to collect for over 9,000 tax jurisdictions and also, by the way, under the MFA you could be subject to audit in those 9,000 tax jurisdictions, do you think you would have pursued this business if you were worried about that?

Ms. O'STEEN. Definitely not. I would have maybe continued to do what I was doing, selling stuff around the house on eBay to try to just make a little extra money for my family just to get by, because, literally, we were in such a tight situation then that that is basically what it was, so that I could buy them new clothes.

But, if I had to pay those kind of—had that kind of tax compliance, I would not have started my own Web site. It would have been too overwhelming a thought. It is, like, a whole new taxation agency. So, it is like a secondary IRS, is what it is seeming like to me, which is, to me, just threatening that I would not want to open myself up to.

Senator AYOTTE. Yes. So, Senator Heitkamp asked you about the pet shop in North Dakota that is worried they have to collect 10 percent sales tax, and maybe these jurisdictions should think about dropping their taxes. I mean, that might be a way to solve this, rather than making businesses collect taxes for over 9,000 jurisdictions in the country. What do you think about that?

Ms. O'STEEN. Oh, yeah. I completely agree with you. The issue is the competition. I mean, we online are also charging—and I am not saying that this is a reason not to charge sales tax, but we are also charging shipping. So, we are dealing with lower margins. I mean, if government could help work with businesses and that would help them to at least—

Senator AYOTTE. Right.

Ms. O'STEEN [continuing]. Deal with what they have, or maybe they need to find a way to become more competitive, as well. And, we have to—we are always trying to find ways to become more competitive, working with very little. And, we also are in the same retail location, and it is very difficult for us, because we have—we ship to multiple jurisdictions in the State of California, so we are still paying jurisdiction tax all over the State of California.

Senator AYOTTE. I actually come from a state, the State of New Hampshire, that does not have a sales tax, and if we want to talk about fairness, the way that New Hampshire has decided to compete is by not having a sales tax. So, as we look at this so-called Marketplace Fairness, it is really a money grab from Washington to allow other states to require states like mine, who have made a choice to be competitive by not having a sales tax, to require our businesses to become the tax collectors for the nation.

Senator Heitkamp talked about how you could be subject to the use tax, too. Well, there is a big difference between the use tax and what they are talking about with this online sales tax, because the use tax—the collector for the use tax is the state or municipality, not requiring the private business—yes, you could be subject to asking for information for that use tax, but they are not asking you to collect the use tax. This is done by the actual state or the municipality. So, the government is collecting it.

You know, what is so unbelievable about this proposal is that they are asking businesses like you—here you are, a small business owner—to be the tax collectors and to take on that role for over 9,000 jurisdictions. What a mess.

I would say to these other states, decrease your sales tax. Be competitive. Be like New Hampshire. Do not just impose this big

Washington mandate to make these businesses become the tax collectors for the nation.

I know that Senator Enzi, whom I have a great respect for, talked about the small business exemption under both the Senate MFA proposal and the House proposal. Well, the House proposal actually phases out the small business exemption after three years, so, yes, you can be small for three years, but then become a tax collector for the country. And then, also, if you have an eBay business, that does not have an exemption whatsoever.

And, so, as you look at this small business exemption, one of the things to be aware of, it sounds good on paper, but the people here who want to collect an online sales and the states who want the money, eventually, they are going to want that money from small businesses too.

I just appreciate your hard work in starting your own business and I am going to do everything I can to fight this money grab and the requirement that would make businesses like yours, or larger businesses, or businesses across this country become the tax collectors for over 9,000 jurisdictions in this country. By the way, I got that wrong. It is not electronics. It is electronic marketplace that is exempt. So, eBay. So, that is a big issue. So, the House version actually, I think, puts you people, a lot of people who start their business and use eBay would be subject, apparently, to this.

But, in any event, I just do not think this is a role for the federal government, and I have great respect for my colleagues like Senator Heitkamp and Senator Enzi, but this is one I do not think that we should be imposing on businesses across the country.

Chairman VITTER. Okay. Thank you, Senator Ayotte.

Thanks to all of our witnesses. I have several questions. I am going to submit those to the record, because we are a little squeezed for time and we have a very significant second panel and I do not want to be disrespectful to them. But, thank you all very, very much for your testimony, for being here.

And now, I will invite our second panel to come up and get seated. As they do, if you all could try to do it as quietly as possible, I am going to go ahead and begin to introduce them, in the interest of time.

Nick Karellas is Tax Counsel for the National Federation of Independent Business. Prior to joining NFIB in October of 2014, Nick worked as Tax Counsel to Representative Lynn Jenkins and for Senator Kit Bond. NFIB represents over 350,000 small business owners across the country in every region and every industry.

Next is Tom Mathison. He is principal and co-founder, along with his son, of Mathison | Mathison Architects, a full-service architectural and planning firm in Grand Rapids, Michigan. They have projects throughout several states in housing, K through 12 and higher education, commercial and institutional facilities. And, Tom is here today representing the National Small Business Association and sits on its Board of Trustees. He is also Past Chair of the Small Business Association of Michigan and Past Vice Chair of the American Institute of Architects.

Jeffrey Porter is a tax practitioner at Porter and Associates, based in Huntington, West Virginia, and he is the Immediate Past Chair of the Tax Executive Committee of the American Institute of

Certified Public Accountants and Chair of the AICPA Tax Reform Task Force. He is testifying today on behalf of the AICPA, the world's largest member association representing the accounting profession.

Caroline Bruckner is a Tax Professor at American University's Kogod School of Business. She is also the Managing Director of the Kogod Tax Policy Center, which conducts nonpartisan research on tax and compliance issues specific to small business and entrepreneurs. Prior to her appointment, Ms. Bruckner served on the staff of this committee as Chief Counsel, focusing on tax and budget issues.

And, finally, Dean Zerbe is the National Managing Director for alliantgroup. He is alliantgroup's National Managing Director based in the Washington, D.C., office, and prior to joining alliantgroup, he was Senior Counsel and Tax Counsel to the U.S. Senate Committee on Finance. Senator Coons invited him to speak to the importance of the R&D tax credit, specifically.

Thanks to all of you for being here, and we are looking forward to your testimony.

We will start with Mr. Karellas.

**STATEMENT OF NICHOLAS KARELLAS, TAX COUNSEL,  
NATIONAL FEDERATION OF INDEPENDENT BUSINESS**

Mr. KARELLAS. Good morning, Chairman Vitter and members of the Senate Committee on Small Business. I am pleased to be here on behalf of the National Federation of Independent Business as the committee explores ways to reduce the tax compliance burden on American small businesses.

NFIB is the nation's leading small business advocacy organization and we represent over 350 small businesses, and those businesses are in every region, in every industry, across the country.

The small business economy is slowly emerging from one of the worst recessions in U.S. history. NFIB's monthly surveys show that from 2008 to 2012, businesses reported poor sales were the number one problem, as consumer spending had sharply declined. But, now we see that taxes is now often the top concern reported in our surveys, a problem that is, no doubt, slowing our economic recovery. In fact, tax-related issues comprise five of the top 10 most severe problems for small business owners.

Following a promising string of improvements during the first months of this year, our small business optimism index showed signs of weakness among small business owners. Our June 2015 report showed that the optimism index plunged four points, to 94.1 points, the lowest point of this year and the most significant decline since November 2012, and this is well below our pre-recession average of 99.5. Small business owners reported that they plan to spend less and had weaker expectations for sales growth and business conditions over the next six months.

Regardless of their industry, our members consistently rank tax-related complexity and compliance burdens as their most difficult problems facing their business. Generally, these tax problems fall into three categories: costs, complexity, and the frequency of changes.

The cost of tax obligations for our members include the amount they pay in federal, state, and local taxes, the costs they have to pay to hire a CPA or tax advisor, and the owners' time that is required to put together the paperwork or file their taxes themselves. In fact, 88 percent of our small employer members have gone to hiring a tax preparer to deal with the complexity and to ensure their compliance with the code.

As mentioned by the Chairman earlier, compliance costs are especially problematic for our members. They are nearly 70 percent higher than for their larger counterparts. It costs them \$18 to \$19 billion a year, or about \$74 per hour.

Taking prudent steps to reduce the complexity and uncertainty in the tax code will promote smart business planning, increased compliance, while also reducing the burdens on these small business owners. In the end, it can be a win for the owners, their employees, the economy, and even the IRS.

A couple areas where simplification would ease the compliance burden are expensing and cash accounting. The tax code and the Treasury regulations that determine whether an expense is currently deductible or must be capitalized are one of the most difficult areas of the tax law. Navigating the over 200 pages of regulation requires performing a multiple-step facts and circumstances analysis for many of the most common purchases, regardless of their amount. Increasing the ability to expense even small dollar amounts would reduce the unnecessary compliance burdens that owners face in trying to comply with these complex capitalization rules.

Likewise, expanding the availability of the cash method of accounting is another example where Congress could act to provide compliance relief. The cash method is easier to use, easier to administer, and most closely matches the way that a small business owner will keep his books.

To sum up, the current tax code places an excessive burden on small business owners. Alleviating the significant costs associated with compliance is an essential component in creating a strong, healthy environment for owners to operate and grow their business.

I appreciate that the committee is taking a serious look at easing the tax code challenges facing American small businesses and look forward to answering any questions. Thank you.

[The prepared statement of Mr. Karellas follows:]



Testimony of

Mr. Nicholas Karellas  
*Tax Counsel*

Before the

**U.S. Senate Committee on Small Business and Entrepreneurship**

**Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burdens for  
America's Small Businesses**

July 22, 2015

Good morning Chairman Vitter and Ranking Member Shaheen, and members of the Senate Committee on Small Business. I am pleased to be here on behalf of the National Federation of Independent Business (NFIB) as the Committee explores ways to reduce the tax compliance burdens on American small businesses. On behalf of our members, thank you for the opportunity to provide our perspective on this important issue.

NFIB is the nation's leading small business advocacy organization representing over 350,000 small business owners across the country. Our members represent small businesses in every region and every industry across the country. The typical member employs about 8 to 10 employees with annual gross receipts of about \$500,000, with about 80 percent employing less than 40 employees. All members are independently owned, which is to say that none are publicly traded companies. Regardless of trade or industry, our members consistently rank tax-related issues, including tax code complexity and compliance burdens as among the most difficult problems facing in running their businesses.

### **Small Business Outlook**

The small business economy is slowly emerging from one of the worst recessions in U.S. history. NFIB's monthly Small Business Economic Trends (SBET) survey data shows the dramatic change in consumer spending, employment, owner's confidence and business investments throughout the recession and subsequent recovery<sup>[1]</sup>. While some business activities have made significant improvement over the past four years, capital expenditures and the outlook on business conditions and expansion remain at historically low levels due to economic conditions and the political climate. The threat of higher taxes whether in the form of income taxes, the healthcare law, the estate tax, section 179 expensing limits, or others creates enormous uncertainty among small business owners worried about the impact of policy changes on future business costs.

The SBET survey also tracks which problems most affect owners in operating their small businesses. From mid-2008 through mid-2012, "poor sales" was their number one problem as consumer spending had declined sharply. But now "taxes" is often the number one concern for small business owners, a problem that moderates the economic recovery in the small business sector. In fact, tax-related issues compromise five of the top 10 most severe problems for small business owners.<sup>[2]</sup>

However, following a promising string of improvements in owner optimism during the first months of the year, the most recent Small Business Optimism Index showed disappointing signs of economic weakness amongst small business owners. In the June 2015 report the Optimism Index plunged 4.2 points to 94.1, the lowest point of the year so far and the most significant decline since November 2012. The June Index was well below the pre-recession average of 99.5. Small business owners reported that they plan to spend less, and had weaker expectations for sales growth, expansion opportunities, and business conditions in the next six months. The report was a disappointing sign that economic growth on Main Street is not set for a strong

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<sup>[1]</sup> Dunkelberg, William C., and Holly Wade, *NFIB Small Business Economic Trends*, NFIB Research Foundation, series.

<sup>[2]</sup> Holly Wade, *Small Business Problems and Priorities*, NFIB Research Foundation. Washington, DC, series.



second half of growth. The weakness was substantial across the board, showing no signs of a growth spurt in the near future.

### **Small Business Tax Concerns**

#### *Complexity in the Tax Code*

Unlike their larger counterparts, the typical small business does not employ an in-house accountant or tax lawyer. For this reason, the complicated and unpredictable tax code, places a greater burden on small business owners. The burdens from tax compliance take money and time away from the day-to-day business operations or investing in and expanding their business. Small business owners must then absorb these costs, just like any other into their bottom line or pass them on to the customer in the form of higher prices.

The NFIB Small Business Problems and Priorities survey highlights three main areas of tax policy that are of great concern to small business owners<sup>1</sup>. The survey is a random sample of NFIB members asking them to evaluate 75 potential small business problems and assess the severity of each. The problems are then ranked by their mean score. According to our latest survey five of the top 10 problems are tax-related. These tax problems fall into three categories: cost, complexity and frequent changes.

The cost of tax obligations includes the amount paid to federal, state and local tax agencies, the cost of hiring a CPA or tax advisor to navigate complex tax codes, and the owner's time in providing the required paperwork and/or filing themselves. Eighty-eight percent of small employers use a tax preparer, and most use one to either ensure compliance or because the requirements are too complex. Tax-related regulations cause the greatest difficulties for 40 percent of small employers, more than environmental, health and safety, or employee-related regulations.<sup>2</sup> And compliance costs are especially problematic for small business owners as they are 67 percent higher for small businesses than for their larger counterparts, costing them \$18-19 billion per year, or about \$74 per hour<sup>3</sup>.

Tax-related costs compete with owners' time and ability to use limited profits for the core business activities. For owners, retained earnings are the primary funding source for purchasing new equipment, expanding, hiring and stocking inventory. It is their safety net during the inevitable periods of slow sales or other problems that can befall a small business. For businesses just starting out, tax-related costs are especially problematic because these businesses must almost exclusively rely on profits for operation and are generally not able to access traditional lending sources. Banks traditionally lend to more established firms that they know will be around to repay their debts, and not newer ones due to higher failure rates. However, regardless of the firm's age, tax burdens take a heavy toll on owners' ability to operate their businesses.

The federal tax code is only one layer of tax obligations owners face in operating their business. They must also comply with state and local taxes adding to the overall compliance burden. Unfortunately, only the owner experiences the cumulative effect of all the required taxes and

<sup>1</sup> Wade, Holly, *Small Business Problems and Priorities*, NFIB Research Foundation, 2012.

<sup>2</sup> Dennis, William J., *Tax Complexity and the IRS*, NFIB Research Foundation, Volume 6, Issue 6, 2006.

<sup>3</sup> <https://www.sba.gov/sites/default/files/advocacy/rs343.pdf>

regulations places on their business. Federal, state and local lawmakers and government agencies only see them in isolation, giving a false perception of their true impact. But it's the responsibility of the business owner to manage them all while trying to operate a profitable, successful business.

Taking prudent steps toward reducing complexity and uncertainty in the tax code will help to promote smart business planning, increase compliance, while also reducing the burdens on small businesses. In the end, this is a win for business owners, employees, our economy and even the IRS.

### *Expensing*

The tax code and accompanying tangible property regulations ("Repair Regulations"), determine when a business may deduct the costs for acquiring, repairing and replacing business property as an ordinary and necessary business expense, and when they must capitalize and depreciate that expense over a number of years. At more than 200 pages, the regulations are dense and difficult. For even the seasoned tax professional, trying to make sense of the regulations often results in at best an educated guess. For a small business owner, a simple decision of whether to repair, replace or upgrade a piece of business equipment requires performing a daunting and incomprehensible multi-step facts and circumstances analysis.

A common decision such as should the business pay to repair a broken refrigerator or air conditioner or buy a new replacement unit is no longer a pure business decision once tax considerations are included. The Repair Regulations require the owner, or pay their accountant to determine how many shingles can be replaced on their roof before that repair has become an "improvement," and those costs can no longer be immediately deducted. Similar questions arise for the business owner wanting to replace a window with a more energy efficient model or install safer systems for fire suppression or security. This inherent complexity for even the smallest purchases can force a small business owner to delay or cancel otherwise necessary, smart investments in their business and can lead disputes with the Internal Revenue Service (IRS).

Recognizing this complexity burden, recent Treasury regulations included a business-friendly safe harbor for small-dollar equipment purchases. Specifically, Treasury Reg. §1.263(a)-1(f) provides a de minimis safe harbor election that would generally allow a business to deduct certain equipment purchases and repairs based on a dollar threshold. However, the safe harbor election currently sets two threshold amounts: \$500 for taxpayers without an applicable financial statement (AFS) and \$5,000 for taxpayers with an AFS. Examples of an AFS include a financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders); and a certified audited financial statement that is accompanied by the report of an independent certified public accountant that is used for a substantial non-tax purpose. However, as most small businesses do have an AFS, the \$500 threshold is set too low to achieve its intended purpose.

The current \$500 threshold simply does not reflect the current small business environment and would fail to cover many standard repairs or common equipment purchases. The low threshold also discriminates against small business owners without an AFS. For example, while a larger business with an AFS could immediately deduct a \$1,500 computer purchase or the cost to replace an air conditioner condenser, their small business competitor might be forced to

capitalize and deduct the same cost over a number of years. A meaningful increase the safe harbor is even more important given the constant expiration and extension of Sec. 179, small business expensing.

*Sec. 179 Permanency*

Making the current Sec. 179 expensing thresholds permanent would greatly reduce the complexity of the code. Instead of following complicated depreciation schedules and keeping the paperwork associated with the investment, the business owner can simply claim the deduction in the year the item is purchased. As Congress considers specific issues in the code, making the higher Section 179 amounts permanent would go a long way to reducing complexity and providing an important tax benefit to small business owners. Since 2003, Congress has wisely increased the allowable expensing amount from \$25,000 to \$500,000. Additionally, Congress expanded Section 179 expensing to include real property with the passage of the *Small Business Jobs Act*.<sup>4</sup>

When considering the stress of our members on the topic of expensing the cost of long-lived assets, making the law permanent and eliminating the roller coaster of the maximum deduction would ease their minds considerably. Without knowing what their tax liability will be at the end of this year, business planning becomes very difficult for our nation's number one job creators.

*Cash Receipts and Disbursements (Cash Method)*

Expanding the availability of the cash method of accounting is another example of where Congress could act to provide simplification in the tax code. Under the cash method, income is generally recognized when actually or constructively received, and expenses are deductible when paid. The cash method is comparatively easier to use, practical to administer and more closely matches the way that a small business owner will keep his books. Importantly, it provides for the payment of tax at the time when the taxpayer is most likely to have the ability to pay.

Rather, under an accrual accounting method, income is recorded when a sale is made, even if the business does not receive the payment right away. Accrual method accounting is not based on cash flow but based on fixed rights to receive payment, and is subject to complex statutory and regulatory rules. The timing mismatch between income inclusion and actual receipt of the payment can create cash flow issues for a small business owner. Since the cash method only records revenues and expenses when they are paid or received, a business owner will have a better sense of how much cash they have on hand at any particular moment.

However, under the current law, certain taxpayers with greater than \$5 million in gross receipts are not able to use cash accounting, and rather must use an accrual accounting method. Allowing any business entity with revenues less than \$10 million to use cash basis accounting, as long as the cost inventories are not deducted until sold, would be a small but important change that would benefit small businesses.

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<sup>4</sup> P.L. 111-240

**Conclusion**

Small businesses truly are the engine of economic growth. This isn't just a slogan, as small businesses created two-thirds of the net new jobs over the last decade. Small business owners are risk takers and entrepreneurs. They are the last businesses to lay off employees when business declines and slow to rehire when business picks up. When small business hires an employee, it is their intent to keep them on for the long run.

However, the current tax code has become a confusing and unpredictable challenge for the vast majority of small business owners. Small business owners continue to be excessively burdened by direct, indirect, complicated and ever changing taxes related to operating their business. Alleviating the excessive tax burden on small businesses is an essential component in creating a strong, healthy environment for owners to operate and grow their business.

I appreciate the opportunity to present NFIB's views on the effects of tax policies on small businesses. I appreciate that the Committee is taking a serious look at the tax code challenges facing small businesses and urge you to keep in mind the unique challenges that face small businesses going forward. I look forward to answering any questions you might have.

Chairman VITTER. Absolutely. Thank you.  
And, next, Mr. Mathison. Welcome.

**STATEMENT OF TOM MATHISON, PRINCIPAL, MATHISON |  
MATHISON ARCHITECTS, GRAND RAPIDS, MI, ON BEHALF OF  
THE NATIONAL SMALL BUSINESS ASSOCIATION**

Mr. MATHISON. Thank you. Good morning, Chairman Vitter and Ranking Member Shaheen and members of the committee for inviting me to speak here today. My name is Tom Mathison. I am a principal co-owner of Mathison | Mathison Architects. We are a full-service architectural and planning firm in Grand Rapids, Michigan.

I am a small business owner. Our firm is less than two years old and we have already grown from two to seven staff members, and we recently moved to larger quarters to accommodate our growth.

I am proud to be here representing not only my company, but also the National Small Business Association, where I currently serve on the Board of Directors and the Tax Committee Chair. NSBA has been a consistent proponent of comprehensive tax reform and we welcome Congress' efforts to replace the current broken tax code. However, we also recognize the challenges you face to achieve comprehensive reform in the near future. Therefore, in the interim, we believe this measure, the Small Business Tax Compliance Relief Act, will reduce the complexity and costs of compliance to promote economic growth.

NSBA's members consistently rank the tax and tax compliance burden among the top issues to be addressed. One in three small business owners reported spending more than 80 hours, two full work weeks, per year dealing with just federal taxes and compliance. More than half of NSBA members have fewer than five employees, without in-house accounting, legal, and human resources staff. This means that business owners, like me, have no other choice but to hire outside help to keep track of all the reporting and filing requirements and changes. In fact, according to our member survey, only 15 percent of small business owners handle their taxes internally.

When we asked our members to rate the most significant challenge posed by the federal tax code, the clear majority, 59 percent, picked administrative burdens, and this is up from 53 percent just a year ago. In addition to time, the out-of-pocket cost for legal and accounting services adds thousands more.

I personally know this to be true in my firm. I spend significant time each week in the administration and filing of monthly and quarterly income and payroll reports, as well as trying to stay informed of changes to the tax code, changes to regulations, and the status of expired tax extenders and so on.

The U.S. Small Business Administration Office of Advocacy reports that the proportionate cost of compliance in terms of per cost per employee is three times higher for small business than that of larger firms.

And when surveyed, 70 percent of our members expressed strong support for broad reform of the tax system that reduces both corporate and individual tax rates. Most small businesses are sole proprietorships, Subchapter S Corporations, or Limited Liability Com-

panies, like my company. Eighty-three percent of these businesses pay taxes on their business at the personal income level, the so-called pass-through entities, subject to individual tax rates. For my firm, these pass-through implications are a major driver in our own tax strategy, succession planning, and governance.

And, so, we believe—NSBA believes that addressing only corporate tax reform will only lead to even greater complexity and a massive tipping of the scales in favor of the nation's largest companies at the expense of businesses, and this, in turn, will stymie growth from what is widely recognized as the primary creator of jobs, and that is small business.

So, we support the legislation that Chairman Vitter has announced today and we believe that it will, by increasing the threshold for cash accounting to \$10 million, will provide the flexibility and simplicity that small businesses need. I use a cash accounting system. Forty-six percent of small businesses use cash accounting.

The health insurance deductibility for those who are self-employed will allow those businesses to capture the payroll tax on health insurance premiums that they alone pay. Small firms and NSBA members rated the full deductibility of health insurance costs as the number one most important deduction or credit when it comes to stimulating small business growth.

And, then, requiring the IRS to convene Small Business Review Panels when making rule changes that would impact small businesses and directing the IRS to produce a report that details definitions that can be standardized and made layman-proof will add clarity.

Finally, NSBA believes that without change, the current tax code will continue to serve as a disadvantage to small businesses. The ever-growing patchwork of credits, deductions, and sunset dates is a roller coaster ride for small business, without the slightest indication of what is around the corner. However, short of comprehensive reform, we must fix the tax problems with the current tax code by developing simplification measures. The work of this committee will lead to a better outcome in that respect.

Again, I commend you for working on this legislation and bringing it to the Senate. I would like again to thank you, Chairman Vitter and the members of this committee, for the opportunity to speak with you today.

[The prepared statement of Mr. Mathison follows:]

**Testimony of Tom Mathison**

**Principal and Co-Founder**

**MATHISON | MATHISON ARCHITECTS**

**On behalf of the National Small Business Association**



**Senate Committee on Small Business and Entrepreneurship Hearing:**

**“Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America’s  
Small Businesses”**

**July 22, 2015**

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Good morning. I would like to thank Chairman Vitter, Ranking Member Shaheen and the members of the Committee on Small Business and Entrepreneurship for inviting me to testify today on solutions to relieve the tax compliance burden for America's small businesses.

My name is Tom Mathison, and I am Principal and Co-Founder, along with my son, of Mathison | Mathison Architects, a full-service architectural and planning firm based in Grand Rapids, Michigan. We have projects throughout several states in housing, K-12 and higher education, commercial and institutional facilities. After a 30-year career as an architect in large-multi-disciplinary firms, I was joined by my son, who had practiced on the east coast for eight years, and we formed a new firm less than two years ago.

