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2017 Tax Law – Impact on the Budget and American Families

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Chair Yarmuth, Ranking Member Womack, Committee Members and Staff, thank you for the opportunity to testify today. My name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the Managing Director of the Kogod Tax Policy Center (KTPC), which conducts non-partisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. Our mission is to develop and analyze solutions to tax-related problems faced by small businesses, and promote public dialogue concerning tax issues critical to small businesses and entrepreneurs. Thank you for inviting me, and by extension, the American University students who are here with us today, to talk about the budget impact of the *Tax Cuts and Jobs Act of 2017* (P.L. 115-97) (hereinafter, "tax reform" or "TCJA") on America's families and small businesses.

Prior to joining AU's faculty, I served on the staff of the U.S. Senate Committee on Small Business and Entrepreneurship from 2009-2014, ultimately as Chief Counsel. During my tenure with the Senate Small Business Committee, I handled tax, labor and budget issues for the committee and its chair, and worked with small business stakeholders across the country and political spectrum to develop small business legislation. Before public service, I worked in private practice as a tax attorney with both PaulHastings and PwC's Washington National Tax Services.

Both my public and private sector experience have informed my research at Kogod, and today I want to share with you how my research indicates: (1) the need for a comprehensive strategy for study some of the tax expenditures included in tax reform with respect to women business owners, 99% of whom are small businesses;[1](2) how health care costs for small businesses have been impacted by tax reform; and (3) the budget implications of tax reform's failure to address the tax compliance challenges of the small business owners powering the gig economy.

[1] Michael J. McManus, *Issue Brief Number 13: Women's Business Ownership: Data from the 2012 Survey of Business Owners,* Office of Advocacy, U.S. Small Business Administration (May 31, 2017), *available at* https://www.sba.gov/sites/default/files/advocacy/Womens-Business-Ownership-in-the-US.pdf.

1. Congress Needs to Conduct Oversight on the Effectiveness and Distribution of Business Tax Expenditures with Respect to Women Businesses Owners.

The Committee's effort to conduct oversight on the budget impact of tax reform is commendable, and the Committee should develop a comprehensive strategy of study and oversight of business tax expenditures to consider their impact with respect to women business owners. Although millions of women business owners should see some tax savings from the marginal rate cuts and other expenditures included in tax reform, our research suggests that additional taxpayer investments in expenditures targeted to individuals with business income (IRC §199A) and small business owners (IRC §179) effectively "doubled-down" on a billion-dollar blind spot Congress has when it comes to women business owners and the U.S. tax code. This Committee, pursuant to House Rule X, has express jurisdiction to study this billion dollar blind spot and shed light on any findings.[2]

In June 2017, we published *Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners*, ground-breaking research on how the U.S. tax code's small business tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.[3] Our findings with respect to four specific tax expenditures targeted to small businesses (i.e., IRC §§1202, 1244, 179 and 195) raised questions as to (i) whether the U.S. tax code's small business tax expenditures were operating as Congress intended; and (ii) whether the cost of these expenditures had been accounted for in terms of their uptake by women-owned firms.[4]

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[2]Rules of the U.S. House of Representatives, Rule X, cl.4(b)(6), *available at* https://rules.house.gov/sites/democrats.rules.house.gov/files/116-1/116-House-Rules-Clerk.pdf (noting the Budget Committee's authority to "request and evaluate continuing studies of tax expenditures, devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and report the results of such studies to the House on a recurring basis."

[3] Bruckner, C.L. (2017). *Billion Dollar Blind Spot: How the U.S. Tax Code's Small Business Expenditures Impact Women Business Owners*. Kogod Tax Policy Center Report, a*vailable at* https://www.american.edu/kogod/research/upload/blind_spot_accessible.pdf.

