SMALL BUSINESS MAJORITY

STATEMENT FOR THE RECORD BEFORE THE
U.S. HOUSE COMMITTEE ON SMALL BUSINESS TAX DAY:
EXPLORING THE ADVERSE EFFECTS OF HIGH TAXES
AND A COMPLEX TAX CODE

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John Arensmeyer
Founder & CEO, Small Business Majority

Dear Chairman Williams, Ranking Member Velazquez, and members of the House Committee on Small Business,

As a leading representative of America's 33 million small businesses, Small Business Majority is pleased to provide written testimony to the U.S. House Committee on Small Business regarding the importance of ensuring our tax code supports a thriving and equitable small business economy.

Small Business Majority is a national small business organization that empowers America's diverse entrepreneurs to build a thriving and equitable economy. From our nine offices across the country, we engage our network of more than 85,000 small businesses and 1,500 business and community organizations to deliver resources to entrepreneurs and advocate for public policy solutions that promote inclusive small business growth. Our work is bolstered by extensive research and deep connections with the small business community that enables us to educate stakeholders about keys issues impacting America's entrepreneurs, with a special focus on the smallest businesses and those facing systemic inequities.

For more than a decade, we have examined the reality of how taxation affects America's small businesses and have effectively advocated for policies that support a resilient, inclusive economy. Our research has combined analyses of tax policies' impacts on Main Street, along with scientific research into small business needs and attitudes.

Today's tax code is increasingly more complex for small businesses to navigate. While a cornerstone of today's Main Street tax debate centers around the expiration of the 2017 Tax Cuts and Jobs Act, and despite current inequities faced by small businesses at tax time, extending the TCJA out right will not improve tax fairness for small and microbusinesses. With certain provisions expiring at the end of 2025, we face a historic opportunity to charter innovative tax reforms that would actually deliver tax relief for America's smallest businesses.

Examining the impacts of tax disparities from the 2017 Tax Cuts and Jobs Act—a promise that failed to bolster Main Street America

The enactment of the 2017 Tax Cuts and Jobs Act (TCJA) was largely touted by lawmakers as much-needed tax relief for America's small businesses, but it has since failed to deliver on that promise and rather exacerbated opportunities for wealthier corporations to exploit our tax system.[1] A prime example of how the TCJA failed to deliver for the smallest businesses can be examined through the distribution of the Section 199A pass-through deduction. The Section 199A Qualified Business Income (QBI) Deduction allows pass-through entities to deduct up to 20% of their eligible, pass-through business income from their federal taxes. According to the latest available data, given 95% of small businesses are classified as

[1] "H.R.1 - An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." Library of Congress. December 22, 2017. https://www.congress.gov/bill/115th-congress/house-bill/1/text.

pass-through entities, which include sole proprietorships, partnerships, LLCs, and S-Corporations, many believed the deduction would provide relief to Main Street businesses.[2] However, the vast majority of pass-through deductions have been concentrated among the wealthiest corporations.

- Based on 2022 Tax Policy Center data, only 4.5% of businesses have pass-through business income taxed in the top-two brackets, and 69.2% of all pass-through income is earned by few business owners in these two rarefied brackets.[3] The disparate economic impact is even more pronounced when you factor in the higher marginal tax rates themselves.
- Most of the benefit of the pass-through deduction in the TCJA flows to the wealthiest 4% of businesses, not your typical Main Street enterprises.[4]
- The concentration of pass-through income at the top has also resulted in the concentration of deductions among higher earning individuals and businesses. Taxpayers with more than $200,000 in annual gross income (AGI) claimed more than two-thirds of 199A deductions, while taxpayers with more than $1,000,000 in AGI claimed over one-third of the deductions.[5] The financial benefits for a pass-through entity making $500,000 are 20 times higher than the benefits for a business making $75,000.
- This leaves behind America's smallest businesses and self-employed entrepreneurs, who make an average annual profit of just over $33,000.[6] Meanwhile, much larger and wealthier pass-through entities take advantage of yet another unnecessary tax cut.