We are part of the 97 percent of architectural firms in the U.S. who have 49 or less employees in their small business. As co-founders of our firm, we have created and nurtured our practice from the ground-up. Starting in entrepreneurial fashion in late 2013 as a two-person venture, our staff has now grown to seven, and we have recently moved to larger quarters to accommodate our growth. In a state as hard-hit in the past recession as Michigan, and in a national sector as hard hit as design and construction, the improving economy is encouraging to start-ups like ours.

I am proud to be here representing not only my company, but also the National Small Business Association (NSBA)—the nation's first small-business advocacy organization. NSBA is a uniquely member-driven and staunchly nonpartisan organization—where I currently serve as a Board of Trustees Member and Tax Committee Chair.

Recently, there have been ambitious policy efforts in Congress to replace the current U.S. Tax Code. I welcome the eagerness of lawmakers to fix America's broken tax system, but I also recognize there are significant challenges with enacting comprehensive tax reform legislation in the near future. Therefore, in the interim, I commend this committee's efforts to reform the tax system in order to reduce its complexity and compliance costs and to promote economic growth and prosperity. Several of the provisions included in Chairman Vitter's measure—the *Small Business Tax Compliance Relief Act*—will provide simplification to the most complex provisions of the code and may help to significantly reduce the burden on individual taxpayers and small businesses.

While there are many obvious problems with the current tax system, there are two paramount issues that must be addressed. The first major problem with the system is the generally high marginal rates of taxation on income. The other, perhaps more significant dilemma is the almost impossible task of compliance with all the rules and regulations. It is time that Congress acts to reexamine the tax code and simplify or repeal some of its most complex provisions.

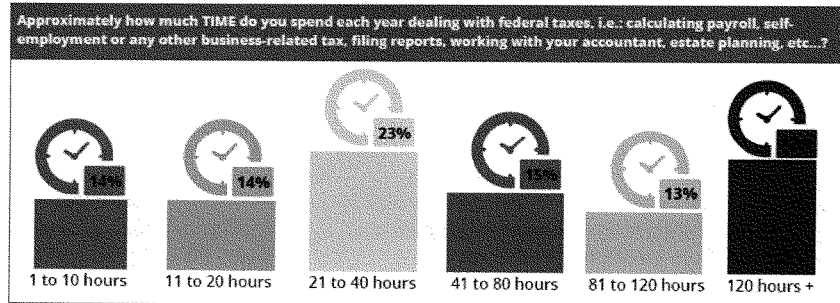


### *Compliance Costs*

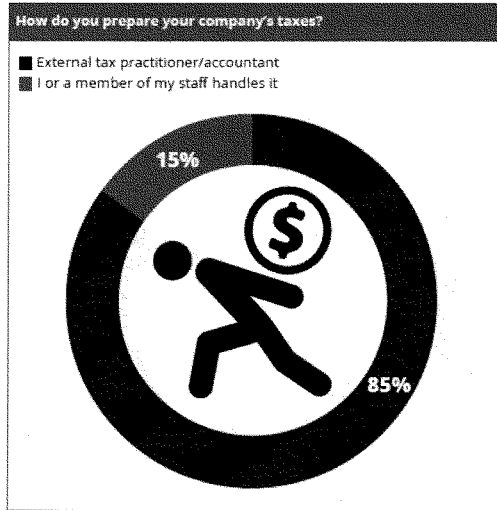
Although NSBA's members operate a wide variety of businesses, they all consistently rank reducing the tax burden among their top issues for Congress and the administration to address. The compliance burden on taxpayers, because of the complexity of our code, is truly staggering. While the actual tax liabilities for small firms is a huge issue, the sheer complexity of the tax code—along with the mountains of paperwork it necessitates—is actually a more significant problem for America's small businesses.

While I was part of larger corporations for most of my career, I had been accustomed to significant accounting, legal, and human resource personnel in-house. They provided the research and access to expertise that I now have to pay for through accounting, legal, and human resource consultants and advisors. For a start-up small business, the proportionate cost is significant, and the investment of time is even more consequential because it takes away from our productivity and growing the firm. Unlike larger corporations which have in-house 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 and tax code.

According to the [NSBA 2015 Small Business Taxation Survey](#), one-in-three small-business owners reported spending more than 80 hours per year dealing with federal taxes—that's two full work weeks spent just on federal taxes. Nearly 73 percent of small firms spend more than 40 hours per year on federal taxes alone. Just imagine the collective business and job growth that could be done absent that burden.



More than half of NSBA members have fewer than five employees—few, if any of whom is a tax specialist—leaving business owners—such as myself—with no other choice but to hire outside help to keep track of all their additional reporting and filing requirements. In fact, according to the [NSBA 2015 Small Business Taxation Survey](#), only 15 percent of small-business owners handle their taxes internally—meaning 85 percent are forced to pay an external accountant or practitioner—this data should send a strong message to the IRS and Congress that the tax code is far too complex.



Furthermore, when asked to rate the most significant challenge posed by the federal tax code to their business, the clear majority, 59 percent, picked administrative burdens—up from 53 percent last year—while 41 percent highlighted financial burdens as the most significant challenge to their business posed by federal taxes. The time it takes is not the only administrative burden either, more than half report they spend more than \$5,000 annually on the administration of federal taxes in the form of accountant fees, internal costs, legal fees and so on. This is before they even pay their actual taxes! In my company's case, the bill for preparing the company's taxes and my personal taxes as the owner of Mathison | Mathison Architects is thousands of dollars each year.

In addition to outside consultants, I personally spend significant time each week in the administration and filing of monthly and quarterly income and payroll reports, as well as trying to stay informed of changes to the tax code, changes to regulations, the status of expired tax extenders that may affect my business if they are extended or not, and so on. The aggregate cost of this represents thousands of dollars per employee and time away from doing more productive work to manage and grow my business.

According to a U.S. Small Business Administration (SBA), Office of Advocacy report entitled, "The Impact of Regulatory Costs on Small Firms," the compliance costs incurred by businesses are estimated to be about \$95 billion annually but may be as much as 50 percent higher. Individual and not-for-profit compliance costs are, of course, quite substantial as well.

In the case of small businesses these costs include the time of small-business owners and their accounting staff devoted to collecting necessary information and filling out Internal Revenue

Service (IRS) forms and the costs incurred hiring outside accountants and lawyers for advice about how to comply with the tax law. Small business compliance costs relative to income, revenues or per employee is disproportionately high. The SBA study quantifies this disproportionate impact, showing that the impact on small firms in terms of per employee costs is three times that of larger firms.

*Tax Compliance Cost per Employee by Firm Size, According to SBA Office of Advocacy*

	All Firms	Firms with <20 Employees	Firms with 20-499 Employees	Firms with 500+ Employees
Tax Compliance Cost per Employee	\$800	\$1,584	\$760	\$517

There will always be some compliance costs in any tax system. But today these costs are very high and if there is one thing the NSBA membership is almost universally agreed on, it is that the current compliance costs are too high and that the tax system needs to be simplified.

We should aim to raise the revenue needed by the federal government in the least costly way. The costs of the current system represent a huge waste of resources that could be better spent growing businesses, creating new products, conducting research and development, or purchasing productivity enhancing equipment.

These costs also represent a significant drag on the economic growth, on job creation and on the international competitiveness of U.S. businesses. Compliance costs must be recovered by businesses in the sales price of their goods or services. Otherwise, the businesses will fail. Reducing these costs is within our control and it should be a priority of Congress.

#### ***Fair Tax***

Clearly, the current tax system is irretrievably broken and constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes, with widespread competitive disadvantages to small firms. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required.

To that end, NSBA was the first small-business organization in the country to support the Fair Tax (S. 155)—a national 23 percent tax on the end point-of-sale for all goods that would replace all current individual and corporate tax schemes. It would dramatically reduce the tax bias against work, savings and investment, and would substantially reduce complexity and compliance costs. Additionally, the Fair Tax would make the U.S. an extremely attractive




location to manufacture goods and put U.S. produced products on even footing with foreign produced goods. Nearly the majority of small firms (49 percent) expressed support for the Fair Tax in NSBA's Small Business Taxation Survey.

### *Principles of Tax Reform*

While we firmly believe the Fair Tax is the best path forward, NSBA understands the political landscape and need to move forward on broad reform, even if in a different iteration. As such, NSBA has developed nine principles as part of the NSBA Tax Reform Checklist to which any broad tax reform package ought to adhere. The nine principles are:

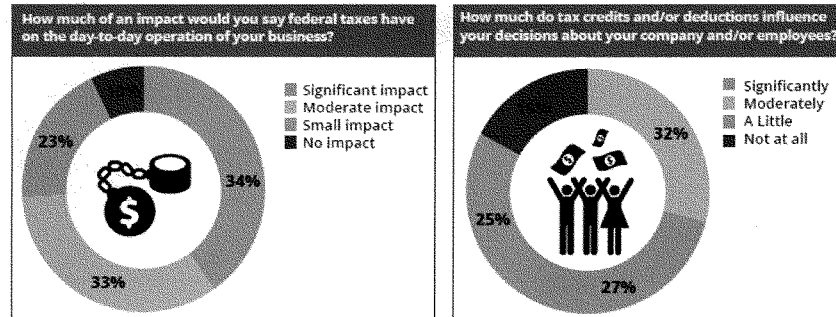
- ✓ Designed to tax only once
- ✓ Stable and predictable
- ✓ Visible to the taxpayer
- ✓ Simple in its administration and compliance
- ✓ Promote economic growth and fairness between large & small businesses
- ✓ Use commonly understood finance/accounting concepts
- ✓ Grounded in reality-based revenue estimates
- ✓ Fair in its treatment of all citizens
- ✓ Transparent

This kind of broad reform is what small firms want: according to NSBA's 2015 Small Business Taxation Survey, a large majority, 70 percent, expressed support broad reform of the tax system that reduces both corporate and individual tax rates, coupled with reducing both business and individual deductions.

Please indicate your level of support for each of the following tax reform proposals			
	 SUPPORT	 DON'T SUPPORT	 NOT SURE
Reduce both corporate and individual tax rates, and reduce both business and individual deductions	<b>70%</b>	<b>13%</b>	<b>17%</b>
A broad reform of the tax system in-line with the Fair Tax (elimination of all income and corporate tax rates as well as all deductions, and instead implement a 23 percent tax on the end point-of-sale for all goods)	<b>49%</b>	<b>24%</b>	<b>27%</b>
Reduce the corporate tax rate and eliminate some business deductions	<b>46%</b>	<b>22%</b>	<b>31%</b>
A European type value added tax	<b>7%</b>	<b>56%</b>	<b>37%</b>
Moving the current U.S. tax system from a "worldwide" tax system, in which all income is taxed regardless of its origin, to a "territorial" system, in which all foreign-source income is exempted from tax	<b>19%</b>	<b>48%</b>	<b>33%</b>

### *All Tax Credits are Not Created Equal*

According to NSBA's tax survey, the majority of small businesses, 67 percent, say that federal taxes have a significant to moderate impact on the day-to-day operation of their business and 59 percent say credits and deductions have a significant to moderate influence over their decisions about their company and employees.



The discussion of tax policy must not occur in a vacuum. NSBA is firmly committed to seeing the deficit reduced, and as such, we believe it is important to promote those tax credits that stand to offer the most benefit to the most people, both directly and indirectly.

While there are a number of tax deductions, credits and exclusions that are very beneficial to small-business growth and overall economic stimulation, some do little to promote economic growth. They may have other policy objectives and may or may not achieve those objectives, but they do not materially affect the incentives to work, to save or to invest. One in particular that, while good-intentioned, does not offer broad relief is the hiring tax credit whereby a firm would receive a credit for hiring a previously unemployed individual. Small firms are unlikely to hire a new person simply for that tax credit – those that are in a place to hire will likely do so regardless of a temporary, one-time credit, and they will look for the person best suited with the appropriate skills. Unfortunately, if that person isn't among the long-term unemployed, that will not likely be a factor in the employer's decision making process.

Adequate capital cost recovery allowances, preferably expensing, are critical to maintaining a reasonable cost of capital and to firms of all sizes being able to afford the capital investment necessary to compete in the international marketplace. It is hard to overstate this point. Capital formation is critical to maintaining long-term competitiveness and preserving relatively high U.S. wage rates. Unless U.S. firms invest in productivity-enhancing or innovative cutting-edge equipment that provides new capabilities, U.S. firms will only be able to compete by accepting

lower returns and by paying workers less. If, of course, they fall far enough behind their domestic and foreign competitors, the firms will simply fail.

Not only do these kind of investment-spurring tax credits and deductions help the qualifying firm, it helps promote economic growth by encouraging firms to make investments and purchase equipment from other firms. These tax provisions are the epitome of stimulatory.

#### ***Taxation of Pass-through Entities***

Most small businesses are sole proprietorships, subchapter S corporations, or limited liability companies—such as Mathison | Mathison Architects. Most of the remainder are partnerships (either limited or general). There also are some business trusts. All of these businesses (83 percent, according to NSBA data) pay taxes on their business at the personal income level, or are so-called “pass-through” entities that are subject to individual tax rates – not corporate tax rates. For my firm, the pass-through tax implications are a major driver in our tax strategy, succession planning, and governance each year. It is no surprise then, that income taxes were ranked the most burdensome administratively, while payroll taxes were ranked the most burdensome financially, by small firms.

Some small businesses are C corporations that are subject to the corporate income tax, but these are a relatively small percentage and a large portion of these companies’ net income before compensating the owners’ is usually consumed by paying the owners’ salary. This salary is also subject to the individual tax rates as, of course, are any dividends paid by the corporation to its shareholders. Thus, even for small C corporations, individual tax rates are key.

Broad reform of the entire tax code is necessary, not just for corporate entities. Many proposals have called for reducing the corporate tax rate while eliminating various business deductions and credits, which—if not examined more closely—sounds like a fine plan. However, many pass-through entities, small businesses, utilize these tax benefits that would be on the chopping block. So now I would be facing the same, high tax rate on my business income, but I could no longer take advantage of some important tax credits and/or deductions. The result is a tax increase on my firm while large corporations would be given a tax cut. Allowing the smallest businesses to pay a much higher tax on their business income than a multinational, multi-billion corporations undercuts any semblance of fairness.

I firmly believe that addressing just one piece of the puzzle—such as corporate tax reform—will only lead to even greater complexity and a massive tipping of the scales in favor of the nation’s largest companies at the expense of small businesses.

Imposing higher tax rates on small firms will stymie any growth from what is widely recognized as the source of much of the economic growth and dynamism in the U.S. economy: small business. For the overwhelming majority of small businesses, individual marginal tax rates are much more important than corporate marginal tax rates. Since small businesses

disproportionately contribute to job creation, raising individual marginal tax rates can be expected to have a disproportionate negative impact on job creation. It is this kind of shortsightedness that has made the IRS a major foe of small firms and why so many of us support broad tax reform.

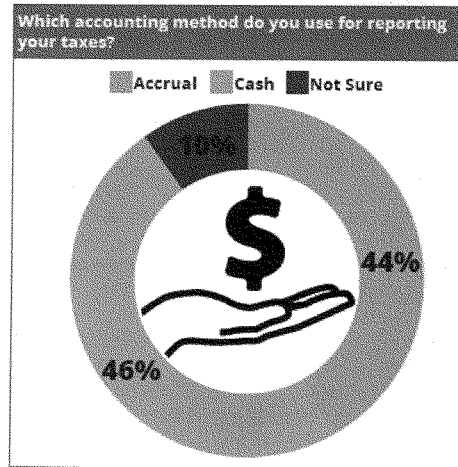
If Congress overhauls the tax system by dramatically broadening the base—cutting the breaks that litter the tax code—and lowering ALL rates, we would see real economic growth and raise revenues.

#### ***Small Business Tax Compliance Relief Act***

The current tax code is comprised of more than 10,000 pages of laws and regulations that serve as a disadvantage to small businesses, and are egregiously complex and constantly in flux. Therefore, NSBA is pleased to support legislation introduced by Chairman Vitter that will provide relief from provision in the tax code that are frequently cited as overly restrictive and onerous for small businesses. The *Small Business Tax Compliance Relief Act* intends to help alleviate the administrative burden of tax compliance on small-business owners in a number of ways.

##### a) Increasing the threshold for cash accounting to \$10 million

Providing flexibility and simplicity to small businesses in which method of accounting they use for tax purposes is important. Cash accounting—widely seen as a simpler, more straightforward method of accounting—is utilized by 46 percent of small businesses, according to the NSBA 2015 Taxation Survey and increasing the threshold to \$10 million will provide consistency in defining small business in the tax code. I use cash accounting in my small business because of its relative simplicity, and because it is a more honest reflection of the resources we have to sustain investments in equipment and personnel as we grow. I believe the proposal we are discussing here deserves support because it establishes simpler and more uniform rules and preserves the cash method of accounting for small firms.



- b) Increasing the de Minimis safe harbor threshold for small businesses from \$500 to \$2,500

The de Minimis safe harbor allows taxpayers without an applicable financial statement to deduct amounts paid for property if the amount does not exceed \$500 per invoice, or per item as substantiated by the invoice. NSBA supports raising the de Minimis capitalization to \$2,500 and applauds the measures efforts for including “reviewed” financial statements as “applicable financial statements” as this will certainly add to the number of small businesses able to use the limit.

- c) Self-employed Health Insurance Deductibility

Self-employed individuals (including partners and LLC members), unlike large corporations, cannot fully deduct the cost of their health insurance as a business expense. At issue is the 15.3 percent tax that self-employed individuals must pay on their employer-provided health insurance costs to which nobody else is subjected. The self-employment tax rate on net earnings is the sum of 12.4 percent for Social Security (old age, survivors, and disability insurance), and 2.9 percent for Medicare (hospital insurance).

The self-employed pay an average of \$12,680 per year for health insurance. Because they cannot deduct this as an ordinary business expense, the 15.3 percent payroll tax they alone pay on their premiums amounts to \$1,940 in extra taxes that only the self-employed pay. This is money that could be used to reinvest and grow the business, hire part-time help or cover the ever-increasing costs of health insurance. This additional 15.3 percent tax makes already disturbingly high-priced health care cost even more by adding thousands of dollars to the cost of an individual’s health care. As leaders in the fight for tax equity for the self-employed, NSBA is pleased to see this essential piece in your legislation.

Furthermore, according to the NSBA tax survey, small firms rated the full deductibility of health insurance costs the number one most important deduction or credit when it comes to stimulating small-business growth.

- d) Requiring the IRS to convene small-business review panels when making rules changes that would impact small businesses, as is customary with some agencies under the Regulatory Flexibility Act and the Small Business Regulatory Enhancement Flexibility Act

My fellow small-business owners have often described how the Internal Revenue Service (IRS) repeatedly ignores small businesses’ unique requirements and simply does not understand the impact that many of their rules have on the operation of a small business. By requiring the IRS to convene small-business review panels, we may begin to see better IRS rules which are easier to understand, implement and enforce, and which may draw a more positive reaction from smaller entities. By extending the Small Business Regulatory Enhancement Flexibility Act (SBREFA)



panel process to the IRS, the Chairman's legislation will help small businesses deal with one of the more troublesome and burdensome federal agencies, by requiring the IRS to fully consider the impact of their regulations on small businesses.

- e) Directing the IRS to produce a report that details the various statutory definitions that can be standardized and recommendations for how tax provisions can be "layman proof"

Small-business owners are smart people, but we often experience a hard time dealing with the complexity of ambiguous terms, intricate technical language and difficult sentences. The increased burden causes us to have trouble understanding the requirements. This forces us to spend more time trying to interpret the rules and ensure we are completing the forms accurately thus avoiding being fined by the agency for noncompliance.

The best thing for small businesses is simplicity: simplicity in instructions, in requirements, in consequences and an overall reduction in the amount of the paperwork and the time necessary to complete the forms. I am pleased to see the requirement for the IRS to produce a report that calls for simplification, streamlined definitions and plain-language.

### ***Conclusion***

NSBA strongly believes that the current tax system constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes, with widespread competitive disadvantages to small firms—biased against savings and investment, and impossibly complex. A tax system dedicated to investment, savings and small-business growth must be put in its place.

Complexity and inconsistency within the tax code pose a significant and increasing problem for small businesses. The ever-growing patchwork of credits, deductions, tax hikes and sunset dates is a roller coaster ride without the slightest indication of what's around the next corner. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required. However, unless and until Congress agrees upon a replacement, we must fix tax problems with the current tax code by developing simplification measures that are fair and fiscally responsible.

This committee's leadership and input throughout the tax reform process will lead to a better legislative product with more understanding of how the tax code impacts all stakeholders. Specifically, Sen. Vitter's legislation brings small businesses a step closer to enabling us to invest in new equipment, hire more workers and dedicate more money to new entrepreneurial ideas and innovations, which in turn will help strengthen our economy. I commend you for working to bring this legislation to the Senate floor.

Again, I would like to thank Chairman Vitter and the members of the Committee on Small Business and Entrepreneurship for the opportunity to speak today.

*Testimony of Thomas R. Mathison, Mathison | Mathison Architects  
On Behalf of the National Small Business Association  
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Chairman VITTER. Thank you very much for your perspective, and thank you for that support.

Next, we will hear from Mr. Porter. Welcome.

**STATEMENT OF JEFFREY A. PORTER, OWNER, PORTER AND ASSOCIATIONS, HUNTINGTON, WV, ON BEHALF OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

Mr. PORTER. Thank you. Thank you, Chairman Vitter, Ranking Member Shaheen, and members of the committee. My name is Jeffrey Porter and I am a tax practitioner at Porter and Associates in Huntington, West Virginia. And on behalf of the American Institute of CPAs, I appreciate the opportunity to testify.

Tax compliance is particularly burdensome on small businesses. While our tax code has always had a tendency to change, in recent years, the rate of change has accelerated. New rules and regulations providing guidance on tax laws comes out daily. Extender bills pass annually and then expire within a month, leaving businesses once again unsure what the rules are.

When a small business asks me a simple question, such as what is my tax rate, you have to explain that it is really not that simple, because you have the regular rate, the AMT, the net investment income tax, and a variety of phase-ins and phase-outs. America's small businesses need a tax code that is certain, simple, and transparent.

In preparation for this hearing, I reached out to several of my small business clients and asked them about the impact regulations have on their businesses. To say their response was passionate was an understatement. And before I could explain that I mostly was interested in tax compliance issues, they began to talk about the IRS, the state taxing authorities, OSHA, EPA, the ACA, and a host of other acronyms for government agencies. While we are here today to specifically discuss tax compliance, we need to remember that the cascading burden of government compliance, tax and otherwise, takes the focus of an entrepreneur from expanding their business and hiring more employees to complying with laws and regulations.

Today, I would like to discuss a number of targeted tax reform and administrative solutions, many of which are included in Chairman Vitter's bill, the Small Business Compliance Relief Act of 2015. Although technical, these changes are important and allow entrepreneurs to spend more of their time focusing on operating and expanding their business.

So, first, it is imperative that small businesses and their tax return preparers be able to communicate with the IRS when preparing their taxes and addressing compliance issues. Our members have expressed deep concerns regarding their ability to effectively represent small businesses in an environment where the IRS service levels are so degraded that during the last filing season, the IRS answered only 37 percent of their phone calls, and the IRS's processing of taxpayer correspondence in a timely manner declined by over 16 percent last year, leaving a backlog of almost 79,000 cases.

Having to contact the IRS repeatedly to resolve a tax matter is frustrating and a waste of resources of both the business owner and their advisors. We believe taxpayer service must remain a high priority for the IRS and agree with requiring the agency to produce a report with specific ideas on how to improve its customer service.

Another challenging tax compliance burden that small businesses had to deal with recently was the tangible property regulations, which address how businesses should report the purchase and improvement of tangible property. We appreciate the Chairman's bill, which includes a provision to increase the de minimis safe harbor threshold for most small businesses from \$500 to \$2,500 and provides an opportunity for more small businesses to use the higher \$5,000 threshold.

Currently, to deduct amounts higher than \$500, small businesses must prove that expensing such amounts in the purchase year clearly reflects income. However, the clear reflection of income test can be challenging for any small business, especially for small businesses, forcing them to depreciate the cost of items such as computers or printers over a number of years for tax purposes.

We also support the provisions in Chairman Vitter's bill that address some of the unfair or untargeted penalty provisions. Penalties should deter bad conduct without deterring good conduct or punishing small businesses which are acting in good faith. Targeted penalties that are administered in a reasonable manner encourage voluntary compliance with the laws. Good tax policy also suggests that we avoid strict liability provisions and instead allow the IRS to consider the facts and circumstances particular to a business' situation. Businesses that act in good faith should not be subject to the same rules as businesses trying to scam the system.

The AICPA appreciates the committee's efforts and particularly wants to thank Chairman Vitter for his introduction of the Small Business Tax Compliance Relief Act of 2015, which we believe could ease compliance costs, improve the overall tax system for small businesses across the country. These businesses and their tax practitioners are interested in and need this type of targeted reform.

Again, Mr. Chairman, thank you for the opportunity to testify and I would be happy to answer your questions.