[4] In *Billion Dollar Blind Spot*, we detailed the legislative history and Congress' intent to provide access to capital and opportunities for growth to small businesses with respect to four specific tax expenditures (i.e., IRC §1202 – *100% Exclusion from Capital Gains Tax for Investments in Qualified Small Business Stock*; IRC §1244 - *Ordinary Loss Treatment for Investments in Small Business Stock*; IRC §179- *Expensing for Small Businesses*; and IRC §195 – *Deduction for Qualified Start-Up Costs*). Each small business tax

This research is particularly important because although women business owners account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%, women business owners remain small businesses primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.[5] Notably, women of color are the "driving force behind the growth of women-owned firms."[6] Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.[7]

Despite the good news on their increasing numbers, women business owners still struggle to access capital to grow and scale their businesses.[8] For example, a 2014 Congressional report found that access to capital is a more severe challenge for women-owned firms and that women only account for 16 percent of conventional small business loans, and 17 percent of SBA loans; which means just $1 of every $23 in conventional small business loans goes to a women-owned business.[9] At the same time, "[t]axation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. The major source of equity capital for expansion of a business is reinvested profits. The amount of tax the business must pay determines the amount of money available for growth and expansion."[10]

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expenditure we studied met two criteria: (i) Congress intended the provision to stimulate growth or access to capital or investment in smaller firms; and (ii) Each expenditures generated a cost to U.S. taxpayers of at least $100 million. *Id.* at 7 (noting revenue loss is a key factor in Congress relies on in determining the effectiveness of a tax expenditure).

[5] The 2018 State of Women-Owned Businesses Report, Ventureer (2018), *available at* https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf.

[6] *Id*.

[7] *Id*.

[8] *See*, Farrell, Diana, Christopher Wheat, and Chi Mac, "Gender, Age and Small Business Financial Outcomes." (2019) JP Morgan Chase Institute (finding that "young and female small business owners are well-represented among firms that grow organically, but underrepresented among firms with external financing").

[9] Majority Report of the U.S. Senate Committee on Small Business and Entrepreneurship, 21ST CENTURY BARRIERS TO WOMEN'S ENTREPRENEURSHIP(2014),https://www.sbc.senate.gov/public/_cache/files/3/f/3f954386-f16b-48d2-86ad-698a75e33cc4/F74C2CA266014842F8A3D86C3AB619BA.21st-century-barriers-to-women-s-entrepreneurship-revised-ed.-v.1.pdf.

[10] INTERAGENCY TASK FORCE ON WOMEN BUSINESS OWNERS, THE BOTTOM LINE: UNEQUAL ENTERPRISE IN AMERICA. (U.S. Department of Commerce) (1978).

However, to date, there has been no formal government or Congressional oversight strategy on how the U.S. tax code's more than $333.5 billion of tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.[11] Ultimately, taxpayers do not know if the money Congress has spent on tax breaks to help businesses access capital has been well spent or equitably distributed. This is particularly troubling considering that three of the four small business tax expenditures we studied in *Billion Dollar Blind Spot* (i.e., IRC §1202, §1244, and §179) were so limited in design that they either (i) explicitly excluded service firms (e.g., IRC §1202), and by extension, the majority of women-owned firms; or (ii) effectively bypassed women-owned firms who are not incorporated (IRC §1244) or who are service firms with few capital-intensive equipment investments altogether (IRC §179).[12]

However, neither Congress nor Treasury or SBA has ever studied or conducted oversight on how the U.S. tax code's business expenditures impact women business owners. Moreover, neither the IRS nor JCT collect data or conduct analysis on the distribution of business tax expenditures with respect to women-owned firms.[13] This means we have a billion dollar blind spot when it comes to

[11] Joint Committee on Taxation (JCT), Estimates of Federal Tax Expenditures for Fiscal Years 2018-2022, JCX-81-18 (Oct. 4, 2018), *available at* https://www.jct.gov/publications.html?func=startdown&id=5095. Total includes JCT's 5-year estimates of (1) expensing under Section 179 ($67.8B); (2) 20% deduction for qualified business income ($259B); and (3) exclusion of gain from certain small business stock ($6.7B).

