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Statement of Robert Russell

Attorney – International Tax Controversy, Planning and Policy at alliantgroup

United States House Committee on Small Business, Subcommittee on Economic, Growth, Tax and Capital Access Hearing on “Keep it Simple: Small Business Tax Simplification and Reform, Main Street Speaks”

Mr. Chairman Huelskamp and Ranking Member Chu:

Thank you for inviting me to testify before the Subcommittee on Economic, Growth, Tax and Capital Access on this important topic of tax reform and simplification and making sure that small business does not get left behind in this discussion. I believe it is vitally important to remember that America’s small businesses have needs, interests and resources that differ significantly from those of larger businesses and so it is essential that hearings such as this take place.

As background, the firm I am a part of, alliantgroup, is a leading tax service consultant for small and medium businesses across the country. alliantgroup has approximately 650 professionals located nationwide, focused on assisting small and medium sized businesses avail themselves of proper and available tax incentives, including tax credits, designed to create jobs, promote research and investment, and otherwise help the United States remain the leader in the global economy. We also assist these businesses in tax planning, and we represent them before the IRS and state tax regulators. In providing these services, we work with the CPA firms of these businesses.

We are uniquely positioned to speak to the issues you wish to discuss today because of our work with over three thousand CPA firms and tens of thousands of businesses from all over the country in a remarkably diverse set of industries. Daily interactions with our CPA partners and clients reveal that

cross-border business is a reality for many of our nation's small and medium size businesses. I would specifically like to note a few of our CPA partners, James Guthrie, Jr. of Gallina, Dave Springsteen of Withum, and James Cordova of Windes for their valuable insights on these issues.

Specifically, in my time today, I will speak to the challenges facing small companies when they want to expand their businesses across borders and of the challenges their CPAs face in trying to assist them. Discussion both here and abroad occurs daily on reform of international tax systems, but much of that attention is focused on larger businesses rather than on the difficult challenges facing small businesses.

Mr. Chairman, if there is one takeaway from my message today, it is that although businesses of all sizes are now players in the global economy, our rules and regulations both in the U.S. and in foreign jurisdictions, have been built for big corporations. Our recommendation based on our experience is that a "one size fits all" approach cannot work and should be modified to provide needed adaptability and flexibility for smaller companies with resource constraints.

It is often cited that 95% of the world's consumers are outside of the US.¹ Therefore, it is too simple a view of the world to think that small businesses are not currently engaged in cross-border activities and are uninterested in growing further. Simply put, when considering international tax law modifications, small business needs and resources must be considered.

It is helpful to step back from time to time and focus on the larger economic picture. As colleagues that practice in the area of trade law like to quip "Tax is nothing but a speed bump on the superhighway of trade," or as you learn on day one of Tax Law 100 in law school, "the tax tail should not wag the business dog". Obviously, we are not advocating the elimination of taxes. However, far too

¹ 95% of the World's Consumers Live Outside the United States, U.S. Chamber of Commerce. (May 15, 2012) available at <https://www.uschamber.com/ad/95-worlds-consumers-live-outside-united-states>

often we see taxpayers shy away from expansion because of complexity and burden created by the tax code.

Today, I would like to focus on three areas that create barriers to business expansion, especially for small businesses: (1) Barriers created by information sharing concerns, (2) Barriers due to compliance costs that are needlessly and excessively burdensome, and (3) The need for real international tax reform both domestic and globally.

#1 Barriers Created by Information Sharing Concerns that Impact Simple Business Functions and Operations

It is surprising to many small businesses that expand overseas that there are incredible difficulties in establishing routine business operations. Many Americans would be shocked at activities we take for granted in this country that come with significant consequences when crossing borders. For example, something as basic as trying to open a bank account or create a banking relationship in another country as a US citizen. We have heard many stories of banks refusing to open accounts for US citizens due to the operation of the Foreign Account Tax Compliance Act (FACTA).

If you are able to jump through these hoops to establish financial accounts abroad, then a small business must navigate the overly-complex rules on how to properly report these accounts and assets to the US Government. This information must be reported on multiple forms to multiple agencies with varying amounts of information to be disclosed. The requirements are not consistent in many areas such as reporting to FINCEN versus the IRS. This is increasingly perilous as a failure to properly comply comes with enormous risk. Rules that were crafted to hammer those with hidden bank accounts in Switzerland or Panama leave legitimate businesses in an expensive and risky place – even when they have a history of paying proper amounts of tax and are trying to be compliant. The possible penalties are draconian and can fairly be stated to shock the conscience. The penalty structure for failure to

report these accounts could penalize the taxpayer 100% of the amount in the account even if there is little or no income tax due. A fresh look at the policies, penalties and reporting requirements from a lawmaking perspective is overdue.