[The prepared statement of Mr. Porter follows:]



American Institute of CPAs  
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**WRITTEN TESTIMONY OF JEFFREY A. PORTER**  
**ON BEHALF OF THE**  
**THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**  
**BEFORE**  
**THE UNITED STATES SENATE**  
**COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP**  
**HEARING ON**  
**TARGETED TAX REFORM: SOLUTIONS TO RELIEVE THE TAX**  
**COMPLIANCE BURDEN(S) FOR AMERICA'S SMALL BUSINESSES**  
**JULY 22, 2015**

AICPA's Written Testimony of Jeffrey A. Porter  
U.S. Senate Committee on Small Business & Entrepreneurship  
Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America's  
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## **INTRODUCTION**

Chairman Vitter, Ranking Member Shaheen, and Members of the Committee, my name is Jeffrey Porter. I am a tax practitioner at Porter & Associates, based in Huntington, West Virginia, Immediate Past Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA) and Chair of the AICPA Tax Reform Task Force. I provide tax planning and business advisory services for local businesses and high net worth individuals, and have clients in a wide range of industries, including contracting, wholesale and retail trade, medical, law, and the food industry. On behalf of the AICPA, I am pleased to have the opportunity to testify today at your hearing on Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America's Small Businesses.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 145 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

Tax compliance is particularly burdensome on small businesses. While our tax code has always had a tendency to change, in recent years the rate of change has accelerated. New regulations, revenue procedures and notices come out daily, providing guidance on enacted laws. Extender bills pass annually and then expire within a month, leaving businesses again unsure what the rules are. When a small business client asks a simple question such as "what is my tax rate," you have to explain that it really is not that simple because you have the regular rate, the alternative minimum tax (AMT), the net investment income tax and the variety of phase-ins and phase-outs of various provisions. America's small businesses need a tax code that is certain, simple and transparent. In addition, the inability to receive timely and accurate responses from the Internal Revenue Service (IRS) creates a huge burden on small businesses.

Today, I would like to discuss a number of targeted tax reform and administrative solutions, many of which are included in Chairman Vitter's bill, the Small Business Tax Compliance Act of 2015. We believe that these technical and largely systemic changes are important and will allow entrepreneurs to spend more of their time and resources focusing on operating and expanding their businesses.

We believe that many of the bill's provisions, such as the increase of the safe harbor de *minimis* threshold for the tangible property regulations, will contribute to a more equitable and fair set of rules. We also believe that proposals similar to the penalty waivers in cases

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of good faith promote certainty and transparency in the tax law. Such improvements should reduce small businesses' compliance costs and encourage voluntary compliance through a simplification of the rules.

We, therefore, appreciate this opportunity to provide input on targeted tax reform solutions to help relieve tax compliance burdens for America's small businesses. In the interest of good tax policy and effective tax administration, specifically focusing on the simplification of small business income tax, we respectfully submit comments on the following issues:

1. Permanence of Tax Legislation
2. IRS Taxpayer Services
3. Mobile Workforce
4. Cash Basis Method of Accounting
5. Tangible Property Regulations
6. Tax Return Due Date Simplification
7. Civil Tax Penalties
8. Other Small Business Tax Compliance Issues
  - Removing computer equipment from the definition of "listed property";
  - Providing that the executive compensation section 409A rules apply only to public companies;
  - Eliminating the top-heavy rules (for retirement plans); and
  - Providing full deductibility of health insurance.

## **AICPA PROPOSALS**

### **1. Permanence of Tax Legislation**

Taxpayers and tax practitioners need certainty to perform any long-term tax, cash flow or financial planning and reporting.<sup>1</sup> As a practitioner in West Virginia, one of the most common questions I hear from clients is "if I purchase new equipment this year, how much depreciation, will I be able to claim?" Unfortunately, in the last few years, due to the late passage of legislation, I have been unable to answer that question with any certainty until

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<sup>1</sup> For example, see [AICPA testimony](#) before the U.S. House of Representatives Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access on the September 13, 2012, hearing on Adding To Uncertainty: Small Businesses' Perspectives on the Tax Cliff, and [AICPA written statement](#) for the hearing before the U.S. House of Representatives Committee on Ways and Means Subcommittee on Select Revenue on May 15, 2013, on the Small Business and Pass-Through Entity Tax Reform Discussion Draft.

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very late in the year. For all businesses, and small businesses in particular, the uncertainty in the tax code impacts their cash flow, and, thus, their ability to hire and expand.

The permanence of tax provisions, such as the enhanced section 179 deduction, would promote the growth of small businesses. The section 179 provision allows small and mid-size business owners to immediately take a tax deduction on qualifying equipment, rather than delaying the deduction and taking it in smaller portions over an extended period of years. With the increased section 179 expense provision, business owners could deduct up to \$500,000 of qualifying assets. In 2015, the section 179 expense has reverted back to \$25,000. However, over the past several years, Congress has retroactively passed an increased section 179 limit during, or even after, the applicable tax year. The possibility for such a retroactive action in 2015 still exists; however, the uncertainty creates unnecessary confusion, anxiety and administrative and financial burdens.

## **2. IRS Taxpayer Services**

It is imperative that small businesses and their tax return preparers have the ability to communicate with the IRS when preparing their taxes and addressing compliance issues. However, there has been increasingly limited access to the agency and, as reported by IRS Commissioner John Koskinen, an "abysmal" level of taxpayer service this year.<sup>2</sup>

Our members have expressed their deep concerns regarding their ability to effectively represent small businesses and other taxpayers in an environment where the IRS service levels are so degraded that:

- During the 2015 tax season, the IRS answered only 37% of the telephone calls received from taxpayers seeking to speak with an assistor;<sup>3</sup>
- The average hold time for the Practitioner Priority Service telephone line reached 47 minutes;<sup>4</sup> and
- According to the National Taxpayer Advocate, the IRS's ability to process taxpayer correspondence in a timely manner declined by 16% since 2014, leaving a backlog of almost 79,000 cases.<sup>5</sup>

<sup>2</sup> Commissioner Koskinen, Prepared Remarks of John A. Koskinen Commissioner, Internal Revenue Service, Before the National Press Club, dated March 31, 2015.

<sup>3</sup> National Taxpayer Advocate Report, Volume I: FY 2016 Objectives Report to Congress; Part II: Review of the 2015 Filing Season, dated July 14, 2015.

<sup>4</sup> Joint Operations Center, Customer Account Services, Account Management Paper Inventory Reports, Inventory Age Report, (Jan 1 – Apr 6 statistics).

<sup>5</sup> *Id.*

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Through an informal membership survey conducted earlier this year, we learned that over half of our members were either somewhat dissatisfied or very dissatisfied with the services they received from the IRS this filing season. This is no surprise considering that only 17% of our members responded that the IRS generally answered their telephone calls within 30 minutes. Most of our members were on hold for extended periods of time and other members noted that they generally had to end their own calls because they did not have the time to wait on hold for an IRS agent to answer.

Many of our members also experienced what the IRS refers to as "courtesy disconnects." According to the IRS, they terminate telephone calls from small businesses and other callers, without taking a message or getting contact information, if the caller has been on hold for two hours. As of April 18<sup>th</sup> this year, approximately 8.8 million calls received by the IRS were subject to their "courtesy disconnect" policy, which represents an increase from approximately 544,000 over last year.<sup>6</sup> Nothing is more discouraging, frustrating or inefficient to a caller (whether they are a small business or a tax preparer calling on behalf of a small business) than being disconnected by the IRS after waiting on hold for two hours.

Our survey indicated similar, unacceptable patterns with regards to delays in written correspondence. On average, over half of the correspondence sent to the IRS is not responded to within 90 days of receipt.<sup>7</sup> Meanwhile, the taxpayer waits for a response to their written correspondence and the IRS continues to send notices demanding payment of the tax. These delays often cause the taxpayer or their advisers to need to contact the IRS multiple times to postpone collection activities until the IRS responds to the correspondence. Furthermore, the longer the response time by the IRS, the more interest and penalties are accrued as the small business attempts to resolve their issue.

We appreciate and understand that the IRS has new initiatives and vital unmet obligations and responsibilities (such as addressing identity theft), but taxpayer service must remain a high priority in order for small businesses to receive the assistance they need on tax issues. We are pleased that the Small Business Tax Compliance Relief Act of 2015 includes a provision directing the IRS to produce a report with specific ideas on how to improve its customer service to small businesses.

### **3. Mobile Workforce**

Another burden on small businesses that Congress should address involves the tremendous burden of tracking and complying with the different state non-resident employee tax

<sup>6</sup>National Taxpayer Advocate Report, Volume I: FY 2016 Objectives Report to Congress; Part II: Review of the 2015 Filing Season, dated July 14, 2015.

<sup>7</sup> Joint Operations Center, Customer Account Services, Account Management Paper Inventory Reports, Inventory Age Report, (Jan 1 – Apr 6 statistics).



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withholding and reporting rules for just a few days of work by an employee in a non-resident state. The state personal income tax treatment of nonresidents is inconsistent and often bewildering to multistate employers and employees.

S. 386, the Mobile Workforce State Income Tax Simplification Act of 2015, introduced by Senators Thune and Brown on February 5, 2015, addresses this issue. We are pleased that Senator Peters, a member of this Committee, is a cosponsor of this bill, and hope many others of you will also be cosponsors on it. The AICPA strongly supports S. 386 and urges Congress<sup>8</sup> to enact this legislation to help small businesses in this country ease their non-resident state income tax withholding and compliance burdens.

Small businesses must understand each states' treatment of non-resident employee withholding and assessment of taxes and the unique *de minimis* rules and definitions. Currently, 43<sup>9</sup> states plus the District of Columbia impose a personal income tax on wages, and there are many different requirements for withholding income tax for non-residents among those states. There are seven states that currently do not assess a personal income tax.<sup>10</sup> Employees traveling into all the other states are subject to the confusing myriad of withholding and tax rules for non-resident taxpayers.

Where many businesses once tended to be local, they now have a national reach. This change has caused the operations of even small businesses to move to an interstate basis. Because of the interstate operations of these companies, many providers of services to these companies, such as certified public accountants (CPAs), find that they are also operating on an interstate basis. What once were local taxation issues have now become national in scope, and burdens must be eased in order to promote interstate commerce and ensure businesses run efficiently.

Having a uniform national standard for non-resident income taxation, withholding, and filing requirements, as S. 386 provides, will enhance compliance and significantly relieve these unnecessary administrative burdens on businesses and their employees. Additionally, S. 386 provides a needed 30-day *de minimis* exemption before an employee

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<sup>8</sup> AICPA written testimony before the House Committee on the Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law on Nexus Issues: Legislative Hearing on H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act of 2015," H.R. 1643, the "Digital Goods and Services Tax Fairness Act of 2015," and H.R. \_\_\_ the "Business Activity Tax Simplification Act of 2015", dated June 2, 2015; <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-written-statement-mobile-workforce-subcomte-judiciary-6-2-15-hearing-e-CDB.pdf>.

<sup>9</sup> Note that New Hampshire and Tennessee, which are included in the 43 states, do not tax wages and only subject to tax interest and dividends earned by individuals.

<sup>10</sup> The seven states with no personal income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

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is obligated to pay taxes to a state in which they do not reside. Many small businesses need Congress to enact this legislation.

#### **4. Cash Basis Method of Accounting**

Another need of businesses is the continued use of the cash basis method of accounting. We are pleased to see that the Small Business Tax Compliance Act of 2015 would increase the threshold for cash accounting to \$10 million. The AICPA supports the expansion of the number of taxpayers who may use the cash method of accounting, which is simpler in application than the accrual method, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the income. For these same reasons, we are concerned with, and oppose, any new limitations on the use of the cash method for service businesses, including those businesses whose income is taxed directly on their owners' individual returns, such as S corporations and partnerships. Any legislation that would require these businesses to switch to the accrual method upon reaching a gross receipts threshold would unnecessarily discourage growth. A required switch to the accrual method would negatively affect many small businesses in certain industries, including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.

As the AICPA has previously stated,<sup>11</sup> we urge Congress not to further restrict the use of the long-standing cash basis method of accounting for the thousands of U.S. businesses (e.g., sole proprietors, personal service corporations, and pass-through entities) that currently utilize it. We believe that any legislation that would force more businesses to use the accrual method of accounting for tax purposes would increase their administrative burden, discourage business growth in the U.S. economy, and unnecessarily impose financial hardship on cash-strapped small businesses and entrepreneurs.

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<sup>11</sup> AICPA comment letter on the "Continued Availability of Cash Method of Accounting," August 15, 2013, [http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.08.15\\_Comments\\_on\\_Continued\\_Availability\\_of\\_Cash\\_Method\\_of\\_Accounting.pdf](http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.08.15_Comments_on_Continued_Availability_of_Cash_Method_of_Accounting.pdf), AICPA written statement before the House Committee on Ways And Means, dated May 15, 2013, Small Business and Pass-through Entity Tax Reform Discussion Draft; <http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-May-15-2013-hwmc-srsubcomte-camp-small-bus-submit.pdf>, and AICPA written statement before the House Committee on Small Business, Subcommittee on Economic Growth, Tax and Capital Access, dated July 10, 2014, Hearing on "Cash Accounting: A Simpler Method for Small Firms?"; <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA%20WRITTEN%20STATEMENT%20July%2010%202014%20to%20House%20Subcte%20on%20Economic%20Growth%20Tax%20and%20Capital%20Access.pdf>.

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#### **5. Tangible Property Regulations**

A challenging tax compliance burden that small businesses had to deal with this year was the new final tangible property regulations (TD 9636). The regulations, which became effective last year, address how businesses should report the acquisition and improvement of tangible property for tax purposes. While we appreciate that Department of the Treasury ("Treasury") clarified some rules and provided several small business favorable provisions, we are concerned that the regulations are burdensome for many small businesses.

The AICPA is pleased that the Small Business Tax Compliance Relief Act of 2015 includes a provision to address small business concerns by increasing the *de minimis* safe harbor threshold for most businesses from \$500 to \$2,500, and including a reviewed financial statement in the definition of an applicable financial statement (AFS). We agree with this proposal and recommend adjusting the threshold amount on an annual basis for inflation to maintain the fairness and incentive of the intended benefit.

Currently, small businesses must prove that expensing such amounts "clearly reflects income" to deduct amounts higher than the \$500 threshold. The clear reflection of income test can be challenging for any taxpayer, especially for small businesses. The test is based on the taxpayer's facts, circumstances, and interpretations of those facts and circumstances by the taxpayer and IRS. Thus, it is arbitrary and often difficult to apply. Large businesses (e.g., taxpayers with an AFS), however, are allowed the higher \$5,000 threshold. Subjecting small businesses to the clear reflection of income test at merely \$500, adds unnecessary complexity and compliance burdens to small businesses.

#### **6. Tax Return Due Date Simplification**

Another challenging compliance issue for small businesses is the current illogical order of due dates for various types of tax returns. Taxpayers and preparers have long struggled with problems created by the inefficient timeline and flow of information. Federal Schedules K-1s are often delivered late, sometimes within days of the due date of taxpayers' personal returns and up to a month after the due date of their business returns. Late schedules make it difficult, if not impossible, to file a timely, accurate return.

We are pleased that the Small Business Tax Compliance Relief Act of 2015 and the recent Senate Finance Committee Business Tax Reform Working Group report contain a provision to address this issue. We also acknowledge one of the members of this Committee, Senator Enzi, for being a champion of this issue and introducing legislation in the prior Congresses.

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The AICPA strongly supports the provision in the bill to change the due dates for tax returns of partnerships, S corporations and C corporations because it would:

- Improve the accuracy of tax and information returns by allowing corporations and individuals to file using current data from flow-through returns that have already been filed rather than relying on estimates;
- Better facilitate the flow of information between taxpayers (i.e., corporations, partnerships, and individuals);
- Reduce the need for extended and amended tax returns; and
- Simplify tax administration for the government, taxpayers, and practitioners.

#### **7. Civil Tax Penalties**

We have expressed concerns<sup>12</sup> about the numerous unfair or untargeted penalty provisions in the Internal Revenue Code ("Code") and are pleased that the Small Business Tax Compliance Relief Act of 2015 would address many of them.

Penalties should deter bad conduct without deterring good conduct or punishing small businesses which are acting in good faith. Targeted, proportionate penalties that clearly articulate standards of behavior and that are administered in an even-handed and reasonable manner encourage voluntary compliance with the tax laws. On the other hand, overbroad, vaguely-defined, and disproportionate penalties, particularly those administered as part of a system that automatically imposes penalties or that otherwise fail to provide basic due process safeguards, create an atmosphere of arbitrariness and unfairness that is likely to discourage voluntary compliance.

For example, penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Good tax policy would also suggest that we avoid strict liability provisions that do not grant the IRS discretion to take into consideration the facts and circumstances of a particular business' situation.

The AICPA points out the following specific penalty-related issues with the current system and are pleased that the bill would provide these improvements:

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<sup>12</sup> See the "AICPA Tax Penalties Legislative Proposals," submitted to Congress in April 2013: <http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-legislative-proposals-penalties-2013.pdf>; and the "AICPA Report on Civil Tax Penalties," submitted April 2013: <http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-report-civil-tax-penalty-reform-2013.pdf>.

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**a. Trend Toward Strict Liability**

We appreciate that the bill would address strict liability issues. The IRS discretion to waive and abate penalties where small businesses demonstrate reasonable cause and good faith is needed most when the tax laws are complex and the potential sanction is harsh. This reason is especially true where the taxpayer's state of mind is central to the conduct that is subject to penalty. Because it is not feasible to anticipate every possible situation to which a penalty might apply, permitting a reasonable cause defense and avoiding fixed-dollar amount penalties helps to ensure that a disproportionately large penalty is not applied to an unforeseen and/or unintended set of facts.

**b. An Erosion of Basic Procedural Due Process**

Penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Judicial review of an IRS decision to impose a penalty or to deny waiver is an important constitutional check on Executive authority. Statutes that prohibit judicial review of agency penalty determinations undermine voluntary compliance by undercutting taxpayers' faith in the system and eliminating an essential and expected avenue of potential redress.

**c. Repeal Technical Termination Rule**

We are pleased that the bill contains a provision, similar to prior AICPA recommendations,<sup>13</sup> to repeal section 708(b)(1)(B) regarding the technical termination of a partnership.<sup>14</sup> Under current law, when a partnership is technically terminated, the legal entity continues, but for tax purposes, the partnership is treated as a newly formed entity. The current law requires the partnership to select new accounting methods and periods, restart depreciation lives, and make other adjustments. Furthermore, the final tax return of the "old" partnership is due the

<sup>13</sup> AICPA submitted comments to the House Committee on Ways and Means on the Tax Reform Act of 2014, dated January 12, 2015; <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-2014-Camp-Draft-General-Comments-Final.pdf>.

<sup>14</sup> AICPA submitted letters and written statements on Option 1 and Option 2 of Chairman Camp's Small Business Tax Reform Draft: See Option 1 comments at "AICPA testimony on Small Business and Pass-through Entity Tax Reform," dated May 17, 2013; [http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13\\_Testimony\\_on\\_Small\\_Businesses\\_and\\_Pass-Through\\_Entity\\_Tax\\_Reform\\_Discussion\\_Draft.pdf](http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013.05.13_Testimony_on_Small_Businesses_and_Pass-Through_Entity_Tax_Reform_Discussion_Draft.pdf), and Option 2 comments, dated July 30, 2013; <http://www.aicpa.org/Advocacy/Tax/Partnerships/DownloadableDocuments/AICPA-Option-2%20-comments-7-30-13.pdf>.

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15th day of the fourth month after the month-end in which the partnership underwent a technical termination.<sup>15</sup>

A technical termination most often occurs when, during a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. Because this 12-month timeframe can span a year-end, the partnership may not realize that a 30% change (a minority interest) in one year followed by a 25% change in another year, but within 12 months of the first, has caused the partnership to terminate.

In practice, this earlier required filing of the old partnership's tax return often goes unnoticed because the company is unaware of the accelerated deadline due to the equity transfer. Penalties are often assessed upon the business as a result of the missed deadline. Although ignorance is not an acceptable excuse, this technical termination area is often misunderstood and misapplied. The acceleration of the filing of the tax return, to reset depreciation lives and to select new accounting methods, serves little purpose in terms of abuse prevention and serves more as a trap for the unwary.

#### **d. Late Filing Penalties**

Sections 6698 and 6699 impose a penalty of \$195 per partner related to late-filed partnership or S corporation returns. The penalty is imposed monthly not to exceed 12 months, unless it is shown that the late filing is due to reasonable cause. 2014 amendments to sections 6698 and 6699 adjust the penalty for inflation beginning after 2014.

The AICPA proposes that a partnership (or S Corporation), comprised of 50 or fewer partners/shareholders, each of whom are natural persons (who are not nonresident aliens), an estate of a deceased partner, a trust established under a will or a trust that becomes irrevocable when the grantor dies, and domestic C corporations, will be considered to have met the reasonable cause test and will not be subject to the penalty imposed by section 6698 or 6699 if:

- The delinquency is not considered willful under section 7423;
- All entity income, deductions and credits are properly allocated to each owner; and

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<sup>15</sup> For example, a partnership that technically terminated on April 30 of the current year due to a transfer of 80% of the capital and profits interests in the partnership to be timely filed must file its tax return for that final tax year on or before August 15 of the current year.

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- Each partner/shareholder fully reported its share of income, deductions and credits of the entity on its timely filed federal income tax return.

**e. Failure to Disclose Reportable Transactions**

Taxpayers who fail to disclose a reportable transaction are subject to a penalty under section 6707A of the Code. For penalties assessed after 2006, the amount of the penalty is 75% of the decrease in tax shown on the return as a result of the transaction (or the decrease that would have been the result if the transaction had been respected for federal tax purposes). If the transaction is a listed transaction (or substantially similar to a listed transaction), the maximum penalty is \$100,000 for individuals and \$200,000 for all other taxpayers. In the case of reportable transactions other than listed transactions, the maximum penalty is \$10,000 for individuals and \$50,000 for all other taxpayers. The minimum penalty is \$5,000 for individuals and \$10,000 for all other taxpayers.

The section 6707A penalty applies even if there is no tax due with respect to the reportable transaction that has not been disclosed. There is no reasonable cause exception to the penalty. The Commissioner may, however, rescind all or a portion of a penalty, but only in the case of transactions other than listed transactions, where rescinding the penalty would promote efficient tax administration and only after the taxpayer submits a lengthy and burdensome application. In the case of listed transactions, the IRS has no discretion to rescind the penalty. The statute precludes judicial review where the Commission decides not to rescind the penalty.

Under section 6662A, taxpayers who have understatements attributable to certain reportable transactions are subject to a penalty of 20% (if the transaction was disclosed) and 30% (if the transaction was not disclosed). A more stringent reasonable cause exception for a penalty under section 6662A is provided in section 6664, but only where the transaction is adequately disclosed, there is substantial authority for the treatment, and the taxpayer had a reasonable belief that the treatment was more likely than not proper. In the case of a listed transaction, reasonable cause is not available, similar to the penalty under section 6707A.

The AICPA recommends an amendment of section 6707A to allow an exception to the penalty if there was reasonable cause for the failure and the taxpayer acted in good faith for all types of reportable transactions, and to allow for judicial review in cases where reasonable cause was denied. Moreover, we propose an amendment of section 6664 to provide a general reasonable cause exception for all types of reportable transactions, irrespective of whether the transaction was adequately disclosed or the level of assurance.

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**f. 9100 Relief**

Section 9100 relief, which is currently available with regard to some elections, is extremely valuable for taxpayers who miss the opportunity to make certain tax elections. Congress should make section 9100 relief available for all tax elections, whether prescribed by regulation or statute. The AICPA has compiled a list<sup>16</sup> of elections (not all-inclusive) for which section 9100 relief currently is not granted by the IRS as the deadline for claiming such elections is set by statute. Examples of these provisions include section 174(b)(2), the election to amortize certain research and experimental expenditures, and section 280C(c), the election to claim a reduced credit for research activities. We do not believe taxpayers are likely to abuse or exploit hindsight, as the IRS would continue to have discretion as to whether to grant relief for each specific request.

**g. Form 5471 Penalty Relief**

On January 1, 2009, the IRS began imposing an automatic penalty of \$10,000 for each Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, filed with a delinquent Form 1120 series return. When imposing the penalty on corporations in particular, the IRS does not distinguish between: a) large public multinational companies, b) small companies, and c) companies that may only have insignificant overseas operations, or loss companies. This one-size-fits-all approach inadvertently places undue hardship on smaller corporations that do not have the same financial resources as larger corporations. The AICPA has submitted recommendations<sup>17</sup> regarding the IRS administration of the penalty provision applicable to Form 5471. Our recommendations focus on the need for relief from automatic penalties assessed upon the late filing of Form 5471 in order to promote the fair and efficient administration of the international penalty provisions of the Code.

<sup>16</sup> AICPA letter on "Tax Reform Administrative Relief for Various Statutory Elections," submitted January 23, 2015: <http://www.aicpa.org/advocacy/tax/downloadabledocuments/aicpa-letter-to-congress-on-9100-relief-1-23-15submitted.pdf>.

<sup>17</sup> AICPA submitted comments to the IRS, dated March 26, 2013; <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comments-on-Form-5471-Penalties-3.26.13.pdf>.



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## **8. Other Small Business Tax Compliance Issues**

There are several other small business tax compliance burden proposals that we support and are pleased that are addressed in the Small Business Tax Compliance Relief Act of 2015, including:

- Removing computer equipment from the definition of "listed property";
- Providing that the executive compensation section 409A rules apply only to public companies;
- Eliminating the top-heavy rules (for retirement plans); and
- Providing full deductibility of health insurance.