Furthermore, the current tax code is characterized by a substantial gap between top individual rates and top pass-through rates, which incentivizes wealthy individuals to manipulate the system by declaring themselves as pass-through business entities. Although the law restricts certain industries from accessing the pass-through rate, there is no effective mechanism to prevent the abuse of the deduction, which we see play out in real time. Since the passage of the 2017 tax law, we have seen that the benefits continue to go directly to millionaires and billionaires, not Main Street businesses. For example, Americans for Tax Fairness found that billionaires became $2.2 trillion richer since the law was enacted; while at the same time, our federal programs supporting small businesses continue to struggle for funding following an increased demand during the COVID-19 pandemic.[7] The permanency of this package, as it stands in the law, would cost American taxpayers another $3.8 trillion.[8] As we look to the expiration of the TCJA and its provisions, Congress must think critically and strategically about what worked and what didn't when deciding who gets the next best tax break Washington can broker. We believe that the expiration of this sweeping legislation provides an opportunity for reform that can translate to real relief for the smallest businesses.

The forthcoming expiration of numerous provisions set in place by the 2017 tax law, including the 199A pass-through deduction, presents a critical opportunity for impactful reform that can have a significant, direct benefit to small businesses and self-employed individuals, as opposed to large businesses. Small businesses that see a benefit in this deduction simply will not receive enough savings to grow or invest back in their businesses, as their minimal profits leave them with little to nothing to reinvest.

[2] "9 facts about pass-through businesses." Brookings Institution. May 15, 2017. https://www.brookings.edu/articles/9-facts-about-pass-through-businesses/#:~:text=Rather%2C%20most%20businesses—about%2095,partnerships%2C%20and%20S%2Dcorporations.
[3] "Sources of flow-through business income by statutory marginal tax rate; current law, 2022." Tax Policy Center. March 1, 2023. https://www.taxpolicycenter.org/model-estimates/distribution-business-income-february-2023/t23-0028-sources-flow-through-business.
[4] Ibid.
[5] "How do business owners respond to a tax cut? Examining the 199A deduction for pass-through firms." Columbia Law School. https://www.law.columbia.edu/sites/default/files/2023-03/Goodmanetal_199A_Deduction_2022.pdf.
[6] Sources of flow-through business income by statutory marginal tax rate; current law, 2022." Tax Policy Center. March 1, 2023. https://www.taxpolicycenter.org/model-estimates/distribution-business-income-february-2023/t23-0028-sources-flow-through-business.
[7] "Billionaires are $2.2 trillion richer since 2017 Trump-GOP tax law." Americans for Tax Fairness. September 28, 2023. https://americansfortaxfairness.org/billionaires-2-2-trillion-richer-since-2017-trump-gop-tax-law/.
[8] Ibid.

To ensure our tax code reflects the needs of America's smallest businesses who keep our economy running, we propose replacing the 199A deduction with a bottom-up, small business standard deduction of $25,000 so that the smallest businesses with thin margins may benefit. A bottom-up approach will allow pass-through (S-Corporations) small businesses to deduct their first $25,000 of qualifying business income (QBI), thus benefiting the vast majority of small businesses from the bottom-up rather than continuing to deploy current and unevenly distributed top-down tax breaks that only benefit a select number of the wealthiest businesses.9 This deduction should be accompanied by a phase-out for businesses with $150,000-200,000 in AGI to ensure it benefits the entities most in need.

We encourage Congress to consider this proposal, which would provide simplified and streamlined tax relief to millions of small businesses, giving them the ability to save and invest back into their businesses to grow their operations.

Small Business Majority research shows that business owners want tax fairness, not more tax breaks for larger, wealthier corporations

There is no contesting the fact that small businesses often must compete, albeit unevenly, with larger, wealthier corporations, due in part to the TCJA providing unfair loopholes for those who can afford to avert paying their fair share of taxes. In 2021, we conducted a survey to better understand the perspectives of small business owners when it comes to tax policy.[10] Our research revealed that America's small businesses strongly believe our nation's tax system favors large corporations and the wealthy over Main Street. Specifically, small businesses feel disadvantaged by loopholes that allow larger and wealthier businesses to avoid paying their share of taxes. The following are some of our research findings:

- A majority of business owners (73%) agreed that the current tax system favors big businesses over their small businesses.
- Additionally, 69% cited that offshore tax loopholes allowed bigger businesses to avert paying their fair share.
- An overwhelming 76% of respondents cited that more tax incentives for small businesses should be provided.
- Our respondents showed strong support for provisions aimed at leveling the playing field through tax reforms, such as the proposed 15% minimum tax requirement levied on the biggest corporations through the Inflation Reduction Act. In examining corporate profits, especially those made offshore, 66% of our network said they support setting a minimum tax rate of 21% on corporate offshore profits.