United States procedural requirements also have real world impact on foreign businesses wanting to work with US taxpayers. Experience in working with our clients and CPAs has uncovered situations where, for example, foreign joint ventures have been rejected where the foreign company admitted to using a lesser quality competitor because they did not want to deal with the US reporting requirements that came along with the US partner.

We also have clients who express frustration at losing business with foreign partners due to required over-withholding of taxes simply by administrative burdens. This is the effect of the extreme difficulty that foreign parties doing business with US partners have in obtaining US tax identification numbers. While intended to prevent abuse, the practical effect is excess tax withholding on a transaction with no practical remedy. In reality, these transactions should be granted the benefits of a tax treaty that was put in place specifically to facilitate trade in this manner. Many times the difference between the proper amount of tax withholding from a transaction compared to the over-withholding by reason of administrative difficulties is enough to kill many business deals for US businesses.

#2 Barriers Created by Complexities of International Expansion and Compliance Costs

Mr. Chairman, too many times when changes are considered to our tax system, whether in changing the law or in issuing guidance by the Treasury Department, the costs to the taxpayer in time and professional fees are not adequately considered. As could be expected, studies have shown that compliance costs skyrocket when dealing with overseas activities.² While there are a multitude of

² See Dharmapala, Dhammika and Slemrod, Joel B. and Wilson, John D., Tax Policy and the Missing Middle: Optimal Tax Remittance with Firm-Level Administrative Costs (May 5, 2008), and Slemrod, Joel. "The Compliance Cost of Taxing Business." Mimeo. University of Michigan. (2006).

examples we see frequently, we would like to highlight two areas in the cross-border context where the compliance burden, and risk for non-compliance, for small business should be addressed.

The first area can be shown by a real example. In this case, there is a small specialized equipment manufacturer looking to expand business overseas. They set up a foreign affiliate in the new country to distribute and sell equipment locally. For this one enterprise with a seemingly simple setup comes an almost debilitating compliance cost and / or risk. In this operation there may be inter-company payments for equipment purchased or services provided between the related entities. There also may be distribution and service / warranty agreements. Under highly complex transfer pricing rules, these transactions must be analyzed in comparison to the outside marketplace, and the mandatory documentation requirements are simply not adapted for small businesses. Furthermore, the rules provide for penalty protection against IRS audit if proper analysis is completed to support the taxpayer position. Small taxpayers and their CPAs are concerned. Transfer pricing is one of the most audited issues by the IRS and billion dollar audit adjustments with penalties do not only make the tax press but also the mainstream media. Honest taxpayers looking to be compliant with the by-the-book documentation requirements and penalty protection must decide whether to engage economists, lawyers and accountants at significant costs because of the required analysis.

Currently, there is no saving grace for small business. There are no de minimis exceptions for low-risk transactions where little abuse occurs, and there are no flexible documentation applications for smaller transactions and smaller businesses. Examples do exist in other countries where small and medium size businesses are subject to simpler rules based on items such as employee number, turnover or assets. Alliantgroup has met with the IRS and the Treasury Department in the past in an effort to create Transfer Pricing guidelines that will prevent abuse but not drive smaller companies out of cross-border business. This idea of a transfer pricing “lite” would be a huge step forward for those companies with limited resources but that want to be compliant with transfer pricing rules.

We note that during the OECD's recent Base Erosion and Profit Shifting (BEPS) project, consideration was given to how developing countries could interpret transfer pricing guidelines. It was recognized that throwing thousands of pages of rules at them and asking the tax administrations with limited resources to enforce these convoluted rules was untenable. There is no reason why a similar look should not be taken regarding the transfer pricing rules with respect to smaller businesses here in the US.