### **a. Listed Property**

We are pleased that the Small Business Tax Compliance Relief Act of 2015 would remove "computer or peripheral equipment" from the definition of "listed property" in order to simplify and modernize the traditional tax treatment of computers and laptops. We agree that classifying computers and similar property as "listed property" under section 280F is clearly outdated in a business environment where employees are increasingly becoming expected to work outside of traditional business hours. Various forms of technology, including laptops, tablets and cell phones, are all converging to serve similar purposes. The costs for the internet and service plans are now frequently sold in "bundles" and shared between multiple devices and it has become arguably impossible to segregate the cost of service between a cell phone, tablet, and laptop. The AICPA believes legislative change to update the treatment of mobile devices is the needed simplification, similar to section 2043 of the Small Business Jobs Act of 2010, where cell phones were removed from the definition of listed property for taxable years beginning after December 31, 2009.

### **b. Executive Compensation**

The AICPA supports the Small Business Tax Compliance Relief Act of 2015 provision which provides that the section 409A requirements apply only to public companies. Section 409A, which applies to compensation earned in one year but paid in a future year, was enacted to protect shareholders and other taxpayers from executives guarding their own financial interests without concern for the financial interests of the organization, its shareholders or other creditors.

The rules apply to a broad array of compensation arrangements, including many business arrangements that are not thought of as deferred compensation. Nonpublic companies often want arrangements with employees to allow for sharing equity or providing capital

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accumulation for long-term employees, and the nonpublic business owner should not be constrained by rules designed to protect absentee shareholders.

Many nonpublic entities have found themselves with noncompliant plans that cannot be corrected under the existing administrative correction programs. The cost of a noncompliant 409A plan is excessive given the unintended violations. In addition to accrual base income recognition, the additional 20% penalty tax applies to the recipient, often a person unknowingly affected by the violations. Private companies should not be required to pay for the specialized tax guidance needed to ensure that a compensatory arrangement is 409A compliant. The cost of imposing 409A requirements on nonpublic companies is far in excess of any benefit derived.

**c. Elimination of Top-Heavy Rules (for Retirement Plans)**

Small businesses are especially burdened by the overwhelming number of rules inherent in adopting and operating a qualified retirement plan. Therefore, we are pleased that the bill repeals the top-heavy rules, which limit the adoption of 401(k) and other qualified retirement plans by small employers. Since the top-heavy rules were enacted in 1982, there have been a number of statutory changes which have significantly decreased their effectiveness. The sole remaining top-heavy rule is a required minimum contribution or benefit. The determination of top-heavy status is difficult and the required 3% minimum contribution is often made for safe harbor 401(k) plans. Without the top-heavy rules, more small businesses would adopt plans to benefit their employees.

**d. Provide Full Deductibility of Health Insurance**

We are pleased that the bill would provide full deductibility of health insurance costs for self-employed individuals. Similar to a proposal in the AICPA Tax Legislative Compendium, the bill would equalize the tax treatment with respect to the deduction for health insurance costs in determining income subject to Old Age, Survivors, and Disability Insurance (OASDI) and health insurance (HI) taxes as was allowed temporarily under the Small Business Jobs Act of 2010.

Deductions allowable in determining a particular tax should remain consistent amongst taxpayers subject to such tax. Employees subject to OASDI and HI taxes are allowed a deduction for health insurance costs in determining their net income subject to these taxes while self-employed individuals subject to these same taxes are not allowed a deduction in determining their net income subject to these taxes.

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The provision in the bill would provide that deductions allowed in determining income subject to OASDI and HI taxes remain consistent amongst taxpayers regardless of whether they are employees or self-employed individuals.

**CONCLUDING REMARKS**

The AICPA understands the challenges that Congress faces as it tackles the complex issues inherent in drafting tax legislation, and note that both small businesses and their tax practitioners are interested in, and need, tax simplification. We have consistently supported simplification efforts because we are convinced such actions will significantly reduce small businesses' compliance costs and encourage voluntary compliance through an understanding of the rules. We look forward to working with the 114<sup>th</sup> Congress, this Committee, and the tax-writing committees as Congress continues to address tax reform.

Again, Mr. Chairman, thank you for the opportunity to testify. I would be happy to answer any questions.

Chairman VITTER. Thank you very, very much for your testimony.

And next will be Ms. Bruckner.

**STATEMENT OF CAROLINE BRUCKNER, PROFESSOR, ACCOUNTING AND TAXATION, AND MANAGING DIRECTOR, KOGOD TAX POLICY CENTER, KOGOD SCHOOL OF BUSINESS, AMERICAN UNIVERSITY**

Ms. BRUCKNER. Members of the committee and staff, thank you for the opportunity to testify today. My name is Caroline Bruckner and I am a Tax Professor at American University's Kogod School of Business. As part of my responsibilities at American University, I am also the Managing Director of the Kogod Tax Policy Center, which conducts nonpartisan research on tax and compliance issues specific to small businesses and entrepreneurs.

Prior to my appointment at Kogod, I served on the staff of this committee from 2009 until 2014, ultimately as Chief Counsel under the leadership of its former Chair, Senator Mary Landrieu. During my tenure with the committee, I handled tax, labor, and budget issues and worked with small business stakeholders across the country and political spectrum to develop small business legislation, including provisions of the Small Business Jobs Act of 2010, which provided more than \$12 billion of tax relief for small businesses.

In addition, at the direction of Chair Landrieu, I organized multiple hearings and roundtables to discuss tax and compliance issues specific to small businesses and entrepreneurs and advised the Chair on small business tax policy recommendations in response to Senate Finance Committee requests for tax reform proposals.

In my current role at Kogod, I direct our team of small business tax policy experts, economists, and researchers, and we are currently focused on developing research on the tax and compliance issues impacting emerging entrepreneurs, who are America's latest iteration of small business owners.

Emerging entrepreneurs are the new self-employed entrepreneurs who are powering the evolving on-demand digital economy. These emerging entrepreneurs are renting rooms, providing ride sharing services, running errands, and selling goods for consumers in business transactions coordinated online and through app-based platforms developed by companies such as Airbnb, Flipkey, Onefinestay, Uber, Lyft, Taskrabbit, Instacart, and others.

As you know and have heard today, overwhelming complexity and inefficiency are the hallmarks of the current tax code. This reality is particularly acute for many emerging entrepreneurs who are first-time small business owners and have little experience with the requirements of quarterly estimated payments or self-employment taxes. As a result, many emerging entrepreneurs are finding out for the very first time this filing season that they are liable for tax underpayment penalties.

In the coming months, we will be publishing research and corresponding policy recommendations for your committee and colleagues to review. In the meantime, we applaud the committee's initiative in discussing targeted tax solutions for America's small businesses.

As many of you know, a one-size-fits-all approach for small business tax compliance burdens is inefficient and fails to recognize the specific attributes and various criteria policy makers, academics, government agencies, and legal authorities rely on to characterize small businesses as opposed to other firms.

The definition of “small business” has very significant implications for policy consideration purposes, as the numbers can vary widely. For example, the U.S. Department of Treasury has developed a methodology based on taxpayer filing information to identify more than 23 million small businesses. However, SBA’s Office of Advocacy, relying on U.S. Census Bureau data, has identified more than 28 million small businesses for purposes of its programs. Consequently, a discussion of targeted tax solutions for small businesses should include some facts about small business as generally used for tax administration purposes.

According to GAO’s most recent research released this week, small businesses are primarily individuals who report some business income, either as a sole proprietor or a landlord, on a separate schedule together with their Form 1040s. This group of approximately 16 million small business taxpayers, which is about 69 percent of all small businesses, on average earns \$100,000 or less per year and generates \$1.4 trillion of the total small business income reported to the IRS every year. In contrast, the remaining 7.3 million small businesses, which is about 31 percent of reporting small businesses’ income, are partnerships, S Corporations, or C Corporations that earn, on average, about \$450,000 or more per year and generate approximately \$4.5 trillion of total small business income.

Given the foregoing facts regarding small business taxpayers, it is no great surprise that millions of small business owners, mostly individuals running businesses and earning less than \$100,000 each year, are unnecessarily burdened by an antiquated tax code and an IRS that cannot address their questions. Targeted tax proposals can alleviate some of the burdensome recordkeeping requirements or inequitable treatment small business owners sometimes encounter in complying with the code.

This committee has a long history dating back to its days as a Select Senate Committee of working on behalf of America’s small businesses on tax issues. Beginning in 1953, this committee prepared a comprehensive survey of the impact of federal taxes on small businesses, culminating in an annual report to the Senate with key recommendations. Since then, this committee has held more than 38, now 39, hearings over the years on tax-related concerns of small businesses. The work continues.

Again, I thank you for the opportunity to testify today and for the work you do on behalf of America’s small businesses and I welcome any questions from the committee or its staff.

[The prepared statement of Ms. Bruckner follows:]



## Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America's Small Businesses

Testimony of Professor Caroline Bruckner, Executive-in-Residence, Accounting and Taxation and Managing Director, Kogod Tax Policy Center, Kogod School of Business, American University, before the U.S. Senate Committee on Small Business and Entrepreneurship

July 22, 2015

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Members of the Committee and staff, thank you for the opportunity to testify today on targeted tax reform solutions to relieve the tax compliance burdens of small businesses. My name is Caroline Bruckner and I am a tax professor at American University's Kogod School of Business. As part of my responsibilities at American University, I am also the Managing Director of the Kogod Tax Policy Center, which conducts non-partisan research on tax and compliance issues specific to small businesses and entrepreneurs. The Center develops and analyzes solutions to tax-related problems faced by small businesses and promotes public dialogue concerning tax issues critical to small businesses and entrepreneurs.

Prior to my appointment at Kogod, I served on the staff of this Committee from 2009 until 2014, ultimately as Chief Council, under the leadership of its former Chair, Sen. Mary Landrieu. During my tenure with the Committee, I handled tax, labor and budget issues and worked with small business stakeholders across the country and political spectrum to develop small business tax legislation, including the Small Business Jobs Act of 2010, which provided more than \$12 billion of tax relief for small businesses. In addition, at the direction of Chair Landrieu, I organized multiple hearings and roundtables to discuss tax and compliance issues specific to small businesses and entrepreneurs, and advised the Chair and Committee Members on small business tax policy recommendations in response to Senate Finance Committee requests for tax reform proposals.

In my current role at Kogod, I direct our team of small business tax policy experts, economists and researchers, and we are currently focused on developing research on the tax and compliance issues impacting "Emerging Entrepreneurs," who are America's latest iteration of small business owners. Emerging Entrepreneurs are the new, self-employed entrepreneurs who are powering the evolving on-demand digital economy. These Emerging Entrepreneurs are renting rooms, providing ride-sharing services, running errands, and selling goods for consumers in business transactions coordinated online and through app-based platforms developed by companies such as Airbnb, Flipkey, Onefinestay, Uber, Lyft, Taskrabbit, Instacart and others. Emerging Entrepreneurs need maximum flexibility to grow their businesses and enhance their contributions to this dynamic new sector of the American economy (the "Emerging Entrepreneur Economy").

As you know, overwhelming complexity and inefficiency are hallmarks of the current tax code and the Congressional record is replete with examples of how unduly burdensome the current system is across taxpayers' experience.<sup>1</sup> This reality is particularly acute for many Emerging Entrepreneurs who are first-time, small business owners and have little experience with the

<sup>1</sup> See United States Senate Committee on Finance, The Business Income Tax Bipartisan Tax Working Group Report, July 2015, available at <http://www.finance.senate.gov/newsroom/chairman/release/?id=e9eefc66-7e11-4276-939f-3eca6fd6d959>.

requirements of quarterly estimated payments or self-employment taxes.<sup>2</sup> As a result, many Emerging Entrepreneurs are finding out for the first time that they are liable for tax underpayment penalties.<sup>3</sup>

In addition, as reported by the *Wall Street Journal* earlier this year, some Emerging Entrepreneurs are facing penalty and audit exposure, despite the fact that in some cases, income earned from short-term residential rentals coordinated through a platform provider (e.g., Airbnb, HomeAway, Onefinestay and Flipkey) is, in fact, tax free.<sup>4</sup> Our preliminary research has identified these and other related issues as unnecessary burdens notwithstanding that, anecdotally at least, many Emerging Entrepreneurs “generally want to be honest and pay what they owe, but the tools and resources don’t exist.”<sup>5</sup>

The relative inexperience of many Emerging Entrepreneurs as small businesses owners is further compounded by the lack of uniformity in the income reporting forms used for Emerging Entrepreneur Economy transactions. Although some platform providers have attempted to designate the Form 1099-K, which is used to report credit card and third-party payments, as the industry standard, others use Form 1099-MISC, which is for miscellaneous income. Irrespective of whether taxpayers receive a Form 1099-K or Form 1099-MISC, neither of these forms was designed to accommodate these types of transactions and their increasing frequency. In fact, Congress enacted the Form 1099-K reporting requirements in 2008, well before the advent of the Emerging Entrepreneur Economy, and the information reporting thresholds for Form 1099-MISC have not changed since 1954.<sup>6</sup>

As one prominent economist recently noted in an article on the tax challenges of the Emerging Entrepreneur Economy “[p]robably most of those providing services through the new service companies have no experience with the tax obligations of businesses...to comply with tax laws, these microentrepreneurs will be spending relatively large amounts on return preparation assistance and devoting large hours to record keeping...the sharing economy will be bearing significantly larger than average tax compliance costs.”<sup>7</sup> The predominately electronic payment nature of transactions conducted in the Emerging Entrepreneur Economy provides opportunities to both reduce the burden on and increase the compliance of Emerging

<sup>2</sup> Kathleen Pender, “Here’s why Uber and Lyft send drivers such confusing tax forms.” *SF Gate*, Feb. 20, 2015, “many [Emerging Entrepreneurs] are self-employed for the first time and unaware of the need to keep careful records and make estimated tax payments four times a year. They’ve never filed a Schedule C, or paid self-employment taxes.”

<sup>3</sup> Derek Davis (founder, [www.sharedeconomycpa.com](http://www.sharedeconomycpa.com)), email message to witness, April 13, 2015.

<sup>4</sup> Laura Saunders, “Airbnb income may be tax-free – but there’s a catch.” *Wall Street Journal*, April 2, 2015.

<sup>5</sup> Derek Davis, in discussion with witness, April 9, 2015.

<sup>6</sup> Mark P. Keightley, “Economic Analysis of the Enhanced Form 1099 Information Reporting Requirements.” *Congressional Research Service Report for Congress* (R41400), Jan. 21, 2011.

<sup>7</sup> Martin A. Sullivan, “10 Tax Challenges for the Sharing Economy.” *Tax Notes*, July 13, 2015.



Entrepreneurs. In the coming months, we will publish tax research and corresponding policy recommendations for your Committee and colleagues to review.

In the meantime, we applaud the Committee's initiative in discussing targeted tax solutions for America's small businesses. As many of you know, a one-size fits all approach for small business' tax compliance burdens is inefficient and fails to recognize the specific attributes and various criteria policymakers, academics, government agencies, and legal authorities rely on to characterize small businesses as opposed to other firms. The latest U.S. Government Accountability Office (GAO) research on small business tax compliance issues illustrates just how challenging it is to define small businesses as a distinguishable category of taxpayers and readily acknowledges "a consensus does not exist on a definition of small businesses, including which specific attributes or thresholds distinguish small businesses from other firms."<sup>8</sup>

For example, the Internal Revenue Service (IRS) Small Business and Self-Employed division is responsible for individual with business income and business returns with less than \$10 million of income, which is one official threshold for defining small business. Alternatively, the U.S. Small Business Administration (SBA) generally considers a small business to be an independent business with fewer than 500 employees, although even that definition can vary by industry.<sup>9</sup>

The definition of "small business" has very significant implications for policy consideration purposes as the numbers can vary widely. Using taxpayer reporting data, the U.S. Department of Treasury's Office of Tax Analysis (OTA) has developed a methodology to identify more than 23 million small businesses, however, SBA's Office of Advocacy, relying on U.S. Census Bureau data, has identified more than 28.2 million small businesses.<sup>10</sup> Consequently, a discussion of targeted tax solutions for small business should include some facts about small business as generally defined for tax administration purposes.

According to GAO's research using data from OTA, the great majority of small businesses are individuals with business income. That is, most small businesses are individuals who report some business income as a sole proprietor or as a landlord on a separate schedule, together with their Form 1040s. This group of approximately 16 million small business taxpayers (69% of all small businesses), on average, earns \$100,000 (or less) per year and generates \$1.4 trillion of the total small business income reported to the IRS.<sup>11</sup> In contrast, the remaining 7.3 million small businesses (31% of reporting small businesses) are partnerships, S corporations or C corporations that earn, on average \$450,000 (or more) per year, and generate approximately

<sup>8</sup> GAO, "Small Businesses: IRS Considers Taxpayer Burden in Tax Administration, but Needs a Plan to Evaluate the Use of Payment Card Information for Compliance Efforts." GAO-15-513 (June 2015) [hereinafter GAO-15-513].

<sup>9</sup> SBA Office of Advocacy, Frequently Asked Questions about Small Business, March 2014, available at [https://www.sba.gov/sites/default/files/advocacy/FAQ\\_March\\_2014\\_0.pdf](https://www.sba.gov/sites/default/files/advocacy/FAQ_March_2014_0.pdf). [hereinafter SBA Advocacy FAQ]

<sup>10</sup> GAO-15-513, *supra* note 8; SBA Advocacy FAQ, *supra* note 9.

<sup>11</sup> GAO-15-513, *supra* note 8.

\$4.5 trillion of total business income.<sup>12</sup> In contrast to the estimated average total income of \$121 million for larger businesses, \$250,000 is the “estimated average total income across all types of small business.”<sup>13</sup>

Given the foregoing facts regarding small business taxpayers, it is no great surprise that millions of small business owners—mostly individuals running businesses and earning less than \$100,000 each year—are unnecessarily burdened by an antiquated tax code and an IRS that cannot address their questions.<sup>14</sup>

Targeted tax proposals can alleviate some of the burdensome recordkeeping requirements or inequitable treatment small business owners sometimes encounter in complying with the requirements set forth in the Internal Revenue Code. For example, at Kogod, we have done extensive research on how liberalizing tax laws to permit more small businesses to adopt the cash method of accounting, as opposed to being required to adopt the more cumbersome accrual method, will reduce record-keeping and tax compliance costs with a minimal loss of accuracy or tax revenues to the government.<sup>15</sup> We were encouraged to see bipartisan support for expanding the number of businesses eligible to use the cash method as discussed in the U.S. Senate Committee on Finance Business Income Tax Bipartisan Tax Working Group Report.

This Committee has a long history, dating back to its days as select Senate committee, of working on behalf of America’s small businesses on tax issues. Beginning in 1953, the SBC prepared a comprehensive survey of the impact of federal taxes on small businesses, culminating in an annual report to the Senate with key recommendations. Since then, the SBC has held more than 38 hearings over the years on tax-related concerns of small businesses. The work continues. Again, I thank you for the opportunity to testify today for the work you do on behalf of America’s small businesses. I welcome any questions from the Committee or its staff.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 9.

<sup>14</sup> Lisa Rein, “A standard dejection in the IRS helpline,” *Washington Post*, April 7, 2015.

<sup>15</sup> *Cash Method of Accounting: A Simpler Method for Small Firms: Hearing Before the Subcomm. on Economic Growth, Tax and Capital Access of the House Comm. on Small Business*, 113<sup>th</sup> Cong. (2014) (written testimony of Prof. Donald Williamson, Kogod Eminent Professor of Taxation, Howard S. Dvorkin Faculty Fellow, Executive Director, Kogod Tax Policy Center, American University Kogod School of Business) available at [http://smbiz.house.gov/uploadedfiles/7-10-2014\\_williamson\\_testimony.pdf](http://smbiz.house.gov/uploadedfiles/7-10-2014_williamson_testimony.pdf).

Chairman VITTER. Thank you very much, Ms. Bruckner. Now, we will hear from Mr. Zerbe. Welcome.

**STATEMENT OF DEAN ZERBE, NATIONAL MANAGING  
DIRECTOR, ALLIANTGROUP, HOUSTON, TX**

Mr. ZERBE. Thank you, Mr. Chairman. I appreciate it. Thank you very much for having this important hearing about tax reform and how tax reform can help deal with the burdens for small businesses in terms of tax compliance. Just as a brief note, alliantgroup works with small and medium businesses across the country, working with them to help them benefit from the tax code, the tax provisions that you all have placed into the code, and also working with CPA firms very closely to assist in their working with their clients. We also work with small businesses, representing them before the IRS. So, I have a good sense of knowledge of the issues before you.

Mr. Chairman, when I think of what you are trying to deal with in this in terms of the tax code and small business, I step back and think of kind of three points. One, you want to talk about policy and say, okay, what can we do to make sure the policy and the tax laws, the tax regulations, are working for small businesses and understanding the problems there. I give you a lot of detail on the R&D credit in my testimony, but that is just a one-off.

We have provision after provision after provision in the tax code that is very difficult and hard for small businesses to qualify for. It can be the law. It can be the guidance. You heard the testimony earlier from the question from Senator Ernst. Sometimes it can be they learn about it later or it is very cumbersome, like the work credits. So, I think understanding more in detail why is it that a small business cannot take this credit is critical.

I think that then leads you to the next step of, okay, now that we understand the problems, now let us talk about what could be the solutions. What can we do to make this code provision, this incentive work better for small businesses, and I think that could be safe harbors, it can be things that you proposed, different rules for small businesses. All those are ways that you can get there to get small businesses able to take advantage of the credits and incentives that are in there for the code.

I would say, as a general rule, simpler is going to be a better place for you to do, but I do think thinking about ways that you can have a credit or provision that works for small business is also a start point. So, I think it is getting the policy right.

Then it is education. I could not have asked for a better—again, the statement from Senator Ernst to the question, education is huge. So many small business owners do not have a clue in the world what is out there for the credits and incentives that the Congress has put forward. That is what I spend all my days, out there talking to them about what is out there that you have put forward. We could do so much more.

To be honest, the IRS is not really pulling oars on this. I know they have got a lot on their plate, but they could do more to help other tax service providers that are trying to educate folks on what is going on. SBA may be a way to do this, as well, too. But, I cannot tell you enough how much small business owners do not have

any idea what is out there for them to take advantage of. So, I think education is a key part.

The third part, then, is compliance, and there are two parts to compliance. One is service. You heard earlier, it is exactly right. IRS not answering phones, IRS not answering letters, people who do not have good training at the IRS. That is not a happy day for a small business owner and their CPA. They want people who will respond to their phone calls, will answer their letters, and know what they are talking about.

So, I think the committee has got to look long and hard about the level of professionalism and service that we want to see out of the IRS, the resources we want to see for the IRS to accomplish that, and also management of the IRS's resources that they currently have. But, we have got to look at that.

So, if you can get the law better, if you can get education in a place where people know they can qualify and how they can qualify, you get service better, better guidance—what you are talking about, I think, is exactly spot on, Chairman—all that, I think, will then get you to the bottom line on the enforcement. It will help the burden on compliance, but it will get you to enforcement, as well, too, and I think you will be in a better place in enforcement.

Obviously, the IRS needs to have an enforcement presence, but I would tell you quite frankly, and I put it into detail in my testimony, we are a little bit afraid the IRS does not have its feet on the ground on some cases in some enforcement. Overall, yes, it can be fine, but the trend line is not good regarding small business. They tend to have a tendency to treat small businesses like big businesses in terms of requirements for what they want to accomplish in terms of recordkeeping, production of data, all that.

So, I have laid out some details for the committee in my testimony. A lot could be done, I think, to get the IRS back on the rails in terms of where they are on that. So, I think all that can accomplish a great deal in terms of what you are looking at and trying to achieve.

I just want to take one last moment on the Startup Act, just because—let me say this. I think as you are looking at reform, I gave you three areas that I think this committee, in particular, should think about in reform: entrepreneurs, greater employee ownership, and also capital for startups. But, the tax code right now does a pretty lousy job of helping startups because they do not have income and we are basically based around that. But, the problem is, for a business owner, they are paying tax. They are paying a lot of tax. They are paying—for them, it looks, walks, talks like a tax. We put it with different labels, with the payroll tax, there is this kind of tax. For the business owner, it is a tax.

And, I think for Senator Coons, his proposal that says, hey, we are going to make the R&D credit available for startups, starts being the driver for both innovation and for new jobs in this country, is a godsend. I think it is going to be a game changer in really helping so many of our new innovative companies across the board finally take advantage of the R&D credit.

I know Senators make lots of wonderful speeches about, geez, R&D credit, we are going to help those two fellows in a garage who are starting their new business. In simple reality, it does not help

them a bit. It helps IBM. It helps 3M. It helps a lot of the companies that we work with, you know, kind of the 200-person tool and die shop, but it does not work for them. So, I think with Senator Coons' provision that just got passed the other day—congratulations, Senator—we are on a good start there. But, that is just one example of a host of things that are out there.

With that, I will stop, and thank you very much, Chairman, for having today's hearing.

[The prepared statement of Mr. Zerbe follows:]

July 22, 2015

Statement of Dean Zerbe  
National Managing Director of alliantgroup

United States Senate Committee on Small Business and Entrepreneurship Hearing On  
“Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America’s Small Business”

Mr. Chairman Vitter and Ranking Member Shaheen:

Thank you for inviting me to testify before the Senate Committee on Small Business and Entrepreneurship on this important topic of tax reform and small business. It is vital that as Congress considers tax reform that consideration is given to the burdens the tax code places on small businesses and new businesses. While Congress hears every day from the Fortune 500 it is critical that the voice of small businesses is also heard as we discuss tax reform – so I commend you Mr. Chairman Vitter and Ranking Member Shaheen for having today’s hearing.