[12] *Billion Dollar Blind Spot*, *supra* n. 3. As part of our research, we conducted a survey of the members of Women Impacting Public Policy (WIPP) and its coalition partners. We designed our survey to gauge whether and how familiar self-identified women business owners are with the tax expenditures we studied and whether those women-owned firms accessed them. WIPP and its coalition partners invited their memberships to participate in the online Survey Monkey survey, which was conducted from March 9, 2017 through April 11, 2017. We received 515 completed responses from women who, on their own, or with other women, owned at least 51% of a business, from the more than 550,000 WIPP or coalition partner members invited to participate in the survey. Our survey data of 515 experienced, engaged women business owners corroborated our research findings, and suggested that when women-owned firms can take advantage of tax breaks, they do (*see., e.g.,* uptake rates for IRC §195).

[13] For example, Congress designed IRC §1202, which allows angel investors to invest in qualified small business corporations, to explicitly exclude service firms. Our research found that this limitation has resulted in only a very small minority of women business owners being able to utilize it. In fact, we identified only three women business owners who had ever used IRC §1202 to raise capital for their business. Keep in mind, this is a $6.7 billion tax break Congress specifically designed to enable small businesses to attract capital. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available IRS or Treasury taxpayer data to prove it. Similarly, with respect to IRC §179, our survey results found that women business owners claimed this tax break at significantly lower rates (47%) than existing government research finds for businesses generally (60% to 80%). This tax break is one of the more expensive small business tax incentives (i.e., it will cost taxpayers $67.8 billion from 2018-2022), and yet we don't have any IRS or Congressional research on how it benefits women business owners, and what research we do have suggests that women business owners benefit less than businesses generally.

understanding how effective and equitable tax expenditures are, and the latest distributional analysis from JCT on certain provisions from tax reform indicates that Congress doubled-down on it.[14]

In fact, our assessment of two of the key tax investments of the TCJA (§199 and §179), which Congress designed based on two of the small business tax incentives we studied (§1202 and §179), confirms that questions we raised in *Billion Dollar Blind Spot* were not robustly investigated in connection with Congress' efforts on tax reform.[15] Instead, Congress made additional billion dollar investments in tax expenditures that our research suggests are less favorable to women business owners in terms of distribution of tax benefits, which the JCT's April 2018 distributional analysis supports.

For example, according to Table 3 of JCT's distributional analysis of the TCJA, more than 90% of the revenue loss generated from the new deduction under IRC §199A will flow to firms with income of *more than* \$100,000 in 2018 and 2024.[16] However, the most recent data available finds that 88% (or 10,775,600) of women business owners generate revenues *less than* \$100,000.[17]

This inequitable distribution is even more pronounced when considered at higher income levels: only 1.7% of women-business owners have receipts of \$1,000,000 or more, <u>but JCT found in 2018, 44% of the IRC §199A will flow to pass-through businesses with \$1,000,000 of income</u>. Moreover,

[14] For more on the history of tax expenditure analysis, *see* Anthony C. Infanti, *A Tax Crit Indentity Crisis? Or Tax Expenditure Analysis, Deconstruction, and the Rethinking of a Collective Identity*, 26 Whittier L. Rev. 707 (2005).

[15] We submitted summaries of our research and links to Billion Dollar Blind Spot to multiple Congressional committees in 2017 during the tax reform debate. *See e.g.,* Bruckner, Caroline (July 27, 2017). *Statement for the Record to the U.S. House of Representatives Committee on Ways & Means Tax Policy Subcommittee in connection with July 13 hearing, "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs."*; Bruckner, Caroline (July 17, 2017). *Submission to the U.S. Senate Finance Committee in Response to the Chair's Request for Recommendations for Tax Reform*; Bruckner, Caroline (June 28, 2017). *Statement for the Record to the U.S. Senate Committee on Small Business and Entrepreneurship in Connection with the June 14 Hearing Titled, "Tax Reform and Barriers to Small Business Growth." See also,* Bruckner, C. L. (August 30, 2017), *"Women in Business Must Be a Priority in U.S. Tax Reform Plans"* FINANCIAL TIMES, *available at https://www.ft.com/content/ebda758c-8cb7-11e7-a352-e46f43c5825d*.