While small businesses make up more than 99% of all U.S. businesses and account for 44% of all U.S. economic activity, our current tax code fails to deliver tax relief for small businesses who continue to lack the resources and capital necessary to compete with larger and wealthier corporations, and who already have the upper hand.[11] [12] Similar to small businesses nationwide, 75% of the small businesses in our network have fewer than 10 employees (one-third of which are solopreneurs). These microbusinesses simply do not have the in-house capacity, tax expertise, or legal counsel to help them take advantage of tax loopholes as their larger wealthier counterparts do. Small businesses already have a difficult time competing with large ones in areas ranging from providing benefits, to accessing capital. The tax code should not work to exacerbate these inequities, but that is simply the reality we find ourselves in today.

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[9] "Qualified business income deduction." Internal Revenue Service. February 23, 2024. https://www.irs.gov/newsroom/qualified-business-income-deduction.

[10] "Small businesses share views on proposed tax reforms, workforce shortages." Small Business Majority. August 18, 2021. https://smallbusinessmajority.org/our-research/small-businesses-views-on-tax-reforms-workforce-shortages.

[11] "Small businesses generate 44 percent of U.S. economic activity." U.S. Small Business Administration Office of Advocacy. January 30, 2019. https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/.

[12] "Frequently asked questions about small business 2023." U.S. Small Business Administration Office of Advocacy. March 7, 2023. https://advocacy.sba.gov/2023/03/07/frequently-asked-questions-about-small-business-2023/#:~:text=Most%20businesses%20are%20small%2D%2099.9,46.4%25%20of%20private%20sector%20employees.

Initiatives to bring parity to the tax code and recover lost revenue would greatly support our small business community

It is no secret that small business growth is thriving, with an estimated 16 million new business applications filed in the last three years alone.[13] To sustain this historic small business boom, it is paramount that federal agencies receive the proper funding and resources to carry out their mission of serving small businesses who rely on federal programs to start, scale, and improve their ventures. Recovering lost revenue from the exploitation of corporate and international tax loopholes presents an opportunity to bolster domestic federal programs that are critical to small business growth and development.

The TCJA further reduced the amount of revenue generated through taxation by creating new incentives to outsource production and jobs, cutting the tax rate in half for overseas versus domestic investments. The money that corporations are writing off in tax deductions overseas could be better spent here at home on critical programs small business owners rely on every day. A few examples of programs that could use this funding include (but are not limited to) increased lending capacity through the U.S. Small Business Administration (SBA), and the SBA's entrepreneurial development programs including Women's Business Centers and Small Business Development Centers. Other agencies that benefit small businesses have fought hard to see an increase in funding. For example, the Minority Business Development Agency, which was authorized at $110 million in the Bipartisan Infrastructure Law, has yet to be funded at that level, leaving a critical gap in support and capacity for businesses that are minority-owned and in desperate need of technical assistance.

These are simply a few examples of how additional financial support could be deployed to grow our entrepreneurial economy. Ironically, these are the very same programs that must scrape by with marginal increases in funding despite increased demand, just as Congress struggles to increase federal revenue to keep key programs afloat.

The time is now to enact systemic and impactful tax reform to uplift America's small business community

Over the last few years, small business owners have made their message clear to Congress: small businesses want a simplified and streamlined tax system that will also help level the playing with large corporations, but they got the opposite. Small businesses are the heart of our nation's economy, and a fair, equitable tax code is critical to ensuring our Main Street businesses can compete on a level playing field with their larger, wealthier counterparts.

Congress must act to not only hold wealthy corporations accountable for paying their fair share, but to deliver much needed tax relief to America's small businesses, allowing them to scale and grow their businesses. We hope that the conversation today sheds light on some of the solutions to achieving those goals to uplift our nation's smallest but most innovative job creators and economic contributors.

We thank you for the opportunity to comment on how the current tax code is impacting small businesses nationwide and look forward to working with Congress to deliver tax reform and relief to America's Main Street. For any questions or additional information, please contact Government Affairs Director, Alexis D'Amato at [adamato@smallbusinessmajority.org.](mailto:adamato@smallbusinessmajority.org)

Sincerely,

John C. Arensmeyer

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Founder & CEO, Small Business Majority

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[13] "New business applications reach record 16 million under Biden-Harris administration." U.S. Small Business Administration. January 11, 2024. https://www.sba.gov/article/2024/01/11/new-business-applications-reach-record-16-million-under-biden-harris-administration.