As background, alliantgroup is a leading tax service provider for small and medium businesses across the country. alliantgroup has approximately 650 professionals (lawyers, accountants as well as technical experts in biology, chemistry, engineering, etc.) located nationwide with headquarters in Houston, TX. Since its founding in 2002, alliantgroup has worked with hundreds of CPA firms and assisted them in helping over 15,000 small and medium businesses realize over \$3 billion in tax incentives (for example, we help small and medium businesses qualify for the Research and Development Tax Credit, IC-Disc export incentive; Section 179D energy efficient commercial buildings, etc.). In addition, alliantgroup has approximately 50 attorneys that– assist and defend small and medium business when they are subject to examination by the IRS.

Mr. Chairman, I wanted to touch on five points in my testimony – 1) making the incentive and credits in the tax code work better for existing small businesses; 2) making the tax code work better for new businesses; 3) encouraging greater employee ownership – “every man an owner”; 4) IRS service, assistance and education for small businesses; and, 5) issues and concerns regarding IRS examination of small businesses.

#### **1. A Tax Code for Small Business**

One of the most important changes that Congress could make in Tax Reform is to take steps to ensure that the credits and incentives that are provided to businesses actually work for small businesses. Too often lost in the balloons and speeches surrounding a new tax incentives is that the tax incentive has built-in provisions that will effectively bar or limit small businesses from taking the tax benefit or that the burden of recordkeeping and compliance is so great that for a small business the tax benefit simply isn’t worth the candle.

Let me give you a real example from a world I know well – the Research and Development (R&D) Tax Credit. The R&D tax credit is the largest tax credit available for businesses – approximately \$10 billion dollars a year. As a General Accountability Office Report “Tax Policy: The Research Tax Credit’s Design and Administration Can Be Improved”<sup>1</sup> found businesses with receipts of \$1 billion or more accounted for about 65 percent of credits claimed – but businesses with \$250 million or less in receipts accounted for 16.7 percent of credits claimed in 2005 and the smallest businesses (those less than \$5 million in receipts) getting approximately 7 percent of the credit.

Why are small and medium businesses not taking advantage of the R&D tax credit? It certainly isn’t the case that small and medium businesses aren’t doing innovative work – these companies are often the leaders in innovation and job creation. The bar for small and medium businesses is three

<sup>1</sup> GAO – 10 – 136 (November 2009) [www.gao.gov/new.items/d10136.pdf](http://www.gao.gov/new.items/d10136.pdf)

things: the law, the IRS and taxpayer education. Let me talk about the law first – and will discuss the IRS and taxpayer education as part of my comments about the IRS.

The law is easily the biggest barrier for small companies taking the R&D tax credit. Right now Section 38(c) of the tax code serves as a high hurdle for thousands of small and medium businesses to take the R&D tax credit. In short, Section 38(c) says that a company's owner cannot reduce her taxes below the AMT amount with the R&D tax credit (as well as a host of other business credits – see Section 38(b)).<sup>2</sup> The end result, hosts of small and medium businesses that do work that qualifies for the R&D tax credit can't utilize the R&D tax credit. It is common for alliantgroup – working with our partner CPAs to find in a review of the CPA's clients that 7 or 8 out of ten companies that are doing work that qualifies for the R&D tax credit can't utilize the R&D tax credit because of the AMT bar.

To argue that business owners can roll the credit forward to the next year is not realistic or practical. Qualifying for the R&D tax credit is not a walk in the park for a business – and to put forward time, costs and expenses this year for a possible potential benefit down the road is not a good use of a small business owners limited resources. The end result – small and medium business owners don't take the R&D tax credit.

Now, Congress – led by Senators Grassley (R-IA) and Baucus (D-MT) – put in place a one-year fix to this problem in the Small Business Jobs Act of 2010. The AMT bar was removed for the R&D tax credit and other credits for one year. The result of this change? – dancing in the street by small and medium business owners. We saw first-hand the real change this provision being able to use the R&D tax credit made for hundreds of small and medium business owners, their local economies and their ability to create jobs.

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<sup>2</sup> For a detailed discussion of the mechanics of the AMT bar, a good guide is this [article](#) – "New Law Opens Door for Businesses to Take R&D Tax Credit and Other General Business Credits" by myself, Ben Yaker and David Ji published by Thompson Reuters.



Unfortunately, it was only a one-year fix. The Senate Finance Committee last year (led by Senators Roberts (R-KS); Schumer (D-NY) and Grassley) had the AMT turnoff included in the markup of extenders – agreed to by the House but dropped in conference when agreement couldn't be reached with the administration on the overall bill. We strongly encourage the Senate to include the AMT turnoff for the R&D tax credit in this year's extenders. The House – in its R&D tax bill by Congressman Kevin Brady (R-TX) has included the AMT turnoff. So fingers crossed.

I tell you all this Mr. Chairman and Ranking Member – not just to ask for your help to get this commonsense fix signed into law (which we would greatly welcome) – but as an illustration of how one code section – 38(c) can serve to completely undermine the Congressional policy and goals of another code section – Section 41 the R&D tax credit. Further – this is not a one-off – the tax code is replete with these types of problems for small and medium businesses (the code giveth with one hand and taketh with the other). I would note – even with all the good work and effort by a number of Senators and Members of Congress, it has not been an easy lift by any means to get this bipartisan fix to the popular R&D tax credit done.

My recommendations in tax and for tax reform:

- 1) Reform can start today – make where possible changes in the law that will allow small and medium businesses to take advantage of the credits and incentives in the tax code. As an easy example, the AMT turnoff for R&D tax credit. In addition – permanency of the tax extenders – especially Section 179(d) expensing and the R&D tax credit would be of particular benefit to small businesses. Also, the Committee should consider the negative implications of Section 280C(c) which serves as another disincentive for small and medium companies taking the R&D tax credit -- allowing 280C(c)(3) reduced credit election on amended returns – would eliminate the headache of having to amend state returns which is a deterrent for some small businesses in

taking the credit as the compliance costs may outweigh the benefit and the amended returns may result in higher state taxes. One related note – the Committee should also consider what Treasury is doing in regulations – Treasury can do much good to help small businesses (and has – see footnote 4 below ) but Treasury can also take steps unhelpful for small business – for example proposed regulations on family limited partnerships could potentially harm family business planning. See *“IRS Takes Aim at an Estate Planning Strategy,”* Wall Street Journal, June 26, 2015.

- 2) Knowledge is king. This Committee especially – but also the entire Congress -- needs to understand better what are the roadblocks and barriers keeping small businesses from fully benefitting from the credits and incentives provided in the tax code. The SBA Office of Advocacy issued a report in November 2013, entitled, “Measuring the Benefit of Federal Tax Expenditures Used by Small Business.” The report highlights some of the same issues I’ve put forward – small businesses often getting the short stick on tax expenditures – but doesn’t get at all into the “why.” This Committee should ask the SBA Office of Advocacy as well as the Taxpayer Advocate at the IRS and the GAO to analyze and discuss the barriers for small businesses preventing them from fully benefitting from tax expenditures<sup>3</sup>. The GAO did an excellent job of identifying the problems and barriers for small businesses in their report on the R&D tax credit (cited above) – and should be tasked to do a more expansive review. The bottom line – when small and medium businesses are not proportionally claiming a credit or incentive – is to ask why? alliantgroup and its CPA advisors would also be happy to assist the Committee in this effort.

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<sup>3</sup> See the Taxpayer Advocate’s thoughtful testimony on these issues generally from a House Small Business Committee hearing, April 13, 2011 *“How Tax Complexity Hinders Small businesses: The Impact on Job Creation and Economic Growth.”*

- 3) Ask the hard questions. When the Senate is considering tax reform – this Committee should review and consider what the impact will be on small businesses. Will small businesses be able to fully qualify for the tax benefits? Are there any limitations to small businesses benefitting? Can these be addressed? Should/can there be a safe harbor or a simpler rule for smaller businesses to qualify for the same tax benefit?
- 4) Simpler and easier. This goes in some ways hand-in-hand with number 3 above. In reviewing tax legislation, the Congress needs to be aware that the more complicated provision is, the more bells and whistles in the legislation -- what that really translates into for small businesses is higher compliance costs and a good likelihood that the small business will not even seek the tax benefit (thus undermining the policy goals Congress wants to accomplish). A good example is some of the hiring credits and incentives at the state and federal level – they often require taxpayers to hop-on-one-foot; wear-a-pink-dress and have-a-bow-in-your-hair requirements to qualify for x dollars that for small business owners they (and their CPA advisors) don't even bother.<sup>4</sup> As a general rule – a heightened sensitivity to the costs and burdens for small businesses of tax compliance is vital to bear in mind when considering tax reform.

Finally, Mr. Chairman, I have not had the opportunity when this testimony was written to review all the details of your proposed legislation – The Small Business Tax Compliance Relief Act – but from what I've seen so far – increasing the safe harbor for purchases of tangible personal property; expanding eligibility for cash accounting; and others will certainly be welcomed by a partner CPA firms. Proposals from the AICPA, including allowing delay of partnership filing to after April 15<sup>th</sup> merit consideration.

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<sup>4</sup> An example of a burden for small businesses that was recently eliminated through a change in the regulations is allowing businesses to take the R&D Alternative Simplified Credit on amended returns. Previously, businesses could take the Alternative Simplified Credit for R&D only on an original return. This regulatory burden disproportionately burdened small businesses – see my [article](#), “Surprise Change To R&D Tax Credit Rules Is Big Help For Small Business” in Forbes providing further details. Bottom line – a seemingly small issue – that you can't take a provision on amended returns – has significant and disproportional negative impact on small businesses.

alliantgroup would be happy to work with and the Committee as the Senate considers this legislation further. I commend you for your efforts on behalf of small businesses.

## **2. Tax Code -- New Business and Entrepreneurs**

The Committee is right to declare that it is a Committee for both Small Business and Entrepreneurship. Supporting and encouraging entrepreneurship is vital to the long-time success and growth of this country. A 2010 NBER [paper](#), "*Who Creates Jobs? Small v. Large v. Young*" highlights the enormous importance of new businesses in creating jobs.

There is much that the tax code could do to encourage entrepreneurs and job creation. One of the biggest difficulties is that it is difficult for startups to benefit from tax incentives because the incentives are designed only for businesses that pay income tax. It is important to remember that startups – even those not making a profit – still pay a great deal of taxes (payroll, excise, etc.) even if they are not paying income tax. For the business owner it's all tax regardless of how it's labeled.

I see this problem of tax benefits not being available for startups and new businesses particularly in play with the R&D tax credit. Some of our most innovative and cutting edge work is being done by small start-ups – yet these companies that we should most want to encourage get zero benefit from the R&D tax credit.

I commend Senator Coons (D-DE), a member of this Committee, for his thoughtful approach with The Innovators Job Creation Act – a bipartisan bill introduced with Senators Roberts (R-KS) and Schumer (D-NY). The legislation allows start-ups to take the R&D tax credit against employment taxes – up to \$250,000 per year. Finally! Start-ups doing some of the most interesting work in the country can look to benefit from the R&D tax credit – if this becomes law. Thanks to the hard work of these three Senators – this legislation was included in the tax extenders bill passed by the Senate and was accepted by the House. It was only when there was a failure to reach an overall deal on tax extenders that this

important legislation was not included in the final agreement. The Finance Committee will soon be marking up the tax extenders bill – and I have high hopes that this will be included in the Senate package. I would encourage the Committee to voice its support for this legislation. Thanks to Senator Coons’ leadership we have a chance to see a real game-changer in terms of tax policy for startups.<sup>5</sup>

Mr. Chairman I should note that your state of Louisiana (as well as Minnesota and a number of other states) had a refundable R&D tax credit program. Alliantgroup has worked with scores of Louisiana entrepreneurs and business owners to qualify for the Louisiana R&D tax credit – both the regular state credit as well as the refundable credit. Unfortunately, due to budget limitations, Louisiana has effectively set aside the state’s refundable R&D tax credit. The state’s actions are most unfortunate – leaving scores of Louisiana small and new businesses in the lurch – businesses that hoped and counted on the dollars from the Louisiana refundable R&D tax credit to keep their doors open, grow their business and create more jobs.

Mr. Chairman, I wish you good luck on your efforts to become Governor of Louisiana and I hope that once you are sitting in the Governor’s chair you take a moment to revisit the Louisiana refundable R&D tax credit – first to make certain that the businesses that in good faith applied for the credit are treated fairly and equitably; and, second, to look at bringing back the refundable R&D tax credit that did so much to put out the “welcome” mat for innovative businesses to come to Louisiana.

Some final thoughts on encouraging entrepreneurs – consideration must be given to how to bring capital investment to new business and encourage risk-taking. I encourage the committee to look at the excellent work done by the Kaufmann Foundation -- especially their report on the “Start-up Act 3.0.” Particularly interesting is the Foundation’s proposal for a 100% exclusion for gains on investments in small business stock – Section 1202. Proposals that the Committee should also consider include \$100

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<sup>5</sup> For more details on Senator Coons’ proposal see article in Harvard Business Review by myself and Dhaval Jadav “Finally, A good idea from Congress (and it helps start-ups)”.

exclusion on corporate taxable income by a qualified small business (\$50 million valuation) in its first year of profits and 50% exclusion for years two and three (put forward by the National Advisor Council on Innovation and Entrepreneurship at the Department of Commerce).<sup>6</sup>

### **3. Encouraging Employee Ownership – “Every Man an Owner”**

Mr. Chairman – you know better than I that the phrase “Every Man A King” is a part of the fabric of Louisiana politics. As you and your colleagues in the Senate consider tax reform, I would ask that Congress consider embracing a new standard: “Every Man An Owner.”

As Congress considers tax reform, hard consideration should be given – especially by this Committee – as to ways to encourage greater employee ownership.

The tax code, especially with ESOPs and estate tax provisions has encouraged business owners to provide for employees to have more of a stake in their company. Recent research – brought forward in a compelling recent book, “The Citizen’s Share” by Professors Blasi, Freeman and Kruse (Rutgers, Harvard and Rutgers respectively) highlights the significant analysis that shows the marked benefits of greater employee ownership for everyone – shareholders and employees. Benefits of greater employee ownership include according to the book:

“Strong evidence that employee stock ownership and profit sharing have meaningful impacts on workers’ wealth. Workers with profit sharing or employee stock ownership are higher paid and have more benefits than other workers.”

The book also highlights findings that greater employment and profit sharing lead to providing workers more job security and better working conditions. Further, employees with ownership interests

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<sup>6</sup> A general discussion of these ideas and others can be found in my Forbes [article](#): “Top 7 ideas for tax incentives to create jobs”

state that they are willing to work harder, are more loyal, will make suggestions to improve the company and are willing to stay with the company.

Some of these goals of greater employee ownership are similar to those voiced by supporters of ESOPs – and I applaud that Senator Cardin (D-MD) has authored legislation to address issues regarding ESOPs, particularly of note expanding eligibility for ESOPs for certain SBA programs. I encourage the Committee to review the recent articles in Tax Notes – the first, April 23, 2015 *“The Problem With ESOPs,”* by former Treasury Official William Bortz and a response *“Do ESOPs Need Reform? A Look at What the Data Tell Us,”* by Corey Rosen of the National Center for Employee Ownership, June 22, 2015.

However, while it is important to look at ways to improve and strengthen ESOPs -- my view is that the Senate should step back and look at new and bolder ways to encourage employee ownership -- to look beyond ESOPs. With Presidential candidates now speaking up about profit-sharing and employee ownership – it is time for the Committee and the Senate to consider these issues closely and not just look at half-measures or token gestures (especially so, given the evidence of the benefits for workers) – but rather, swing for the fences. Specifically tax incentives for businesses (for example, lowering of the corporate rate or the individual rate for business owners) that provide substantive employee ownership/profit sharing as part of a workman’s pay package. The Committee needs to consider what changes would be required in the tax code, including estate tax, to force a real rethink and change in business in regards to employee ownership and profit-sharing as part of workers compensation.<sup>7</sup>

As a path to greater employee ownership and sharing of profits – I encourage the Committee to also look at the area of tax and accounting treatment of stock options – with a useful primer from the

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<sup>7</sup> See the NY Times oped by Professor Folbre *“Wanted: More Worker-Owners”* and my article in Forbes, *“Raising Minimum Wage? How About Raising Employee Ownership?”* -- both providing useful discussion and links to other articles and discussions on this issue.

Congressional Research Service – “Employee Stock Options: Tax Treatment and Tax Issues” by James Bickley, June 15, 2012. It is beyond this testimony, but my impression from talking to business owners is that the current tax laws discourage and limit employees benefitting from the success of their company through stock options and grants of stocks. In particular, the tax laws are not kind when it comes to significant stock options that will encourage employee ownership. For example when compensation for an employee is 50 percent cash and 50 percent stock options – the employee may not have cash to exercise the options or pay the taxes upon exercise. Congress needs to engage with industry and find a workable solution – all to the benefit of workers getting a bigger piece of the pie.

A key part of tax reform should be making the path easier and smoother for employees to benefit from the success of the company’s they work for – such reforms would be a critical step to addressing equity for working families in today’s world.

#### **4. IRS Service, Assistance and Education**

It is an old chestnut in tax administration that often forgotten is the “service” part of the Internal Revenue Service. However, particularly for small business owners – and their CPA advisors – the service part of the IRS is an important and critical part of tax administration.

##### **Service and Assistance**

Unfortunately, Senators on this Committee – and certainly tax practitioners – are familiar with the litany of problems at the IRS – phones not answered, service centers not properly manned. I was dispirited to see recently in Houston a line stretching outside for 30 yards in the Summer heat for people waiting to talk to an IRS official at a taxpayer assistance center (that was just to get in the room to then wait with another 50 people).



For a small business owner -- subject to an audit or examination the problems at the IRS only get worse. If it is a correspondence audit -- it can be maddening to deal with a new person every time you call the Service Center -- and have to explain all over again what the problem and issue (assuming you get through). If it is an in-person audit -- the hope and prayer is that the examiner is trained and knowledgeable about the tax issues. If not, it can be hours of additional time and cost for the small business owner dealing with an examiner who isn't familiar with the law.

Let me be clear -- I view that there are a strong number of good, capable people at the IRS -- doing important work. There are also a small number of employees that are problems. In between though there are a significant number of IRS employees who are well intentioned and dedicated but haven't received proper training, guidance and support.

The IRS senior management faces a significant challenge of showing and convincing leadership in Congress that they are responsive to concerns about the agency. IRS senior management must every day work to restore the confidence of the Congress and the taxpayer in the IRS. My hope is that the Congress will also take steps though and pass taxpayer rights legislation -- including small business taxpayer rights -- that will address the concerns of overreach and improper actions by the IRS. That said -- the current situation at the IRS in regards to service is untenable. After necessary reforms are passed, Congress needs to revisit the adequacy of IRS resources in relation with the required work of the IRS and the level of service the Congress wants IRS to provide taxpayers. At the end of the day -- small business owners and their CPAs want an IRS that is performing and functioning in a manner expected of a professional service organization -- answering phones, responding to letters, providing necessary guidance, examiners knowledgeable in the law, etc. Improvements in service will translate into lighter burden, less time and lower cost for small business owners to comply with the tax code -- and better compliance.

I would suggest that the Committee consider writing the IRS on the following regarding service:

Online service -- Individuals can get access to their accounts but there is not a way for business entities to have online account access. Online account access could help with resolving account issues when a business gets an IRS notice without having to call and being on hold for long periods of time just to get an account transcript. For example, maybe a payment has been posted to the wrong tax year or account, employment versus income tax. Penalties could result. Also, individuals can check on status of amended returns online but businesses cannot. It is hard for a business to find status of amended returns. The IRS should make this a priority of work.

Written correspondence-IRS has acknowledged previously that backlogs exist in correspondence. A taxpayer should not have to respond multiple times to the same inquiry when it is due to IRS not reviewing a prior response. The IRS should be asked what efforts are being made to address this issue.

#### **Education**

Hand-in-hand with service is education. As I mentioned at the beginning of my testimony, so often a reason a small business owner doesn't take a credit or incentive is simply due to lack of knowledge and information about the incentive. Too often there is a view of small business owners that the tax credits and incentives provided by Congress are really just for the big boys -- the Fortune 500. I know that is not the case -- but the view dies hard. In addition, small business owners don't have the benefit of an army of tax lawyers and accountants in-house to call on to provide advice on all the intricacies of the tax code. The CPA firms for small businesses are understandably often up to their neck just trying to comply with significant basic blocking and tackling necessary for their clients. The end result -- small businesses don't take a good number of the credits and incentives available for them in

the tax code because of either self-censoring (thinking they don't qualify – only for the big guys) – or just plain “don't know.”

The IRS has certainly beaten the drums on encouraging taxpayers to take some tax credits and incentives – such as the Earned Income Credit and some of the credits and incentives from the recent health care bill. However, the IRS is often dead silent when it comes to educating small business owners about tax credits and incentives. I appreciate that the IRS has a great deal on its plate and can't be all things to all people. However, what is concerning is that not only does the IRS do little in the way of education, but also the IRS can at times give a fairly hard eye to those seeking to educate small business owners about credits and incentives provided for by Congress. Let's be clear – I'm not talking about someone hawking some borderline tax shelter – I'm talking about some of the most basic credits and incentives in the tax code.

I would suggest that it would be most helpful for the Committee to ask the IRS: 1) what it is doing to encourage and educate small businesses about the tax credits and incentives that are available for qualified business owners; 2) to cooperate with tax service providers and CPA firms who work with small businesses to assist in education and awareness of tax credits and incentives; and, separately, 3) to ask the SBA Office of Advocacy to step up and do more to educate small and medium business owners on the tax credits and incentives for which they may be eligible. Such education will go far in ensuring that the tax credits and incentives put in place by Congress actually achieve the policy goals that were intended.

##### **5. IRS Examination and Audit**

Mr. Chairman, it is important for the Committee to understand as it considers tax reform— the shadow cast on small business owners by IRS examination. Unlike large businesses who view an IRS examination as par for the course, for a small business owner an IRS phone call is a source of great

dread and anxiety. The shadow of a possible IRS exam is a key reason some small business owners shy away from taking otherwise available tax credits or incentives—even if the credit or incentive is right-over-the-plate for them to qualify. Therefore—ensuring that IRS examinations are done fairly and professionally goes hand-in-hand with tax reform and ensuring that the tax provisions work for both big businesses and small businesses -- as intended by Congress.

I recognize that the IRS has to conduct examinations and audits -- as part of an overall effort to ensure tax compliance. That said, it is possible to improve the manner in which the IRS exams small businesses.

alliantgroup represents hundreds of taxpayers across-the-board -- small, medium and large before the IRS in examination and audit. Let me be the first to say that most of the examinations for which we serve as the taxpayer representative -- the IRS agent is professional, knowledgeable and courteous and the exam is fair, open and transparent. This does not mean we always agree but at the end of the exam we feel that our client was treated fairly and with respect.

However, we are concerned with what we are increasingly seeing, especially in audits of smaller businesses. Too often the IRS in an audit treats a small business the way it treats large businesses seemingly unconcerned with the burdens of data and document requests. It seems at times, with exams of small businesses the IRS doesn't appreciate the differences with a large business that a small business may have in terms of quality and quantity of record keeping as well as timekeeping. The IRS should not have the same expectations for Exxon as it does for Thibodeaux's Oil and Pump.

Again, I don't want to suggest we see these problems with all IRS agents and small business examinations – but we are concerned. And our concern is only exacerbated by budget declines and the resulting lack of sufficient training, education, and strained staffing.

And, in view of our concerns, it is vital Congress provide fair oversight and have its voice heard in these matters of examination. Congress should pass legislation to strengthen taxpayer rights for both individuals and small business. Senator Cornyn (R-TX) has introduced a thoughtful bill on taxpayer rights for small business that this Committee should review closely and my former boss, Senator Grassley recently introduced legislation on individual taxpayer rights. Both bills have a number of smart ideas – and I'm sure the Committee in its work can add its own set of good proposals - there remains much to be done.

Mr. Chairman and Ranking Member – I just want to touch briefly on some areas in examination of small businesses that we see and find particularly concerning – and am happy to discuss these and other matters in more detail with the Committee staff:

Openness and transparency in an examination. Particularly with examinations of small businesses we see the IRS less open in discussing issues under review. This is not only frustrating for the business owner but hampers efforts by the business owner and their tax advisors to be responsive to the material and information the IRS is requesting. In addition, the IRS examiner should keep the taxpayer informed of the progress/status of the exam.

Further – we are seeing agents with less and less authority. Too often the IRS examiner will be relying on “the man behind the curtain” – an IRS expert or technician. That help is provided is fine. However, taxpayers and their representatives are often frustrated in light of our lack of ability to approach and discuss issues with the expert or technical advisor who dominates the case process and is not intimately familiar with the facts of the particular taxpayer. Thus, the IRS technical advisors are at

times, providing advice that is not encompassing the full knowledge of the underlying matter. The taxpayer should be able to talk directly to this expert -- rather than engage in a time consuming and frustrating version of "telephone."

Third party contacts. In the 1998 IRS Restructuring Act Congress sought to rein in third party contacts. The then-Chairman of this Committee Senator Bond (R-MO) wrote to the IRS Commissioner Rossotti on February 25, 1999 about this provision -- concerned that IRS was improperly harassing small business owners with third party contacts (ex. contacting clients, business partners):

Our intent in enacting this provision was that the taxpayer should have the opportunity to provide information requested during an examination before the IRS turns to any third party. In addition, once the IRS determines that such information can only be obtained from third party parties, the taxpayer has a right to reasonable notice concerning the third parties that the IRS needs to contact and to receive such notice before the inquiries are made.

In representing small business clients, we are seeing extensive third party contacts. These third party contacts do not appear to be done as a last resort or because the taxpayer has refused to provide information. Instead the IRS uses the rubric of "verifying" what the taxpayer has stated. This is done even in cases where there is no evidence to suggest that the taxpayer is incorrect and is done without giving the taxpayer a chance to address an IRS question). The end result can be devastating to the business of the taxpayer -- as business partners and clients are contacted by the IRS. I would encourage the Committee to ask the Taxpayer Advocate her views on the IRS actions in this area -- and recommended reforms.

FOIA. Like many agencies -- the IRS is not setting speed records on responding to FOIAs. In some cases this may reflect a need for additional budgetary support. FOIA is often a key way for a taxpayer to understand fully the areas of concern in an IRS examination.

Fast-Track Process. Fast track has been a wonderful vehicle for large businesses to resolve tax issues with the IRS quickly and at low cost. This mechanism should be applied to small businesses as a way to expedite matters and in an effort to reach amicable resolutions of examinations. I would suggest the Committee ask the IRS and the Taxpayer advocate for a review on this matter and steps to make certain that fast-track is uniformly available to all manner of taxpayers so it can be a real benefit for small businesses – not just big business.

I close this discussion by noting that the vast numbers of small business owners want to comply with the tax laws (and yes there are certainly bad actors out there that IRS should focus on).<sup>8</sup> Further, tax practitioners want to make the road as easy for their clients as possible with the IRS. There is much that can be done to encourage compliance with greater cooperation and best practices between the IRS and tax practitioners.

Mr. Chairman, as stated earlier – getting small business owners in a better place in relation to the IRS and examination and audit is critical if the Congress is going to see tax reform work for small businesses. There is much that needs to be done and much good that can be realized but it will take Congress – and this Committee – showing the leadership necessary to make improvements in IRS examination of small businesses.

#### Conclusion

Thank you Mr. Chairman Vitter and Ranking Member Shaheen – alliantgroup prides itself on being a voice for small and medium businesses and we are happy to assist the Committee in its work.

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<sup>8</sup> The Committee might consider asking the IRS to review the SBA Office of Advocacy Report: “An Examination of the 2001 IRS Tax Gap Estimates’ Effects on Small Businesses,” March 2011 – which raises questions about the focus on small businesses and the tax gap – particularly in relation to examination and audit priorities.

Chairman VITTER. Great. Thanks to all of you for your testimony, very much.

Now, we will go to Senator Enzi if you would care to stay, but if you cannot, we understand.

Senator ENZI. I am late——

Chairman VITTER. Okay.

Senator ENZI [continuing]. But I wanted to hear the testimony.

Chairman VITTER. Yes. Thank you.

In that case, we will go to Senator Fischer.

Senator FISCHER. Thank you, Mr. Chairman.

This would be a question for the entire panel, if you would like to weigh in on it. The Senate Finance Committee marked up tax extender legislation that would reenact all the provisions that expired in December of 2014. So, if these provisions are good enough for the past decade, and in many cases almost 30 years, such as the R&D credit, then should not they be made permanent?

I hear about the 179 deduction all the time. More than 21,000 Nebraskans work in equipment manufacturing, and that is about one in five Nebraska manufacturing employees. Sales of goods produced by equipment manufacturing and related industries are almost \$3.4 billion.

So, my constituents would like to see a longer extension of this deduction allowing up to \$500,000 to be expensed in a given year. So, do any of you have objections to making it permanent, and if so, what would you propose instead?

Mr. ZERBE. I guess I will start, Senator——

Senator FISCHER. We will let the gentleman from Omaha go first.

Mr. ZERBE. Thank you, Senator, very much——

Senator FISCHER. It is nice to see you.

Mr. ZERBE. Thank you very much. Glad to see my Omaha ties have finally come in handy.

[Laughter.]

I think it would be terrific. I think, for everyone, 179, little “d” in particular, if I had to pick one out, that would probably be it, along with the R&D credit, because they are based on behaviors that you are trying to affect. I think you are absolutely right, though. It is really the devil that you have this stop and start in terms of the tax provisions, and to get those put into permanency would be a godsend.

Ms. BRUCKNER. I think it was really encouraging to see that the two-year extension for the 100 percent exclusion from cap gains on 1202 stock, which is investments into certain qualified small business stock. Chair Vitter, your bill builds on that specific provision in a number of ways. We know that that provision operates to get equity into the hands of entrepreneurs and it would be—it would likely be a very successful provision in the code if it were made permanent at the 100 percent exclusion level.

Mr. PORTER. I, likewise, agree completely, that what we need more than anything is permanency in the code. The in and the out, you know, constantly, it is maddening for clients and it is maddening for us. I mean, I have clients that have me on their speed dial in December and they call me every other day. “Has the bill passed? Has the bill passed?” So, I think it is a huge issue, and then passing them late in the year, as we have been doing, ends



up to the point where clients do not have the ability to go out and invest like they need to invest and they keep waiting and waiting for that. So, I agree. Many of the provisions need to be made permanent.

Mr. MATHISON. I would echo the same thing. NSBA is very clearly in support of making them permanent. This is the roller coaster I referred to in my testimony. This is the knowing, not knowing, pass, expire, try to get it redone. This is a mess and needs to be fixed.

Mr. KARELLAS. Yes, I join the chorus. This 179, in particular, is one of the items we hear about repeatedly from our members, especially in December, wanting to know what the chances are that Congress is going to pass this, at least for the year that just happened. And, so, we, of course, are for permanency. Our members always want the opportunity to be able to plan ahead. If we cannot get permanency, we hope to at least get something that looks as far ahead of time as we can.

Senator FISCHER. Good to hear. It is such a problem when there is no certainty for businesses. And, as you said, you receive hundreds of calls, thousands of calls, as the deadline is approaching and people do not know how they are going to make decisions that are going to improve their business.

Mr. Porter, earlier this year, I introduced legislation which was the Taxpayer Accountability Act, which would require the IRS to provide a substantive written response, not just an acknowledgment letter, to any written correspondence from a taxpayer not later than 30 days after receiving such correspondence, and if the IRS discloses any taxpayer information to any federal, state, or local government, to provide that to the taxpayer in a written notification within 30 days. Do you think that would help to resolve some of the issues that you highlighted in your testimony?

Mr. PORTER. Yes, ma'am, I think it would, and let me give you a scenario of how it typically works in my practice. A client comes in with a notice from the IRS and so you have to provide some supporting information. The notice may be right, may be wrong. So, you send in a letter, and 45 days later, you get a letter that says, we have not had time to look at your letter yet. You know, so then you say, okay. Forty-five days later, you may get another letter. So, now you are out to 90 days. But in the meantime, the computers are generating notices every 30 days, adding additional penalties and interest, threatening liens and levies, and so what that means is you have to call the IRS then every time and say, hey, would you put a hold until we get some kind of response to our letter.

It would be hugely helpful if they were to acknowledge that they received your notice and let you know that they have it and that they are going to cease any collections activities until they resolve your issue.

Senator FISCHER. If they do not acknowledge that they received your notice, then the fees continue, right, the fines?

Mr. PORTER. The penalties and interest?

Senator FISCHER. Right, yes.

Mr. PORTER. Oh, absolutely, until it is resolved. Of course, if it is resolved in the favor of the taxpayer, those go away. But, again, it is the client comes running in the door with that letter again

and, you know, you will call the IRS, after you sit on hold for who knows how long and they will say, yes, we have that, I can see it here in the computer system.

Senator FISCHER. Okay. Thank you very much. Thank you all.

Chairman VITTER. Great. Thank you.

Senator Coons.

Senator COONS. Well, thank you, Chairman Vitter and Ranking Member Shaheen, both, for holding this hearing.

It is great to be in a room where we can agree on a lot of different things—one in particular, I suspect. We have heard from a lot of different folks on both sides of the aisle is that when it comes to tax reform, the stakes could not be higher for small business. And, I suspect that every Senator who has been here and questioned and every witness who has testified has suggested that America's tax code today is too long, too complex, frankly, too unfair for small business, and that the \$100 billion a year, roughly, spent in tax compliance is a cost that we should find a way to reduce, that the complexity of the tax code and the difficulty and expense of tax compliance puts small business, innovators, startups, and families really at a significant and unfair disadvantage.

So, Senator Fischer has left, but I was going to agree with her that Section 179 permanency is something I would also support and advocate for. I grew up in a small business-owning family and I hear week in and week out from Delawareans who are trying to run small businesses exactly the points that our panel testified to, which is that they have great difficulty understanding, accessing, affording, taking advantage of the incentives that are provided in the tax code for small business, and that particularly the ones that expire year in and year out are of modest helpfulness, particularly when they seem to always be retroactively enacted.

So, let me speak for a few minutes, if I could, to the Innovators Job Creation Act. I am really grateful for the opportunity to speak to that, and I really appreciate Senator Enzi working with me initially and Senator Roberts being the cosponsor of the provision that, as Mr. Zerbe mentioned, was included in extenders yesterday.

One of the key areas, I think, for tax reform and for us to look at in tax policy is innovation. The R&D tax credit has made a huge difference, particularly for very large and very profitable companies, over a long period of time. And as someone who was in-house counsel to a company that relied on that to help finance its investments in cutting-edge research, I think it is a positive thing. My very first bill as a Senator was permanency for the R&D tax credit.

But, finding ways to make it accessible to early stage and startup businesses is a challenge that eluded me for a number of years, and that is why I first worked with Senator Enzi, and then with Senator Roberts. The Innovators Job Creation Act allows the R&D credit to be claimed against the AMT, the alternative minimum tax. So, even if a company is entitled to the R&D credit, many pass-through entities cannot claim it because the R&D credit cannot be used in its current form against the AMT. Eight out of 10 businesses that could otherwise benefit from taking the R&D credit get little or no benefit because of the AMT. And, this was previously in the Small Business Jobs Act of 2010, but expired after a year.

So, working together, we came up with an innovative solution to solve a major problem. If a startup company cannot access the R&D credit because they do not have an income tax liability, which most early stage startups do not, then they can claim the R&D credit against the taxes they pay on employee wages.

So, I am very pleased to say that Senators Roberts and Schumer introduced this provision in Senate Finance Committee markup, which was adopted unanimously as part of the extenders package, and it is my real hope that it will ultimately become a permanent feature of the R&D credit and that we will ultimately get to a permanent R&D credit.

So, if I might, in the time we have got left, Mr. Zerbe, I would welcome your thoughts on this particular provision. You have been a strong advocate of boosting access to the R&D credit for all businesses. What types of businesses do you think will benefit from this? Given previous testimony about how difficult it is sometimes for small businesses to be informed of and aware of and to access, what recommendations would you have, given that this looks to be on track to be in the extenders for accessing it?

And before I conclude my question, let me simply say I am eternally grateful to J.J. Singh of my staff, who really helped lead all the very hard and disciplined work on this. He has been a tremendous contributor on many different areas, but this one in particular, he should take all the credit for. I am just the person who gets to say publicly—I get to have my name on the bill, but it is really his work that has helped make this possible.

Mr. ZERBE. Yes, J.J. has been fantastic, and I am very sorry that he—I understand he is leaving your staff. I do not know if you did not know that, but—

[Laughter.]

Senator COONS. No, no, I am well aware. It is my loss, but Delaware's gain.

Mr. ZERBE. That is right.

Senator COONS. He is going to move to Delaware, which I am very excited about.

Mr. ZERBE. But, you are right to point out the AMT turnoff, which I was so keen on getting into the refundable piece, but that, Mr. Chairman, goes right to the point I made. The reason small businesses cannot take the R&D credit, the key reason is the AMT. I mean, there is a legal bar to doing it, and that is kind of just a good example. It is not just for the R&D credit. Thirty-two other credits, they cannot take, because that AMT bar for pass-throughs, that is just the devil if they cannot take it.

So, yes, I mean, that will be a massive change. We had it in 2010 for one year. It was just a sea change for folks being able to take it across the board and across the country.

I think for the startup—well, I think the refundable piece of it that will be for new businesses and startups, I think that the industries that will be particularly benefiting from that, Senator, would be biochemistry. We saw that with the Qualifying Therapeutic Discovery Project that we had, which is almost a version of this. That was in the Affordable Care Act. I think biochemical, pharmaceutical, I think anything in the medical field will all be very good targets for this, folks that are trying to find a new new.

But, I think the great thing about, in a sense, working this with the R&D credit is that the R&D credit is as wide as the ocean. In other words, it is not Congress picking winners and losers and saying, this is who should get funding. This is who should not get funding. So, I think you are going to actually encourage more folks to say, hey, I want to do that. I want to make that try. I want to make that leap to that new company to try this, because I know that this provision you have put in place is out there.

So, I think it will be very broad geographically. That is one thing we learned from the QTDP, is that this kind of provision is not going to be limited to just one valley in California, or one part of Route 128. It will be across the board. That is what we found working with companies on the Qualifying Therapeutic. It will help all sorts of businesses throughout the country, and, I think, all types of businesses. But, I think those are the specific ones.

I think you are right. Education is going to be critical, because if the small businesses have difficulty, the startups are going to have a greater difficulty in doing it. And, I think you have done a wonderful job, though, of making it pretty clean and clear how it is going to work and operate, and I think that helps a lot. The rules are pretty clean and simple. It is when you get into, well, hop on one foot, wear a pink dress, have a bow in your hair type of provision, that is when small businesses and CPAs say, you know, maybe not worth the candle.

So, I think you have got, thanks to J.J. and your good work, you have got a nice clean bill. I think it is going to be a challenge to educate. We are certainly going to be doing that and working with other folks who are very much champions of what you have done. But, you are right. That is going to be the big second piece of the challenge to that.

And then it goes to the point we were talking about, Mr. Chairman, is making sure for the IRS that they implement this properly, with service, that they are doing it properly, that they are not there, because if folks think there is a root canal at the end of the day when they are going to take this, they are not going to take it. So, we need to make sure that the IRS is working with them on that. And, I think we can accomplish all that and have a real success here.

Senator COONS. Well, thank you. Thank you very much for your input, for your enthusiasm. I hope all the committee members will take up the opportunity to reach out into our home states and communities, and I really am optimistic that this great work product that Senator Roberts and Senator Schumer played such a central role in getting into extenders will actually be of meaningful benefit to a very wide range of sectors and companies, and I look forward to making sure that that implementation goes as well as possible.

Thank you very much, Mr. Chairman.

Chairman VITTER. Thank you, Senator.

I certainly want to agree with several comments that have been made, including the need for greater access to the R&D credit, including the need for greater permanency, in general. We do not get nearly the bang out of the buck we should from these provisions when we let them limp along by extending them for short periods of time, either at the last minute or actually retroactively. We just

get a pittance of the economic bang for the buck that we could if we made them permanent. And, certainly, including Section 179 expensing, making that permanent, and I am introducing legislation to make it permanent.

Again, to reiterate, this discussion was meant as a prelude, in part, to a markup we will be having fairly soon on my Small Business Tax Compliance Relief Act. That is a collection of significant small business tax issues. I look forward to it getting wide bipartisan support in this committee, and we are completely open for suggestions from all committee members as we work toward that markup. I am introducing the bill today, but that is certainly not the end of the discussion. It is the beginning of the discussion. And, so, we are actively reaching out to every committee member to work toward a markup and come together around a really strong bipartisan committee product focused specifically on key small business provisions.

It will not be overall tax reform. It will not be everything I would like to see. It will be very significant provisions that mean a lot for small business specifically that we can move forward on, hopefully sooner rather than later, and not wait on the whole world and the whole tax code being solved to pass these common sense reforms. So, that is the idea behind it.

Again, thanks to all of you for your testimony. Thanks again to our first panel for their testimony.

And with that, our hearing is adjourned.

[Whereupon, at 11:49 a.m., the committee was adjourned.]



## **APPENDIX MATERIAL SUBMITTED**



**ANGEL CAPITAL ASSOCIATION**

July 9, 2015

The Honorable David Vitter  
United States Senate  
516 Hart Senate Office Building  
Washington, DC 20510

Dear Chairman Vitter:

On behalf of the 13,000 members of the Angel Capital Association (ACA), the national professional association of accredited angel investors, I write in support of the *Small Business Tax Compliance Relief Act*, which would bring much needed reforms to Section 1202 of the United States Tax Code. Along with the members of ACA, I commend you for your leadership in promoting a fairer tax code for American small businesses and entrepreneurs and promoting US job growth.

As angel investors, the members of ACA, who are located in every state, are at the wellspring of capital formation and job creation in the United States. The current economy as well as the investment environment is much more dynamic than when section 1202 was first created with many companies going from start up to angel investment to private equity, then on to the public markets faster than ever. *The Small Business Tax Compliance Relief Act* would reduce the current five year holding period on qualified small business investments to three years. This reduction in the holding period is a welcome change for angel investors and will ensure that early stage angel investors don't delay a company's growth trajectory because of a potential tax liability. This change will allow any qualified investors who have held a stock for a minimum of two years to sell at a reduced capital gains rate, encouraging additional capital formation as angels re-invest their money in additional small businesses.

Another reflection in the change of the market is the time and detailed research it takes for qualified investors to roll any proceeds over into a new investment tax free. The current 60 day maximum is much too short for an individual or an angel group to properly research a new investment, ensure that the new investment is ready for a non-public offering, and deploy capital. Your bill's recommended one year period for an individual or a group to do due diligence, invest smartly and deploy capital on a thoughtful and strategic basis will ensure that much needed financing is going to the most deserving startups.

Thank you for introducing the *Small Business Tax Compliance and Relief Act* and for your leadership in promoting smart tax reform which will lead to economic growth. Your emphasis on job creation and capital formation is appreciated by the Angel Capital Association and we look forward to working with you to see the goals highlighted in this bill become US law.

Sincerely,

A handwritten signature in black ink, appearing to read 'Christopher Mirabile'.

Christopher Mirabile,  
ACA Chair  
Launchpad Venture Group

A handwritten signature in black ink, appearing to read 'Michael J. Eckert'.

Michael J Eckert  
ACA Policy Chair  
NO/LA Angels

A handwritten signature in black ink, appearing to read 'Marianne Hudson'.

Marianne Hudson  
Executive Director  
Women's Capital Connection





P.O. BOX 80258  
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[www.labi.org](http://www.labi.org)

225.928.5388 (T)  
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July 14, 2015

The Honorable David Vitter  
United States Senate  
516 Hart Senate Office Building  
Washington, D.C. 20510

Dear Senator Vitter:

On behalf of the Louisiana Association of Business and Industry (LABI), the state's largest and most effective business advocacy group representing the interests of more than 2,500 businesses of all sizes, sectors and regions, I write in support of the Small Business Tax Compliance Relief Act, which would help alleviate the administrative burden of tax compliance on small business owners.

Tax compliance and complexity is a huge drain for small businesses that must spend precious time and money complying with thousands and thousands of pages of rules. This does not necessarily serve to send more money to the federal government but simply causes a headache and worry for small businesses who want to comply with the tax code. Small businesses spend 1.7 billion hours annually on tax compliance and \$15 billion on compliance costs. Imagine the economic boom if small business owners could reinvest this money back into their businesses to grow jobs and the economy rather than spending that money on complying with burdensome tax rules.

The Small Business Tax Compliance Relief Act would make commonsense changes to the administration of our tax laws that would not only benefit LABI's small business members but also help the economy. Particularly, making inflationary adjustments for fixed limitation amounts rather than rate brackets would help job creators, especially as they start and grow their young businesses.

Setting up review panels when making rules would greatly help small businesses so they can share real life experience with tax compliance and the government can better understand the impact on those who have to comply with the rules. Another helpful idea in the Act is giving the IRS Commissioner the authority necessary to waive penalties when small businesses have acted in good faith with tax rules. This could help ease the worry that small business owners feel with tax compliance.

LABI thanks you for introducing this important piece of legislation. We look forward to working with you to provide tax relief for small businesses.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen", written in a cursive style.

Stephen M. Waguespack  
President & CEO



June 17, 2015

The Honorable David Vitter  
United States Senate  
516 Hart Senate Office Building  
Washington, D.C. 20510

Dear Senator Vitter,

On behalf of the National Federation of Independent Business (NFIB), the nation's leading small business advocacy organization, I write in support of the *Small Business Tax Compliance Relief Act*, which would help alleviate the administrative burden of tax compliance on small business owners.

Tax complexity is a problem for small businesses because spending time and money on tax compliance drains financial resources. Small businesses annually spend between 1.7 billion and 1.8 billion hours on tax compliance and \$15 billion to \$16 billion on compliance costs. It is no wonder that 91 percent of NFIB members hire a professional tax preparer to handle their taxes and the majority let their tax preparer worry about added complexity in the tax code.

The *Small Business Tax Compliance Relief Act* would make several commonsense changes to the administration of our tax laws that cumulatively would help NFIB small business owner members struggling to comply with an overly complex tax code. Simplification measures such as increasing the de minimis safe harbor threshold for small businesses from \$500 to \$2,500 for purchases of tangible business property would incentivize investments in equipment and would greatly ease record keeping burdens.

Furthermore, NFIB is particularly pleased to see the inclusion expanded eligibility for cash accounting in this legislation. Cash accounting is a longstanding method of accounting and the foundation upon which small businesses have operated for decades. Expanding cash accounting would reduce the administrative and recordkeeping burdens on small businesses, would improve cash flow, and would allow them to focus on running and growing their businesses.

Thank you for introducing this important legislation. We look forward to working with you to provide tax relief for small businesses in the 114<sup>th</sup> Congress.

Sincerely,

A handwritten signature in black ink, appearing to read "Amanda Austin".

Amanda Austin  
Vice President  
Public Policy



July 14, 2015

The Honorable David Vitter  
Chairman  
Senate Small Business and Entrepreneurship Committee  
United States Senate  
516 Hart Senate Office Building  
Washington, DC 20510

Dear Chairman Vitter:

On behalf of the National Small Business Association (NSBA), I would like to express our support for the *Small Business Tax Compliance Relief Act*. While the financial tax liability for small firms is a huge issue, the sheer complexity of the tax code is actually a more significant problem for America's small businesses. In ranking the most significant challenge to their business posed by federal taxes, the majority of NSBA members, 59 percent, have cited administrative burdens, up from 53 percent just one year ago.

Although NSBA's members operate a wide variety of businesses, they all consistently rank reducing the tax burden among their top issues for Congress and the administration to address. The compliance burden on taxpayers, because of the complexity of our code, is truly staggering. While the actual tax liabilities for small firms is a huge issue, the sheer complexity of the tax code—along with the mountains of paperwork it necessitates—is actually a more significant problem for America's small businesses. Small firms tend to be an easy target since, unlike big corporations which have large staffs 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 and tax code.

According to the NSBA 2015 annual Taxation Survey, one-in-three small-business owners reported spending in excess of 80 hours—two full work weeks—per year dealing with federal taxes and nearly spend \$5,000 or more annually on the administration of federal tax alone. Just imagine the collective business and job growth that could be done absent that burden.

While NSBA welcomes the eagerness of many of your colleagues to fix America's broken tax system, we also recognize there are significant challenges with enacting comprehensive tax reform legislation in the near future. Therefore, in the interim, we commend your efforts to reform the tax system in order to reduce its complexity and compliance costs and to promote economic growth and prosperity. Several of the provisions included in your measure will provide simplification to the most complex provisions of the code and may help to significantly reduce the burden on individual taxpayers and small businesses.

Providing flexibility and simplicity to small businesses in which method of accounting they use for tax purposes is important. Cash accounting—widely seen as a simpler, more straightforward method of accounting—is utilized by 46 percent of small businesses and increasing the threshold to \$10 million will provide consistency in defining small business in the tax code.

The de minimis safe harbor allows taxpayers without an applicable financial statement to deduct amounts paid for property if the amount does not exceed \$500 per invoice, or per item as substantiated by the invoice. NSBA supports raising the de minimis capitalization to \$2,500 and applauds your efforts for including “reviewed” financial statements as “applicable financial statements” as this will certainly add to the number of small businesses able to use the limit.

Self-employed individuals (including partners and LLC members), unlike large corporations, cannot fully deduct the cost of their health insurance as a business expense. At issue is the 15.3 percent tax that self-employed individuals must pay on their employer-provided health insurance costs to which nobody else is subjected. While the important 2003 change enabled small-business owners to deduct the cost of health care from their income that income already has been exposed to the payroll tax. Thus, the self-employed effectively pay the self-employment tax on income used to purchase health care.

The self-employed pay an average of \$12,680 per year for health insurance. Because they cannot deduct this as an ordinary business expense, the 15.3 percent payroll tax they alone pay on their premiums amounts to \$1,940 in extra taxes that only the self-employed pay. This is money that could be used to reinvest and grow the business, hire part-time help or cover the ever-increasing costs of health insurance. This additional 15.3 percent tax makes already disturbingly high-priced health care cost even more by adding thousands of dollars to the cost of an individual’s health care. As long supporters of tax equity for the self-employed, NSBA is pleased to see this essential piece in your legislation for 2015.

Small businesses have often described how the Internal Revenue Service (IRS) repeatedly ignores small businesses’ unique requirements and simply does not understand the impact that many of their rules have on the operation of a small business. By requiring the IRS to convene small business review panels, we may begin to see better IRS rules which are easier to understand, implement and enforce, and which may draw a more positive reaction from smaller entities. By extending the Small Business Regulatory Enhancement Flexibility Act (SBREFA) panel process to the IRS, your legislation will help small businesses deal with one of the more troublesome and burdensome federal agencies, by requiring the IRS to fully consider the impact of their regulations on small businesses.

Time and again, we hear from small businesses about their desire to have a more simplified approach to complying with federal regulations and their paperwork requirements. The complexity of ambiguous terms, intricate technical language and difficult sentences causes them to have trouble understanding the requirements. NSBA is pleased to see your requirement for the IRS to produce a report that calls for simplification, streamlined definitions and plain-language.

NSBA strongly believes that the current tax system is irretrievably broken and constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes, with widespread competitive disadvantages to small firms. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required. However, unless and until Congress agrees upon a replacement, we must fix tax problems with the current tax code by developing simplification measures that are fair and fiscally responsible.

Your legislation is a step closer to enabling businesses to invest in new equipment, hire more workers and dedicate more money to savings and investment, which in turn will help strengthen our economy. NSBA supports the *Small Business Tax Compliance Relief Act*, and commends you for working to bring this legislation to the Senate floor.

Sincerely,



Todd McCracken  
President & CEO

**National Small Business Network**

233 SW 2<sup>nd</sup> Street P O Box 639 Corvallis, Oregon 97339 541-829-0033 Fax 541-753-9631

**Statement for the Record**

**Senate Small Business and Entrepreneurship Committee**

**Hearing on**

**Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden for America's  
Small Businesses**

**July 22 2015**

These tax reform recommendations focus primarily on tax reform and administrative burden issues for small and mid-sized businesses because they have the greatest impact on jobs and general economic growth.

Basic tax system reform for small business and economic growth should:

- Simplify and coordinate our overly complex tax code to improve voluntary compliance, provide equitable treatment for all taxpayers, and reduce both taxpayer and IRS administrative expense.
- Make sure business tax reform provides incentives for the growth of pass-through entity small businesses, who provide over half of all jobs, as well as for large corporations.
- Encourage direct long-term business investment by taxing only real economic income, not the effect of monetary inflation by adjusting all tax code provisions to reduce inflation distortions.
- Encourage domestic investment and job creation to the greatest extent possible within the limits of international agreements.
- Assure that any tax reform still provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability. Unfortunately, the “bottom line” is that tax reform needs to be at least revenue neutral, and will need to be revenue positive overall to reduce our debt and unfunded future obligations. Although limited deficit spending can stimulate the economy, economists agree that continuing deficits and our current \$18 Trillion national debt reduce long-term economic growth, are a very real threat to the future stability of our economy. Please see our related recommendations on budgeting and Fiscal Reforms for Sustainable Government on our website at [www.NationalSmallBusiness.net](http://www.NationalSmallBusiness.net)

## 1. Tax Expenditure and Special Tax Rate Recommendations

Congress should review all tax expenditure provisions and special tax rate incentives for their true value as an economic, employment, social, or environmental incentive. All tax expenditures and special tax rate provisions without fixed expirations should be re-evaluated at least every 10 years for possible modification or progressive elimination. Pass permanent or multi-year targeted tax incentives such as business deductions, credits, and accelerated write-offs, only where they are proven to effectively support direct domestic business investment and employment. To obtain the best economic return from tax expenditures, always pass them well in advance, and do not waste resources on retroactive incentives.

Tax law, including tax expenditure incentives, can be a major factor in economic decisions by both businesses and individuals. Tax policy is also one of the few remaining strategic tools to provide targeted economic incentives for domestic economic growth. Businesses and investors often focus on short term profit, rather than on the long-term sustainability of their business, the health of the

national economy, or concern for the environment. Tax policies that overly “broaden the base and reduce the rate” would limit the ability of Congress to provide strategic incentives that promote long term economic sustainability and international competitiveness.

Flat tax structures with lower rates tend to encourage short term speculation instead of long term direct investment. They may also encourage movement of investment capital anywhere in the world where the potential return is highest. Flatter tax brackets also benefit wealthier investors, particularly if capital gains are kept at a lower rate. This would result in an increasingly economically segregated national economy, increased unemployment, and lower total tax revenue. Without adequate revenue offsets, it could also further increase our unsustainable national debt without the broad economic benefits from current targeted tax expenditures.

Reducing most current tax expenditures in order to reduce maximum tax rates would probably significantly increase the effective tax burden on middle income and small business taxpayers while reducing tax revenue from large corporations and the very wealthy. Most tax expenditures, including deductions, credits, and preferential tax rates are limited either by specific maximum amounts, or maximum overall income levels for which the provisions apply. These limits are in place to obtain the greatest economic or policy impact with the least loss of tax revenue, and often have the greatest incentive effect and benefit for middle income taxpayers. Because of the large and growing percentage of total taxable income going to the upper 1% of all citizens, any reduction in the progressivity of personal tax rates on higher incomes will eventually result in an overall reduction in tax revenues.

Even though some tax expenditures can have high value in stimulating economic activity with long term benefits, many provide little benefit in relation to their revenue cost, and some are pure “pork” that benefits a small number of businesses or individuals. Existing Congressional data does not provide an adequate decision making data matrix for Congress to accurately evaluate existing tax expenditures, deductions, and rate preferences. We recommend that the House and Senate Budget Committees and Senate Finance and House Ways and Means Committee jointly request the CBO or JCT to develop a comprehensive analysis of the current economic benefits of all tax expenditures. The report should include at a minimum -

- A summary of the tax expenditure or rate preference, and original reason for it.
- The tax revenue cost over 10 and 20 year periods.
- An estimate of who is actually benefited by the provision, by number and type of taxpayers and by income level; or type of business and total employment and the national economic importance of the provision.
- An evaluation of the total secondary economic benefits and the potential economic multiplier for the expenditure.
- The effectiveness of the tax expenditure in actually causing the desired activity and the current importance of the expenditure, or potential negative effects of its elimination.

## **2. Tax Simplicity, Clarity, and Administrative Burden Reduction Recommendations:**

One of the key goals of tax reform should be to simplify the complexity of the current code, and provide greater tax system clarity and equitability for different taxpayer entities. The current code,



which was built on successive layers of changes by past Congresses, has become too complex with too many adjustments, limitations and phase-outs for taxpayers to understand and comply with. Many provisions either purposely or unintentionally negate or limit the effects of other provisions.

**A. Increase the role of the Joint Committee on Taxation and Treasury-IRS in assisting Members of Congress in the ongoing development of a simpler and better coordinated federal tax code to eliminate some of the layers of changes and reduce the adjustments, limitations and phase-outs.** They could assist Congress in identifying provisions that conflict with related or similar provisions in existing code. In addition, other provisions have become outdated by changes in technology or business practices. This complexity makes it difficult for taxpayers, and even professional tax preparers, to understand and comply with the code. The complexity also increases the administrative burden on the IRS and makes it difficult for them to provide good taxpayer assistance and assure filing accuracy and taxpayer compliance. Often the IRS has to resolve legislative issues with hundreds of pages of detailed regulations which increases the administrative burden on the IRS, and often just further increases complexity for the taxpayer. JCT and the IRS should develop a joint working group to identify existing code issues requiring better legislative clarity or coordination and a process to develop legislation to resolve them.

**B. Revitalize the management and business system reforms of the Internal Revenue Service to provide better taxpayer assistance and an efficient and equitable administration process.** The ability of the IRS to properly and efficiently administer the tax code is currently hindered by incomplete improvements to vital business systems such as data processing and communication technology. The IRS is also facing increased administrative responsibilities, such as the ACA and FATCO, combined with declining budget allocations, and heavy turnover of key staff. With budget cuts, training has been reduced and staff expertise has declined. This is resulting in declining levels of performance in many areas and increased burdens on taxpayers and return preparers. The combination of a complex tax code, declining taxpayer education and assistance, and inadequate IRS budgets has threatened accurate and equitable enforcement of the law. This has also reduced collection of the revenue needed for all Federal programs and services. Any successful business owner will say that the last employees you should eliminate are your accounts receivable and collection staff. The recent budget cuts have required the IRS to reduce the equivalent of both.

The Congress and Administration need to recommit to the goals of the 1998 IRS Reform and Reorganization effort by providing better support for improvements to technology systems and stronger management emphasis on business process re-engineering and greater efficiency in the tax administration process. Commissioner Koskinen is doing a good job trying to identify and resolve problems with the limited resources of the agency. However to do its job properly the IRS needs increased Congressional budget support and better proactive communication on agency issues. The Administration also needs to complete revitalization of the IRS Oversight Board with additional nominations to assist IRS management with continuing organizational improvements and communication with the Congress.

**C. Provide standard tax code definitions and coordinated inflation adjustments for all limit and rate bracket provisions.** Multiple definitions exist for many items of income and types of

credits or deductions. These need to be standardized and simplified. Congress needs to review the Internal Revenue Code for fixed limitations and provisions which are long overdue for inflationary adjustments, such as the business gift limitation, and update them. Then, adopt a standard inflationary adjustment provision to replace the myriad of specific provisions in the code for rate brackets and dollar limitations which should have periodic adjustment. The provisions should require a reasonable minimum inflation change before a periodic adjustment is made. We also support the tax clarity and simplification recommendations of the American Institute of Certified Public Accounts tax policy committee.

**D. Eliminate the Alternative Minimum Tax for all taxpayers with gross income under \$250,000 and replace all surtaxes and deduction phase outs with a single, more rate progressive, tax calculation on Adjusted Gross Income.**

The parallel AMT tax system and various surtaxes and limitations on deductions add unneeded complexity and lack of understandability to the tax code. In 2013, Congress made inflation indexing of the personal AMT exemption permanent, but failed to correct many of the underlying issues, that have a major impact on small business owners. Taxpayer Advocate Nina Olson has repeatedly addressed this issue in her annual reports to Congress. She has stated that if the individual AMT is not eliminated, then Congress should "...eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions, as adjustment items for Individual Alternative Minimum Tax purposes."

Ideally, Congress should at least eliminate the burden of AMT calculation for most taxpayers, through a \$250,000 safe harbor, and by matching of the more economically important provisions in the regular tax code with the AMT provisions. The tax code should at least provide better equality in the AMT treatment of "Small Business Operating Income" reported on a personal Form 1040 return, with the far higher "C" corporation AMT exemption limit.

**E. Remove outdated administrative burdens in the tax code such as the remaining "Listed Property" reporting requirements on standard business computers and communication equipment.** The Small Business Jobs Act of 2010 removed the outdated usage record keeping requirements for employer provided business "cell phones", but failed to remove the equally burdensome and illogical requirements on similar common business communication devices and portable computers. With the merging of cell phones, computers, and cameras into single inexpensive devices, the remaining listed property reporting requirements and deduction limitations for business "computers" when used outside a "qualified office" also need to be removed. As with cell phones, if there is a legitimate business need for a mobile computer, there is usually little or no additional marginal cost for any personal use of the same equipment, because most hardware is replaced long before the end of its potential usable life. The new IRS repair regulations allow a taxpayer to elect to expense replacement items costing less than \$500, which makes the listed property requirements even more illogical.

**F. Simplify state income tax nexus issues for out-of-state businesses by adopting a modernized federal prohibition on state income and business activity taxation, of both services and products, including digital products, delivered from outside a state via public carriers or electronic transmission by businesses without state nexus.** Modern electronic technology has greatly increased the ability of even small businesses to sell both goods and services nationally

without any physical nexus in a state. Unfortunately this increased capability, combined with increased legislative and enforcement activity by revenue starved state governments, is creating significant state income tax nexus problems for businesses.

Complying with out of state income tax or "business activity" tax laws for a small amount of out of state business, often subjects small businesses to significantly higher accounting and tax preparation expenses, and a higher total tax liability. Although states provide some credits for personal income taxes paid to other states, these calculations are complex and often have filing minimums which can result in the taxpayer paying more total taxes than they would have paid to a single state. Corporate income taxes are often calculated differently by each state, and states usually do not provide any credit for corporate taxes paid to other states. Because of this complexity, many small businesses either ignore out of state income tax filings and risk potential penalties, or reject potential out-of-state business, which restricts interstate commerce.

For some service businesses, it is difficult to determine which states have a valid tax nexus. With the growth of "cloud computing" and web-based applications, a person working on a computer in Arizona, using data on a server in New York, for a business website that is used world-wide, could be viewed as having nexus almost anywhere. Some States are now trying to use national internet search engine advertising contracts, which are often used by small business to offset some of their website expenses, as a basis for claiming tax nexus. These new "Amazon Laws" have already been adopted in 24 states, and will spread rapidly, if not controlled by federal legislation. Other states, such as California are trying to extend nexus just because of contracted relationships or corporate affiliations with suppliers within the state.

The "Commerce Clause" of the Constitution makes the Congress responsible for preventing the states from enacting barriers to interstate commerce. In 1986, the Congress passed Public Law 86-272 to remove multi-state tax nexus barriers for mail order marketing of goods. That law prohibits states from imposing a "net income tax" on businesses if the contact with a state is "limited to the solicitation of orders through catalogs, flyers, and advertisements in national periodicals, for sales of tangible personal property which are processed and filled from a stock of goods located outside the state and delivered via common carrier or the U S Postal Service." This law, unfortunately, did not envision the ability of business to deliver services, as well as products, via the internet and other electronic technologies.

Many businesses also conduct limited amounts of business in other states at conferences, trade shows, and national product market which may create nexus under some state's laws. Limited business activity of this nature should also be protected from multi-state income taxation. Quick Congressional action can prevent this problem from growing, and reduce a major non-value-added cost on small businesses without any Federal cost.

**G. Pass marketplace equitability legislation to protect each state's right to use sales and consumption taxes at the state level, and simplify small retailer remittance of interstate consumption taxes.**

Congress should support effective and efficient interstate collection of state sales and use taxes, and provide an equitable business environment for those businesses that properly collect state sales taxes, by passing marketplace equitability legislation. Federal legislation to enable

interstate collection would not create any new taxes, but simply enable states that have chosen to use consumption taxes to collect them on the growing volume of internet sales. It is similar in principle to the many agreements the federal government has with states and foreign countries to exchange tax information to help stop tax evasion. There is no Federal cost other than a potential increase in deductions for state sales taxes paid. Congress should simplify calculation and reporting of sales taxes for interstate sellers by enabling a single, uniform electronic tax reporting and payment processing system.

**H. Allow all income corrections under \$5,000 that are reported to a taxpayer after March 15 of each year to be reported as income or loss in the current tax year, rather than requiring the filing of an amended return for the prior year.**

As individual investment options have become more complex, often involving multiple layers of accounting calculations, more taxpayers are receiving corrected forms 1099 or K1s after March 15<sup>th</sup>. This slows the tax preparation process as more preparers are automatically putting clients on extension because of prior experience with receiving corrected income reports and having to do amended returns. Amended returns add cost and complexity not only for the taxpayer, but also for the IRS. Instead, allow investment brokers and other businesses to report any net income corrections of under \$5,000 as adjustments for the year identified, and provide a new section on the Form 1040 to list net income adjustments from prior years as a taxpayer option to filing an amended return.

### **3. Capital Gains Tax Reform Recommendations:**

**Congress should encourage long term direct capital investment by adjusting the calculation of the long term capital gain on assets held more than 5 years to remove taxation of the phantom gain from monetary inflation, and reflect the true constant dollar value of the gain.** Calculation of the adjustment would be simple, and require only a multiplication of the dollar gain using IRS supplied existing data on the cumulative inflation change from the year of purchase to the year of sale.

The current personal income tax code provides a lower tax rate for a "long-term capital gain" on an asset held for 366 or more days. This actually progressively penalizes investments held more than one year because of its failure to adjust for monetary inflation over the investment life. The President's 2015 budget proposal to increase the capital gains tax rate for top bracket earners to 24.2% or 28% total, including the 3.8% ACA surtax, would make the inflationary distortion even greater. Owners of even relatively small businesses would probably be in the maximum rate bracket in the year they sell their business or business property. This penalizes business creation and direct investment. Most states also add an additional state capital gains tax of up to 10%.

The investments that America needs to build a sustainable economy by starting or growing businesses, or building business infrastructure, are not 366 day speculative investments. True long term business investments may not provide a capital return for 10, 20, 30, or 40 years or longer. Current law provides the same tax incentive for individuals to invest in speculative secondary market investments such as traded stocks which, except for new offerings, provide no new economic investment or funding for business growth. Ironically, secondary economic

investments actually have a greater tax benefit because they can be easily sold after 1 year when the tax benefit is greatest. Where the asset is a business or investment property, this short tax incentive peak also encourages the owners to focus on short term “paper” profitability and the potential for resale, rather than long term growth and sustainability. This 366 day peak incentive also encourages financial speculators to purchase and sell off asset rich businesses, rather than operating and growing them.

Almost all other value comparisons that extend over long periods such as economic statistics, government budgets, and other tax code provisions, are adjusted to remove the effect of inflation. Although compensating for inflation distortion is part of the justification for having a lower tax rate on capital gains, this is a classic case where a “one size fits all” approach does not work. To illustrate the progressive disincentive for long term investment under current law, the table below shows the real, after inflation, return and effective tax rate on a sample investment. It assumes a business was started, or an asset was purchased, for \$1M in 1962 and held for periods of 2 to 50 years before being sold for \$2M. The taxable gain in each case is \$1M and the true constant dollar value of the gain from the year of investment was calculated using US Bureau of Labor Statistics CPI Inflation data. As the chart below shows, the effective tax rate on the real inflation adjusted gain grows significantly after 5 years, particularly if at a higher 28% tax rate.

Holding Period.	Capital Gains tax paid at a 15% rate.	Actual Real Constant Dollar value of the \$1M gain.	Effective Tax Rate* on real gain at a 15% rate.	Capital Gains Tax paid at a 28% rate.	Actual Real Constant Dollar value of the \$1M gain.	Effective Tax Rate* on real gain at a 28% rate.
2 years	\$150,000	\$948,800	15.8%	\$280,000	\$948,000	29.5%
5 years	\$150,000	\$902,200	16.6%	\$280,000	\$902,200	31 %
10 years	\$150,000	\$782,800	19.2%	\$280,000	\$782,800	35.8%
20 years	\$150,000	\$610,050	24.6%	\$280,000	\$610,050	45.9%
30 years	\$150,000	\$419,900	35.7%	\$280,000	\$419,900	66.7%
40 years	\$150,000	\$181,900	82.5%	\$280,000	\$181,900	154 %
50 years	\$150,000	\$131,400	114.2%	\$280,000	\$131,400	213 %

\*The effective tax rate is the current code tax amount on the paper gain, divided by the actual inflation adjusted value of the gain.

The Federal tax paid would actually exceed the total real economic gain after only about 35 years at a 28% tax rate. Although an adjustment should be made on all assets held for more than 5 years, the scoring cost of initial correction legislation could be reduced by limiting the adjustment to business property or direct business investments where the taxpayer is an active owner. Potential revenue offsets for the inflation adjustment include increasing the “long-term” capital gains holding period to 3 years, or slightly increasing the capital gains tax rates.

#### 4. Specific Small Business “Pass Through” Entity Tax Reform Recommendations:

- A. To provide targeted small business growth incentives, with the lowest revenue cost, Congress should differentiate, in the personal income tax code, all net “pass-through income” from a business in which the taxpayer materially participates as “Small Business Operating

**Income" (SBOI). This would include non-salary income from partnerships, "S" corporations, farms, and other business income reported on a personal return.**

Stimulating economic growth through the tax code is complicated by the fact that there are two business taxation systems. Most large businesses pay their taxes through the corporate tax system, which in 2010 collected about 9% of total federal tax revenues. Most smaller business are subchapter "S" corporations, partnerships, LLCs, Schedule "C" or Schedule "F" filers, and pay the taxes on their business operating income on their personal tax return along with their other personal income. The SBA estimates that over 90% of small businesses are pass-through entity taxpayers. As a result, the provisions and rates of the personal tax code can have an unintended negative impact on small business growth. When Congress considers economic stimulus measures or tax system reforms, it is important that both business tax systems be changed in unison. But, unless real pass-through business income can be identified and treated separately, any attempt to provide equitable treatment will result in significant revenue loss from non-business taxpayers.

In 2011 Congress raised effective tax rates on higher income individuals, many of whom are small business owners with the 3.8% surtax on investment income and .9% on other income. Proposed reductions in the large corporation tax rate to 28% or less will potentially shift an even greater percentage of the tax burden onto small businesses and individuals. This has a significant impact on small and midsize businesses that report their business operating income on the owner's personal return, in addition to their other salary and investment earnings. This often results in the small business income being taxed at the highest individual tax rates. When compared to the low tax rates on dividends and capital gains on highly liquid "traded stocks", it is difficult for people to justify the higher risk, and lower after tax return, of most small business investments. Because of their more limited ability to borrow capital, small business operating income must often also be reinvested in the business for survival and growth, leaving little cash available to pay the taxes. It is estimated that two thirds of all small business employees' work for firms with 20 to 500 employees, and many of these firms are likely to be impacted by the higher personal tax rates.

Income resulting from direct business investment and active operation of a business which employs workers and sells a product or service has a much higher value to our overall economy than income resulting from passive speculative activity. By differentiating income from active businesses, Congress can provide targeted tax stimulus with less revenue loss, by not having to provide the same tax treatment on gains from passive investments such as traded stocks.

**B. Congress should enact a lower maximum tax rate, comparable to proposed "C" corporation rates, on up to \$500,000 of Small Business Operating Income reported on a schedule K1, C, or F, for a business in which the taxpayer materially participates. Matching AMT language must also be enacted to prevent the AMT from nullifying the effect of the provision.**

This would allow a limited amount of small business income to be taxed at lower rates to encourage equity reinvestment to finance business growth. Calculating the tax on this income separately from other personal wage and investment income will also prevent the taxpayer's other income from pushing the tax rate on the business income into the highest personal rate brackets.

The Personal Alternative Minimum Tax must also be adjusted for pass-through Small Business Operating Income because it is much different than the “C” corporation AMT, and significantly impacts tax liability on small business income. The combined reporting of both personal and business operating income on the owner’s personal tax return often exceeds the relatively low personal AMT exemption level. This makes taxpayers calculate and pay the additional Alternative Tax on their business income. This is compounded by the lack of deductibility under the AMT of state income taxes, which in some states can exceed 10%. As a result many small businesses pay federal taxes on business “income” they never received, since it was paid in state income tax. In contrast, the Corporate AMT only applies if the 3-year average annual business income exceeds \$7,500,000.

**C. Congress should permanently equalize the deductibility, up to a reasonable cost limit, of individual or group health insurance at the entity level for all forms of businesses and individuals by amending IRC section 162(l) (4). The deductible limit should be adjusted for average health insurance cost inflation.**

For the year 2010 ONLY, the Small Business Jobs Act of 2010 finally allowed self-employed taxpayers, and partners, to deduct the cost of their health insurance, without paying payroll taxes on the insurance cost, as all corporation can. The equal and simple deductibility of group health insurance regardless of the legal form of business entity has been a key issue for small businesses for many years. Prior Congressional action partly corrected this problem for S Corporation stockholders, but 21 million self-employed individuals are still required to treat the expense as a non business expense even if they provide identical coverage for their employees. This results in the taxpayer paying an additional 15.3% on the insurance expense. Because of their small group sizes, the self-employed already pay the highest relative insurance rates. This inability to deduct their own insurance has always been an emotional disincentive for small business owners to provide group health insurance for their other workers.

As more states and the Federal government mandate universal health insurance coverage for all individuals, the impact of this inequity for the self-employed will continued to grow unless corrected. The National Taxpayer Advocate has recommended correction of this inequity in her Reports to Congress. Without Congressional action to re-instate equal exclusion of health insurance from payroll taxes, the 21 million self-employed again face this health care penalty for 2015, along with other health insurance cost increases.

**D. Congress should permanently enact an exclusion on at least 75% of the gain on Section 1202 qualified small business stock and remove the add-back in the AMT calculation. This could revitalize an important tool for small business financing, particularly if capital gains rates increase in the future. As an alternative, Congress might provide an alternative 20% tax credit for investment in Qualified Small Business Stock held for 5 years or longer.**

Congress passed Section 1202 of the tax code to encourage direct investment in small business startups. Most business startups are under-capitalized and are financed largely with expensive short-term borrowing. This is a major reason for their high failure rate. These provisions were adopted to provide new businesses with a stable base of equity capital to survive and grow. It

is very difficult for new businesses to obtain equity capital because of the far higher risk and lack of market liquidity of small business stock compared to other investments.