[16] JCT, *Tables Related to the Federal System as in Effect 2017 through 2026 (JCX-32R-18)*, (April 24, 2018), *available at* https://www.jct.gov/publications.html?func=startdown&id=5093.

[17] The 2018 State of Women-Owned Businesses Report, *supra* n. 5 at 9.

JCT projects that the 44% will increase to 52% by 2024.[18] These alarming estimates warrant immediate study and oversight by this Committee. Taxpayers are entitled to: (i) a government accounting of the distribution of the $415 billion JCT estimated Section 199A will cost with respect to women business owners; and (ii) an analysis as to whether high-earning women businesses owners—the majority of whom are in services and are excluded from claiming Section 199A above certain thresholds—will be effectively barred from being able to use this tax break to grow their businesses.[19]

While most women business owners will no doubt see some limited benefit from IRC §199A, JCT's distributional analysis raises serious questions as to the equity of the distribution of this tax expenditure with respect to women-owned firms, who constitute 40% of all U.S. firms. In addition, our research suggests additional oversight and tax research is warranted with respect to the TCJA's investments into expanding IRC §179.

2. Impact of Tax Reform on Health Care Costs for Small Businesses

One of the most concerning aspects of tax reform is impact on health care costs for small businesses. Small businesses remain deeply concerned regarding the affordability of health care.[20] In fact, the 4.4 million self-employed small business owners who purchase health care for themselves and their families on the individual market are acutely vulnerable to increases in

[18] JCT, *supra* n. 16 at Table 3. *See also*, Exhibit A.

[19] In general, the deduction is available to sole proprietors, independent contractors, and owners of S corps, partnerships, and LLCs. However, if taxable income exceeds certain thresholds ($315,000 MFJ, $157,500 everyone else), and business is a "specified service trade or business," no deduction is available. For purposes of Section 199A the term "Specified Service Business" is based on Section 1202 and includes firms involving performance of services in fields of *health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services*, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners or involves performance of services involving investing or trading. As noted in Exhibit A, half of women-owned businesses are concentrated in three industries: other services, health care and social assistance, and professional/scientific/technical services.

[20] *See, e.g.*, NIFIB Letter to Ways and Means Chair Brady (Jan. 2018), *available at* https://www.nfib.com/assets/NFIB-Letter-of-Support-Healthcare-Tax-Delay-Legislation-01-2018.pdf.

healthcare costs, which represent a "material expense for nonemployer business owners."[21] As part of tax reform, Congress effectively eliminated the penalty that individual taxpayers who have no health insurance and are not exempt from the mandate must pay. In November 2017, during the tax reform debate, CBO issued a report finding that repealing the individual mandate would result in 4 million fewer people carrying insurance in 2019 and 13 million in 2027.[22] In addition, CBO found that "average premiums in the nongroup market would increase by about 10 percent in most years of the decade."[23] Essentially, CBO found that eliminating the individual mandate would mean fewer healthy people would buy insurance, "especially in the nongroup market" and "the resulting increases in premiums would cause more people not to purchase insurance."[24] More than a year later, there is some evidence CBO's estimates were accurate.

For example, an October 2018 issue brief prepared by the Kaiser Family Foundation found that "among insurers that publicly specify the effect of these legislative and policy changes in their filings to state insurance commissioners, we found that 2019 premiums will be an average of 6% higher, as a direct result of the individual mandate repeal and expansion of more loosely regulated plans than would otherwise be the case."[25] Although health care insurance premiums "may be flat or even falling in some places, they would be substantially lower still if not for these policy changes."[26]

[21] Farrell, Diana, Christopher Wheat, and Chi Mac (2017), "Paying a Premium: Dynamics of the Small Business Owner Health Insurance Market." JPMorgan Chase Institute, *available at* https://www.jpmorganchase.com/content/dam/jpmorganchase/en/legacy/corporate/institute/document/institute-smb-health-insurance.pdf.