Another example where compliance costs are not commensurate with the value to the government arises in the area of Passive Foreign Investment Companies (PFICs). While the policy principles behind these rules addressing this specific foreign activity is sound, quite simply, the reporting requirements are not applied to the appropriate group of taxpayers. When businesses operating overseas make investments or arrange capital, many times they are swept into the incredibly complex web of PFIC reporting. There are no consolidation or streamlined filing provisions or de minimis exceptions. We have received numerous reports from CPAs and have worked with clients regarding the hyper-technical and excessive filing requirements for PFIC situations. Even worse, many of these separate forms reported very minor amounts of income and tax owed. This is combined with significant penalties for misreporting PFIC investments. There is a legitimate question as to whether the PFIC reporting rules serve a useful purpose in our tax system. There is no question, however, that as designed they are overbroad and excessive.

This moves to the next point, everyone recognizes the IRS is stretched thin. Speaking to our CPAs and our clients, they are looking for more help from the IRS, including more guidance; more educational outreach; and additional trained people with whom to talk. Our clients and their CPAs are also concerned the IRS systems be secure.

#3 There is a Need for Reform in Both the US and the Global Tax Environment

It is, at this point, a truism that the US international tax system is broken and in need of reform. While we will not go into what reform should look like in this forum, we urge Congress to reform the law and before doing so, consider how that reform will impact small and mid-size businesses. A one-size fits all rule generally makes little sense. This leads to the simplicity part of this hearing. Simplicity is a pillar of tax policy that is many times overlooked. For complex transactions, sometimes complex rules may be necessary, however, in our experience, many rules are written assuming that well-heeled companies will be able to comply, and that there is rampant abuse that must be guarded against. Neither assumption is correct in all cases. We urge that the following questions be asked in each case: (A) Is the rule too complicated for smaller taxpayers to understand and comply with; (B) What are the compliance costs associated with the change; and (C) Is it impossible for tax administration to enforce?

We have discussed problems in our current system. We would also note that our system encourages businesses to keep their foreign profits overseas and not to repatriate them to the US for US jobs and investment—commonly referred to as the “lockout effect”. This is something that big corporations can live with because of the size and scope of their global activities, but it is an enormous challenge for small business where every dollar of profit is needed to grow and reinvest. This highlights the need to lower the tax rates to be competitive globally is even more pressing for small business. We all hear stories of large multi-national companies being able to lower their effective tax rates to significantly less than the headline rate. Small business, especially in the early stages of expansion, do not have the resources to engage in sophisticated tax planning and need their cash back home subjecting them to a high effective tax rate that very few other multi-national businesses ever experience.

To this end, Congress should consider additional incentives for small and mid-side business attempting to expand overseas. One existing example is the highly valuable Interest Charge Domestic

International Sales Corporation or IC-DISC. This is the last existing export incentive and is a great help for businesses selling domestic goods and services overseas.

Finally, Mr. Chairman, I would like to place the importance of US reform in the context of the global tax environment. In 2014, the OECD initiated the Base Erosion and Profit Shifting Project (BEPS) where tax policy makers and administrations came together.³ In 2015, the OECD issued final recommendations for tax policy changes on 15 so-called “Action Items”.⁴ It can be argued that much of BEPS is the result of countries around the globe seeing a pot of US deferred gold. Many of the proposed rules pose cause for concern and may create yet more barriers to small business entering or continuing cross-border business.

While other countries are swiftly implementing these BEPS measures, I commend Congress and Treasury for taking a slower path. While a discussion of each BEPS Action Item is beyond this hearing, we do want to highlight one example of our concern: country-by-country reporting.

Country by country reporting brings two concerns for companies. First, is the added compliance burden (and costs) for businesses to report additional company data. It should go without saying, every dollar spent on compliance cost contributes to less jobs on the assembly line. Second, there are real data security and confidentiality concerns. We support Treasury and Congress for holding the line on exchanging information only through treaties and confidentiality rules being protected against the wishes of many others. We want to acknowledge the importance of taking action when information is not protected by other countries. It is important to note, while there is currently a threshold for

³ OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing.
<http://dx.doi.org/10.1787/9789264202719-en>

⁴ OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD.
www.oecd.org/tax/beps-explanatory-statement-2015.pdf

company size on this reporting, history has shown time and again, limits of this type are lowered or eliminated to engulf many businesses.

Conclusion

Thank you Mr. Chairman Huelskamp and Ranking Member Chu for allowing me to testify today on this important topic of tax reform and simplification for small business. Far too often, small and mid-size business concerns take a back seat in the tax reform discussion and even more so in the international context. I hope today I was able to highlight some real issues facing our nation's smaller business taxpayers when conducting cross-border business.