Section 1202 provided an incentive of a 50% exclusion on the capital gain from a sale of Qualified Small Business Stock held for more than 5 years. The exclusion was raised to 75% in 2009-10, and even to 100% through 2014. However, the taxable portion was subject to a 28% tax rate, rather than the 0% or 20% rates that applied to the gain on traded stock sales. The low capital gains tax rates on safer and more liquid investments combined with the requirement to add back 7% of the excluded gain in calculating alternative minimum taxable income effectively eliminated much of the value of this incentive. The Administration's 2012 Green Book recommended making the 100% exclusion permanent to "...encourage and reward new investment in qualified small business stock."

**E. Provide equitable employee cafeteria benefit options for small businesses.**

Small businesses compete for workers with large businesses and the public sector. Because of differing family situations, differences in benefit options that may be available through other family members or because of different personal preferences, many employees often want different benefits than other workers.

The 2010 PPACA Health Care Bill included provisions for a simplified Cafeteria Plan. However, current restrictions make them unattractive for most small businesses, other than C corporations, because business owners cannot be part of the plan. Current law specifically prevents sole proprietors, partners, and sub chapter S corporation shareholders from participating in a cafeteria benefit plan. These illogical limitations discourage small businesses from offering employees a very logical form of employment benefit and makes small businesses less attractive for prospective employees.

**F. Allow small businesses to reimburse health insurance premium expenses of employees with alternate coverage.**

Most businesses try to provide equitable benefits to their employees in similar positions. But, even when a business provides a group health insurance plan for their employees, some may choose not to take it. Many employees whose spouses work for governments or large employers may already have "family plan" coverage. Workers over 65 may be on Medicare for their primary coverage. Businesses would like to be able to provide an equal health insurance benefit for these workers by reimbursing them for some of their costs for a family plan or Medicare coverage. The IRS believes this kind of reimbursement is prohibited by the ACA legislation and has imposed a \$100 per day penalty on any reimbursement plan. Bi-partisan legislation is pending in both houses to correct this and allow reimbursement of alternative health insurance costs.

**G. Make permanent the \$500,000 expensing limitation for Section 179 property, so businesses can plan for future new business investments when they are needed, and under consistent rules. Congress should also make permanent, the ability to revoke Section 179 expensing on amended returns, and to expense "off the shelf" computer software.**



The Section 179 small business expensing provisions are a key factor in helping small businesses, particularly new start-ups, survive and grow by improving their ability to quickly recover the costs of investments in new equipment. This provides a major stimulus to the general economy from increased purchasing capability, particularly with the limited credit available to small and new businesses. The expensing limit was increased to \$500,000 by the Taxpayer Relief Act of 2012 for 2013, and extended for 2014, but will revert back to \$25,000 for 2015 and future years without new Congressional action.

The Act also extended through 2014, only, the expiration date of IRC 179(c) (2). This provision allows taxpayers to revoke a Section 179 election on an amended return. This option is important for owners of “pass through” entity businesses, particularly those who own interests in multiple businesses. This is because the maximum Sec. 179 expensing limits are applied at both at the individual business level and at the final taxpayer level. A change in election is often needed when the owner taxpayer receives too much pass-through expensing from multiple businesses. This often happens when assets or income were accidentally excluded from the original return, or the IRS re-classifies an expensed item as a capital asset. Unless the originating business has the option to change the Section 179 expensed amount on an amended return, a recipient taxpayer could be allocated a deduction greater than they are allowed to use. Any excess allocation would reduce the taxpayer’s basis in the business without providing any offsetting deduction, resulting in a permanent tax benefit loss. It is important that IRC 179(c) (2) be made permanent regardless of the level of expensing limit.

#### **H. Make permanent the inclusion of limited non-structural real property improvements under Section 179 expensing.**

In 1958, when Section 179 was first approved, the US economy was strongly manufacturing oriented and most small businesses needed to purchase production equipment. Over the last 50 years, the US economy has become more service and innovation oriented and the capital expenditure needs of small businesses have changed.

Today, to compete for customers and clients, businesses need functional and attractive facilities in which to conduct business. Better facilities also help businesses attract and retain more highly skilled employees. New businesses often face significant remodeling costs to prepare a business property for their use, and older businesses need to regularly update their facilities. These improvements must then be recovered over a long period of time. Currently most real property improvements have to be depreciated over 39 years. This may be appropriate for new construction, but is far too long for most commercial remodeling cycles. This can consume a large amount of a business’ initial capital, and make it difficult for the business to survive and grow. The Taxpayer Relief Act of 2012 included the inclusion of up to \$250,000 in certain real property improvements to qualified leasehold, restaurant, and retail facilities under Sec. 179, but this was extended only through 2015 and needs to be made permanent. The language of the legislation also prevented business taxpayers who also own the property, either directly or indirectly, from taking equal expensing treatment. This inequity should be addressed in future legislation.

Congress has also previously recognized the changing capital investment needs of businesses by reducing the depreciable life of larger qualified leasehold improvements, qualified restaurant

improvements, and qualified retail improvements to 15 years in recent short-term stimulus measures. These provisions should also be re-enacted and made permanent.

**I. Modernize and simplify the qualified home office deduction.**

Currently, home-based businesses represent about 52% of all American firms and generate 10% of the country's total GDP, or economic revenue based on SBA research. In the future, that percentage is likely to grow as new technologies and the Internet make new business models possible and increase the ability of people to work remotely. Working from the home has become more attractive because of the increased costs of commuting, high commercial real estate rents, and parking costs. The government should also have an interest in promoting working at home as a way to reduce the need for new highway construction, conserve energy, and reduce "green-house gas" emissions from unnecessary commutes to a distant business office.

In 2012 the IRS provided a regulatory standard for a simplified home office deduction with a maximum of \$1500, but failed to address some basic statutory limitations of the existing code. Internal Revenue Code Section 280A(c) (1) defines the requirements that must be met to deduct home office expenses. It generally permits a deduction for a home office in a taxpayer's residence only if it is used "exclusively" on a regular basis and meets one of two specific use requirements.

(1) The "principal place of business" requirement allows a deduction for a home office if it is "the principal place of business for any trade or business of the taxpayer", but the requirement is severely limited by regulations. Unfortunately, for many small businesses the inability "to conduct substantial administrative activities" at their regular place of business" is often the result of a lack of time, as much as a lack of space. Small business people can have a legitimate business need for a home office in which they can regularly work, even if it is not the "principal place" of business where they physically serve their customers.

(2) The "used by patients, clients, or customers" requirement has been interpreted by the IRS to require clients or customers to be physically present in the home office. IRS regulations state that conversations with taxpayers by telephone and electronic media do not constitute meeting with clients. The actual code only requires that it be "a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business." Today, many businesses "deal" with their customers without any physical presence. Major and minor business transactions are now fully completed, through websites, emails, faxes, video conferencing or just over the telephone. The old physical presence requirements are obsolete and block reasonable recovery of expenses for home-based businesses.

Even when a taxpayer meets one of the above use tests, the current Code also requires any home office space to be used "exclusively" as a place for business. This is a much higher standard than is applied to regular fully deductible business office locations. It is a reality of today's business world, where employees carry cell phones and work on computers connected to the internet, that most workers conduct some personal business and receive some personal calls or emails during the day at their place of business, even in government offices. It is both

unrealistic and unreasonable not to also allow some de minimis personal activity in an otherwise qualified home office area. The recent Tax Court Summary case *Miller v Commissioner* allowed de minimis personal use of a home office, although it cannot be used as precedence. The court ruled that, at least in this case, the exclusive provision was unreasonable. The current regulations and case law do not provide sufficiently clear and equitable standards for deductibility. Many at-home workers are afraid to deduct the use of a home office for fear of audits, the extra record keeping, and the required calculations.

**J. Modernize the unrealistic “Luxury” automobile depreciation limitations. Depreciation and expensing limits for vehicles should be adjusted to allow a person who needs to use an automobile for business to fully recover the cost of a \$25,000 vehicle, with 100% business use, during the standard 6-year recovery period. That amount should be periodically adjusted for average vehicle cost increases.**

The tax code defines passenger automobiles as 5-year property under ADS standards for cost recovery. However, in 1984 Congress limited the ability to expense or depreciate what they felt were “luxury” automobiles being used for business by enacting Section 280F(a)(1). These limits have only increased by about 25% since 1987 because of a restrictive calculation formula based on the characteristics of a typical 1984 car, even with general inflation of over 90% in that time. That means that during the “normal” 6-year recovery period, a business could actually only fully recover the cost of a \$16,935 vehicle. Because of the deduction limits, it would take 11 years to recover the cost of a \$25,000 car. With average use of only 15,000 miles a year, a car used 100% for business would have 165,000 miles at the end of that 11-year period. Many business users easily exceed that annual mileage. To consider an automobile costing less than \$17,000 a “luxury car” is simply unrealistic. The only vehicles that still sell below this depreciation limitation are small compact cars. None of these vehicles are designed to transport five adults, nor are suitable for many valid business uses such as transporting samples. Many of these cheaper cars are also imported, which has helped contribute to the decline of American auto manufacturers. The depreciation limitations also cause businesses to keep older, more polluting, and less fuel-efficient vehicles in use. The tax code should encourage business owners to regularly replace business vehicles, not unreasonably discourage it. Removing this antiquated provision will stimulate business purchases of new vehicles, and help rebuild the American auto industry.

**K. Increase the deductibility of business meals for small businesses up to 75%.**

The 1995 White House Conference on Small Business identified the importance of the business meal deduction to the success of small business. They often do not have appropriate space at their business to meet and work with important clients, referral sources or suppliers. Large businesses often have meeting and conference rooms at their facility which are tax deductible. Small businesses, particularly home based businesses, may have only their dining room table. They often have to use restaurant meals as an opportunity to prospect for business and to complete transactions with clients. Research has indicated that increasing the deductibility of business meals to 80% would increase restaurant sales by \$12 Billion and create an overall economic impact of \$24 Billion. Existing code provisions limit excessive meal or entertainment expenditures.

**L. Return the contribution due date for IRA investments to the extended return due date.**

Prior to the Tax Reform Act of 1986, standard IRA contributions, like all other retirement plan contributions, were permitted up to the earlier of the extended due date of the return, or when the return was filed. Their due date is now April 15<sup>th</sup>, with no extensions. This causes a burden on taxpayers who have to make IRA contributions at the same time that both prior year final tax payments and their current year first quarter estimated tax payment are due. This often results in taxpayers, particularly small businesses, sacrificing their own IRA contribution to meet other expenses.

Congress should return the due date for IRA contributions to the due date of the return, including all permitted extensions, as allowed for other retirement plans. Because the income limitations on converting standard IRA accounts to Roth IRA accounts have been removed, Congress should also remove the income limits on direct contributions to Roth accounts. This would eliminate the need for a two-step process of contributing to a regular account and then having to convert it to a Roth account.

Submitted by Eric Blackledge and Thala Taperman Rolnick, CPA  
For the National Small Business Network

National Small Business Network      P. O. Box 639      Corvallis, OR 97339  
Phone 541-829-0033      Fax 541-752-9631      Email [Tax@NationalSmallBusiness.net](mailto:Tax@NationalSmallBusiness.net)  
Related research and information is available on our website at [www.NationalSmallBusiness.net](http://www.NationalSmallBusiness.net)



July 10, 2015

The Honorable David Vitter  
Chairman  
Committee on Small Business and Entrepreneurship  
U.S. Senate  
516 Hart Senate Office Building  
Washington, D.C. 20510

Dear Chairman Vitter:

On Behalf of the Small Business Advocacy Council (SBAC), I am pleased to support the *Small Business Tax Compliance Relief Act*. This bipartisan legislation reduces compliance burdens frequently cited as overly restrictive or onerous for small business owners and entrepreneurs. Support for this legislation comes from folks from various political persuasions because it makes sense and will empower small businesses across the United States.

The SBAC is a nonpartisan, member-driven, organization representing over 1100 small businesses in Illinois. We actively engage in shaping public policy to reflect the interests of the small business community. The SBAC has also formed powerful coalitions of chambers and trade organizations that actively work to advance nonpartisan, common-sense, legislation on behalf of the small business community. Bringing together tens-of-thousands of small business owners, these coalitions speak with an increasingly strong voice. I commend you for your leadership in introducing this legislation in the Senate.

This legislation does many things that will positively impact small businesses. Among them, this proposal will provide that self-employed individuals are able to fully deduct health insurance costs just like all other businesses. The IRS commissioner will be given the necessary authority to waive penalties or deadlines if a small business is shown to have acted in good faith. It eliminates burdensome record-keeping requirements and increases the threshold for small businesses to use cash accounting methods. This legislation provides needed updates to the tax code that will eliminate unnecessary burdens on the small business community.

For these reasons, the SBAC enthusiastically supports the Small Business Tax Compliance Relief Act. Thank you for your leadership on this issue and I look forward to working with you to bring this legislation to the Senate floor for consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Elliot Richardson', is written over a light blue horizontal line.

Elliot Richardson  
CEO



July 14, 2015

The Honorable David Vitter  
 Chairman  
 Committee on Small Business and Entrepreneurship  
 United States Senate  
 Washington, D.C. 20510

Dear Chairman Vitter:

On behalf of the Small Business & Entrepreneurship Council (SBE Council) and our 100,000 members nationwide, I am writing to express our strong support for the "Small Business Tax Compliance and Relief Act." This legislation includes substantial reform measures that will ease tax complexity and compliance costs for small businesses. It will fix key areas of regulatory pain and inequity for entrepreneurs, and ones that cause harmful distortions. The legislation will provide a real boost to small business confidence and growth.

Simplicity, equity and certainty are attributes that entrepreneurs and small business owners want the tax code to reflect. Over time the tax code has become an abominable mess. Unfortunately, small businesses are bearing the brunt of our dysfunctional tax code. That disparity has been documented by the SBA Office of Advocacy, which found that small businesses spend three times more per-employee on compliance costs compared to their larger counterparts. Complexity and uncertainty drain the entrepreneur of precious resources, time and energy. All of which need to be directed toward growth, innovation and competing in the marketplace. High taxes rates, uncertainty, and excessive compliance costs all combine to make the U.S. tax code destructive to small businesses and a major threat to the future of U.S. entrepreneurship.

Every reform embedded within the "Small Business Tax Compliance and Relief Act" is needed - from regulatory accountability at the IRS, to how the agency interacts and treats small businesses, as well as changes in the thresholds for inventory and de minimis safe harbor. We wholeheartedly support full deductibility of health insurance for the self-employed, the common sense changes to capital gains holding periods, repealing and modifying redundant and unnecessary rules and recordkeeping requirements in a range of areas, and creating a Flexible Retirement Account option with simple rules and less restrictions.

SBE Council agrees with you that small businesses and entrepreneurs should not have to wait for comprehensive tax reform in order to get some relief, certainty and common sense reforms from Washington. The "Small Business Tax Compliance and Relief Act" provides a path for Congress to take for immediate bipartisan action. The prospect for survival and growth for many small businesses will be greatly improved with passage of this important legislation.

Chairman Vitter, thank you for your leadership and continuous support of America's entrepreneurs and small businesses. Please let us know how we can help you advance the "Small Business Tax Compliance and Relief Act" into law.

Sincerely,

A handwritten signature in black ink, appearing to read "Karen Kerrigan". The signature is fluid and cursive, with the first name "Karen" and last name "Kerrigan" clearly distinguishable.

Karen Kerrigan  
President & CEO

*301 Maple Avenue West • Suite 100 • Vienna, VA 22180 (703)-242-5840  
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**Protecting Small Business, Promoting Entrepreneurship**



July 21, 2015

The Honorable David Vitter  
 Chairman  
 Senate Small Business and Entrepreneurship Committee  
 428-A Russell Senate Office Building  
 Washington, D.C. 20510

Dear Chairman Vitter,

On behalf of the Small Business Investor Alliance (SBIA), the premier organization of lower middle market private equity funds and investors, thank you for introducing the Small Business Tax Compliance Relief Act, a bill to update key provisions of the 1202 capital gains tax exclusion for investments in qualified small business stock.

As Chairman of the Senate Small Business and Entrepreneurship Committee, we appreciate your hard work to find new ways to increase investment in small business. The 1202 qualified small business stock tax provision encourages small business investors to make long term capital investments in small businesses. Modernization of this tax provision will increase opportunities for small businesses to attract capital. SBIA supports several reforms to the provision to make it more useful, and your legislation would make two of these changes.

The legislation shortens the holding period for qualified small business stock from five to three years. Reducing the holding period reflects current market conditions as the exit period for many investments is shorter than five years. The legislation also extends the capital gains rollover period in which an investor can reinvest any proceeds from the sale of qualified small business stock in another qualified small business stock. Increasing the rollover period from 60 days to one year will encourage repeat investors to invest in more than one qualified small business.

Beyond this legislation, SBIA also supports making the 1202 provision permanent, clarifying that other business structures (such as partnerships, S-corps, and LLCs) are eligible small business investments, increasing the dollar amount of the definition of qualified small business from \$50 million to \$75 million, and clarifying that stock can include stock acquired



upon the issuance of warrants. Making these additional changes would further enhance the 1202 qualified small business provision.

Thank you again for introducing legislation to make important changes to small business tax provisions. We look forward to working with you on this issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Brett Palmer", with a stylized flourish at the end.

Brett Palmer  
President  
Small Business Investor Alliance



Society of Louisiana  
Certified Public Accountants  
Truth. Strength. Fortitude.

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July 20, 2015

Chairman David Vitter  
Committee on Small Business & Entrepreneurship  
United States Senate  
428A Russell Senate Office Building  
Washington, DC 20510

RE: Small Business Tax Compliance Relief Act of 2015

Dear Chairman Vitter:

On behalf of the Society of Louisiana Certified Public Accountants (LCPA), our 6,200+ members, and the thousands of Louisianans they employ and advise, we appreciate your tremendous efforts devoted to tax reform for small businesses. Our 104-year-strong member association makes it our priority to support small business-friendly legislation — not only to grow the Louisiana economy, but the US economy as well.

We applaud the introduction of the Small Business Tax Compliance Relief Act of 2015. These proposals will reduce unnecessary administrative burdens for small businesses and improve overall tax administration. For example, an increase of the safe harbor de minimis threshold on the tangible property regulations and the provision providing for a full deduction of health insurance for self-employed individuals will contribute to a more equitable and fair set of rules. Other proposals, such as the penalty waivers in cases of good faith, promote certainty and transparency in the tax law. We also support the important modernization "fixes," such as removing computer equipment from the definition of "listed property." Such improvements should reduce small businesses' compliance costs and encourage voluntary compliance through a simplification of the rules.

Your tax reform efforts are appreciated and greatly felt within the small business community. If you have any questions or we may assist you in your efforts, please contact me at 504.904.1123 or [rgitz@lcpa.org](mailto:rgitz@lcpa.org).

Sincerely,

Ronald A. Gitz II, CPA, CGMA  
CEO  
Society of Louisiana CPAs



***The Advocate of South Carolina Small Business***  
**1717 Gervais Street • Columbia • SC • 29201**  
**www.scsbc.org • (803) 252-5733**

July 16, 2015

The Honorable David Vitter  
Chairman  
Senate Small Business and Entrepreneurship Committee  
United States Senate  
516 Hart Senate Office Building  
Washington, DC 20510

Dear Chairman Vitter,

Let me express the appreciation of the South Carolina Small Business Chamber of Commerce (SCSBCC) for your efforts to address small business concerns regarding the IRS. We echo much of the support for the *Small Business Tax Compliance Relief Act* that you have received from other organizations such as the letter from the National Small Business Association, which outlines in detail the value of the bill's provisions.

However while the SCSBCC supports almost all of the provisions in the legislation, we are not able to fully support the bill because of the provision that would put the IRS under full purview of the Office of Advocacy. Our reasons are these:

1. The Office of Advocacy has come under criticism for allowing big business interests to dominate the SBREFA process (Center for Effective Government, 2014) for the EPA, OSHA and the CFPB. The recommendations from the panels thus have not been limited to small business concerns and consequently do not necessarily represent the best interest of small businesses. Adding more responsibility and influence to the Office of Advocacy would not be appropriate until the identified problems are resolved.
2. The SBREFA process, especially when misused to promote big business interests, would drain valuable resources from the IRS and further restrict the agency's ability to respond to small businesses and their accounting firms trying to resolve compliance issues. Thus putting the IRS under the full purview of the Office of Advocacy will actually result in more problems of delay and higher costs for small businesses.

3. Putting another federal agency in an oversight position of the IRS with the power to delay and influence the rule-making process would lend itself to mischievous manipulation by some special interests and cause unnecessary delay even for needed rule changes as those proposed in this legislation.

We would not argue the point that the IRS needs to become more small-business friendly and that obtaining input from real small businesses in its rule-making process would be beneficial. Both of these objectives can be addressed without the involvement of the Office of Advocacy through the report this bill directs the IRS to produce by June 30, 2016. In addition to identifying “ways and ideas to improve its customer service to small businesses and shorten its turnaround time for small entities” the report can also propose a process of the IRS will effectively include small business input into its rule-making process. At that time Congress can determine if the agency has proposed a viable solution instead of imposing a process that has been found to be problematic at other agencies.

We are encouraged that the Senate Small Business and Entrepreneurship Committee is focusing on helping small businesses with tax compliance. Our position is that such compliance issues, just as with any regulatory compliance, is better achieved through the proper funding of the assistance process instead of defunding while adding more responsibility.

As small business owners, we understand that good customer relations starts with proper staffing levels and good training. Otherwise we risk dissatisfied employees unable to do all that is asked and resulting in inferior customer service. This might be exactly where we are today with the IRS.

So when it comes to the IRS becoming more small-business friendly, yes we should enact almost all of the provisions in this legislation. But we should also enhance the agency’s ability to respond quickly, accurately and courteously to requests from small businesses regarding compliance issues. Asking the agency to do more with less will end up hurting small businesses, not helping them.

Thank you for the opportunity to provide our input on this legislation. And thank you for your interest in the success of our small businesses.

Sincerely,



Frank Knapp Jr.  
President and CEO



AMERICAN UNIVERSITY  
KOGOD SCHOOL OF BUSINESS  
KOGOD TAX POLICY CENTER

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W A S H I N G T O N, D C

CAROLINE BRUCKNER  
MANAGING DIRECTOR

August 19, 2015

The Honorable Mike Enzi  
U.S. Senate Committee on Small Business and Entrepreneurship  
428 Russell Senate Office Building  
Washington, D.C. 20515

RE: Questions for the Record From July 22, 2015 Hearing Entitled, "Targeted Tax Solutions to Relieve the Tax Compliance Burden(s) for America's Small Businesses."

Dear Sen. Enzi,

Thank you for the opportunity to testify on July 22 at the hearing titled, "Targeted Tax Solutions to Relieve the Tax Compliance Burden(s) for America's Small Businesses," before the full U.S. Senate Committee on Small Business and Entrepreneurship (the "SBC"). I very much appreciated the opportunity to share with you and the other SBC members my views on specific tax compliance burdens that challenge America's small businesses and recommendations for addressing those challenges. Following the hearing, you posed the following question to me, which you subsequently submitted for the record:

*"I understand you have some familiarity with the Marketplace Fairness Act, a bill I have sponsored. Can you discuss in more detail your perspective on how the bill protects small businesses and provides relief to small businesses whose focus is on the online marketplace?"*

During my tenure with the SBC, Chair Landrieu directed me to engage with your staff to develop language to include in the proposed Marketplace Fairness Act (MFA) to address concerns that Louisiana small business owners raised about the proposed legislation's impact on Louisiana state sales and use tax collections. Specifically, Louisiana has a unique states sales and use tax regime in that parishes retain the authority under the Louisiana state constitution to levy sales tax, independent of, and in addition to, the state sales tax.

The majority of Louisiana small businesses and parish officials we spoke with supported the bill and requested we work to include Louisiana-specific language to ensure that in the event the Louisiana state legislature adopted a streamlined Internet sales collection strategy consistent with MFA's provisions, local parishes would retain their taxing authority pursuant to Louisiana state

law. To that end, we worked extensively with your staff and the Louisiana Department of Revenue to include such language in the version of the MFA the Senate passed in a bipartisan vote on May 6, 2013 (S. 743).

In addition to the language we developed, S. 743 included a small business seller exemption provision designed to exempt small Internet sellers with less than \$1,000,000 in gross annual Internet sales from MFA's collection requirements ("1 million exemption"). As part of my responsibilities to the SBC, I coordinated with small business stakeholders about MFA and its impact on small business Internet sellers, some of whom opposed the bill. In addition, our staff coordinated with the U.S. Small Business Administration Office of Advocacy ("Advocacy"), which is the official Federal government source of small business statistics. According to a 2013 study commissioned by Advocacy, a \$1 million exemption "would subject only a small share of business to the internet sales tax: less than 4.5 percent of electronic shopping and mail order houses and less than 2 percent of all non-store retailers...[h]owever, the volume of sales transactions subject to the tax would represent 57 percent of total U.S. online retail sales."<sup>1</sup>

I hope the foregoing information is responsive to your question. In addition, please do not hesitate to contact me should you need additional information on this or any other small business tax-related issues.

Sincerely,

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Professor Caroline Bruckner  
Managing Director  
Kogod Tax Policy Center  
Kogod School of Business  
American University

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<sup>1</sup> Donald Bruce and William Fox, "An Analysis of Internet Sales Taxation and the Small Seller Exemption," University of Tennessee, Center for Business and Economic Research, Knoxville, Tennessee. Under contract no. SBAHQ-12 M-0183 (November 2013) available online at <https://www.sba.gov/advocacy/analysis-internet-sales-taxation-and-small-seller-exemption>.