[22] Congressional Budget Office, *Repealing the Individual Health Insurance Mandate: An Updated Estimate* (Nov. 2017), available at www.cbo.gov/publications/53300. CBO also found that repealing the individual mandate would reduce deficits by $338 billion between 2018 and 2027.

[23] *Id*.

[24] *Id*.

[25] Kaiser Family Foundation, *How Repeal of the Individual Mandate and Expansion of Loosely Regulated Plans are Affecting 2019 Premiums* (Oct. 2018), *available at* https://www.kff.org/health-costs/issue-brief/how-repeal-of-the-individual-mandate-and-expansion-of-loosely-regulated-plans-are-affecting-2019-premiums/.

[26] *Id*.

And it's not just an increase in premiums that are a cause for alarm with respect to the impact of tax reform. The reported lower refunds taxpayers are receiving as a result of changes in withholding may have unintended, but nevertheless, painful consequences for taxpayers who anticipated higher refunds. For example, banking industry research shows that Americans "increase their out-of-pocket healthcare spending by 60 percent in the week after receiving a tax refund, and the majority of the increase goes towards in-the-moment, in-person care."[27] For those taxpayers who this year are receiving lower refunds, they may have to wait even longer to pay for needed healthcare costs. Although tax reform did in fact create tax savings for most Americans, the distribution of those savings through lower withholding rather than through a higher refund amount may have unintended health care purchasing implications. This Committee should be aware of and tracking these issues in connection with its oversight efforts of tax reform's impact on American families.

3. Tax Reform's Failure to Help Small Businesses Driving the Gig Economy

Finally, I am very concerned that tax reform failed to address the tax compliance challenges of the 2.3 million Americans working side-hustles every month in the gig economy, which directly impact these taxpayers' ability to pay their taxes and be credited with Social Security contributions.[28] In 2016, I published research detailing the findings of a survey on the tax compliance challenges of gig economy workers, and found that more than 60% of the population I surveyed did not receive any tax forms for the income they earned working with a platform and the IRS didn't either. This is because gig economy platforms such as Uber, Lyft, Esty, Airbnb and others are not required to report to the IRS income paid electronically or to send information reporting forms to service

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[27] Farrell, Diana and Fiona Greig. "On the Rise: Out-of-Pocket Healthcare Spending in 2017." JPMorgan Chase Institute, (2018), *available at* https://www.jpmorganchase.com/corporate/institute/document/institute-on-the-rise-report.pdf; Farrell, Diana, Fiona Greig and Amar Hamoudi "Filing Taxes Early, Getting Healthcare Late: Insights from 1.2 million households" JPMorgan Chase Institute (2018), *available at* https://www.jpmorganchase.com/corporate/institute/insight-filing-taxes-early.htm.

[28] Bruckner, C.L. and Thomas Hungerford (2019). *Failure to Contribute: An Estimate of the Consequences of Non-and Underpayment of Self-Employment Taxes by Independent Contractors and On-Demand Workers*. Boston College Center for Retirement Research Working Paper, *available at* https://crr.bc.edu/working-papers/failure-to-contribute-an-estimate-of-the-consequences-of-non-and-underpayment-of-self-employment-taxes-by-independent-contractors-and-on-demand-workers-on-social-security/.

providers and sellers until a $20,000 and 200 transaction threshold is met.[29] However, the majority of gig economy workers do not earn enough income or engage in enough transactions over the course of a year to trigger information reporting.[30] This means that there is a 63% likelihood that the billions of dollars these millions of taxpayers earn is misreported.[31] I testified before the House Small Business Committee as to these findings in 2016 and 2017, and worked extensively with Congressional staff in the last Congress to develop bipartisan legislation, the *Small Business Owners Tax Simplification Act* (H.R. 3717), to help these taxpayers.[32]

Notwithstanding these efforts, the final tax reform legislation failed to address this issue, which is a growing problem that subjects millions of taxpayers to audit and penalty exposure. In fact, recent IRS data shows that the underpayment of estimated taxes rose 40% from 2010 to 2015 up to 10 million from 7.2 million.[33] As a result, there are significant budget and Social Security consequences for taxpayers for this growing problem. For example, in January, Boston College Center for Retirement Research published my latest research, Failure to Contribute, which reviewed existing estimates on the size and growth of the gig economy and independent contractors, and estimated that in 2014 alone, the independent contractors and gig workers I studied failed to properly report more than $7.35 billion in self-employment taxes. Moreover, the

[29] Bruckner, C. L. (2016). *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*. Kogod Tax Policy Center Report, *available at* https://www.american.edu/kogod/news/Shortchanged.cfm.

[30] Diana Farrell, Fiona Greig, & Amar Hamoudi. 2018. "The Online Platform Economy in 2018: Drivers, Workers, Sellers and Lessors." JPMorgan Chase Institute (Sept. 2018), https://www.jpmorganchase.com/corporate/institute/document/institute-ope-2018.pdf (finding average month income ranges in four key sectors of the gig economy were: (1) transportation ($783/month); (2) leasing ($1,736/month); (3) selling ($608/month); and other services ($793/month) and that earnings represented a major sources of supplemental not primary income).

[31] *Shortchanged, supra* n. 28 (citing U.S. tax gap data noting that where income is not subject to withholding or information reporting there is a 63% chance of taxpayers misreporting).

[32] Bruckner, C. L. (February 15, 2018). "*Congress Failed to Fix Tax Woes for Gig Workers*." The Chicago Tribune, *available at* https://www.chicagotribune.com/news/opinion/commentary/ct-perspec-gig-economy-taxes-uber-lyft-airbnb-0216-20180215-story.html. *The Sharing Economy: A Taxing Experience for New Entrepreneurs Part I: Hearing Before the U.S. House Comm. on Small Business*, 114th Congress (testimony of Caroline Bruckner) (May 2016), https://smallbusiness.house.gov/uploadedfiles/5-24-16_bruckner_testimony_.pdf ("House May 2016 Testimony"); *Small Business Tax Reform: Modernizing the Code for the Nation's Job Creators: Hearing Before the U.S. House Comm. on Small Business*, 115th Congress (testimony of Caroline Bruckner) (Oct. 2017), https://smallbusiness.house.gov/uploadedfiles/10-4-17_bruckner_testimony.pdf.

[33] Laura Saunders, *Number of Americans Caught Underpaying Their Taxes Surges 40%*, THE WALL STREET JOURNAL, (Aug. 11, 2017) *available at* https://www.wsj.com/articles/the-numberof-americans-caught-underpayingsometaxes-surges-40-1502443801.

problem of underreporting is not confined to platforms who don't furnish 1099-Ks to their service providers and sellers. Following our research, Treasury's Inspector General released a new report earlier this month finding that the expansion of the gig economy warrants a focus on improving self-employment tax compliance because, in part, IRS failed to work cases for TY 2012 to TY2015 involving $12 billion of payments by gig platforms to workers that potentially wasn't reported.[34] Last month, the Chair and Ranking Member of the House Small Business Committee once again introduced bipartisan legislation to address this issue (H.R. 593, *Small Business Owners' Tax Simplification Act*), and going forward, I urge members of this Committee to consider the growing budget implications of failure to act to facilitate tax compliance by these workers and platforms.

<u>Conclusion</u>

This Committee should be congratulated on holding this hearing and immediately set to work to develop the needed oversight on the distribution of business tax expenditures with respect to women business owners. The existing lack of research and effective Congressional oversight on how business tax expenditures impact women business owners constrains policymakers from developing evidenced-based policymaking on the effectiveness of tax expenditures overall and denies taxpayers information crucial to understanding how their money is being distributed among firms. In addition, this Committee should continue to track the budget implications of how tax reform's changes impact the affordability of health care for small businesses. Finally, this Committee should study the ongoing and growing budget implications of the expanding gig economy. We stand ready to aid the Committee in this important work on behalf of the millions of small businesses impacted by these issues.

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[34] U.S. Treasury Inspector General for Tax Administration, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance*, Reference Number: 2019-30-016 (Feb. 14, 2019), *available at* https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf.